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REGULATORY UPDATE

Dale E. Cantone
Maryland Office of the Attorney General
Baltimore, MD

Susan Grueneberg
Cozen O'Connor
Los Angeles, CA

Patty Hagner
Office of the Illinois Attorney General
Springfield, IL

Theresa Leets
California Department of Business Oversight
Los Angeles, CA

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REGULATORY UPDATE

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I. INTRODUCTION

This paper focuses on franchise developments in 2019 from a regulator’s perspective. It begins with a discussion of the role of the franchise regulator. There are a number of different constituencies in franchising – franchisors, franchisees, prospective franchisees, businesses that provide services and products directed at franchised businesses and last, but not least, government representatives who regulate franchising. It behooves all parties to reflect not only on the different roles they play, but also to understand the vantage points and experience of the other players.

Leading from that perspective, the paper then explores the common compliance problems that regulators have noted this past year, followed by changes that will come into effect in 2020 such as the new State Cover Sheets and issues that are in search of solutions such as social media advertising in the digital age. Last but not least, the authors address trends in enforcement and recent enforcement activities.

II. ROLE OF REGULATORS

To understand the role of state franchise regulators, one must first understand the regulatory framework within which they operate. The North American Securities Administrators Association (“NASAA”) is a voluntary organization, founded in 1919 as a complementary regulatory system working at the federal, state and industry-level providing education and investigative and enforcement services in order to protect public investors. NASAA acts as a licensing agent, as well as an enforcement agency for state security laws. NASAA’s membership includes security regulators from all 50 states, the District of Columbia, Puerto Rico, the US Virgin Islands, Canada and Mexico.

Following the January 2007 amendment to the Federal Trade Commission (“FTC”) Rule on Disclosure Requirements and Prohibitions Concerning Franchising (“FTC Rule”), NASAA adopted those amendment changes and compiled step-by-step instructions for the form and contents of a disclosure document that mirrored those in the FTC Rule (Part VII of NASAA’s 2008 Franchise Registration and Disclosure Guidelines (“NASAA Guidelines”). The NASAA Guidelines are the successor to the document formerly known as the Uniform Franchise Offering Circular (“UFOC”) Guidelines. Technically, the NASAA Guidelines are also referred to as the Amended and Restated UFOC Guidelines.

States regulating the offer and sale of franchises implement the NASAA Guidelines, but state legislatures and administrative rulemaking agencies in the registering states also dictate their own specific disclosure requirements consistent with the FTC Rule. For example, in Illinois, Section 16 of the Illinois Franchise Disclosure Act\(^2\), (“Illinois Act”) sets forth that the form and contents of a franchise disclosure document shall be prepared in accordance with the FTC Rule, as it may be amended; the NASAA Guidelines, as they may be amended; and Administrative Rules necessary to administer and enforce the Illinois Act. Since July 2008, all registering states accept only disclosure documents prepared in conformance/compliance with the NASAA Guidelines.

\(^2\) 815 IL. Comp. Stat. § 705/16 (West 2016).
It is within the confines of the above-referenced federal, state and administrative disclosure requirements that franchise regulators conduct their work. The primary role of a franchise regulator is that of a compliance officer; ensuring that documents are prepared in conformance with the law; and the law is straightforward. The FTC Rule states that failure to follow the instructions of subparts C and D of part 436 while preparing a disclosure document constitutes an unfair or deceptive act or practice enforceable at law.\(^3\)

A franchise regulator looks at each disclosure document through the eyes of a prospective buyer. While the process of training new regulators can be lengthy and tiresome, the benefits gleaned from a fresh set of eyes on a document reminds us of the complex content we address daily. Moreover, from year to year, a single regulator may see a disclosure document through more experienced and better-trained eyes. In our work, the "plain English" requirement is key.\(^4\) As regulators, we are responsible for simplifying language, paring down technicalities and eliminating confusion altogether. Franchise regulators look for current terms and language that is easily read and understood by those unfamiliar with franchising and franchise law. Despite adoption of the amendments to the FTC Rule over 10 years ago, regulators continue to see the following stale terms: Uniform Franchise Offering Circular, Federal Disclosure Document, UFOD and earnings claims. The current required terms are Franchise Disclosure Document, FDD and financial performance representations.

Regulators use the black-and-white instructions of the NASAA Guidelines as their operating manual. They look for short, concise sentences responsive to each disclosure requirement. Regulators view disclosure documents as neither creative writing projects, nor sales tools. Therefore, "helpful" information beyond that required or permitted by the FTC Rule or state law (not preempted by the FTC Rule) is prohibited. In keeping with the black-and-white nature of the NASAA Guidelines, regulators choose plain over fancy every day of the week.

To a seasoned regulator, a Franchise Disclosure Document has a distinct "look" when it has been prepared in conformance with the disclosure requirements. On its face, a well-drafted document is predictable and familiar because it embodies the framework, chronology, and in certain instances - the exact words required by the NASAA Guidelines. Thoughtful compliance with the FTC Rule and the NASAA Guidelines results in a disclosure document that provides consistent information throughout. Experienced franchise regulators are experts at rooting out inconsistencies. Keen regulators assess and compare the following, to name a few:

- Governing law disclosed on the State Cover Page compared to Item 17(w);
- Franchisor's corporate name on Form A (the state application facing page) and the FTC Cover Page compared with that disclosed in Item 1;
- Training tuition disclosed in Item 11 compared to Initial Fees in Item 5;
- Affiliates identified in Item 1 compared to any required use of source-specific resources in Item 8;
- The identity of fees and payees disclosed in Items 5, 7 and 8;

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3 16 C.F.R. § 436.6(a).

4 16 C.F.R. § 436.3(a).
• Revenue disclosures in Item 8 contrasted with Franchisor’s audited financial statements;

• The Issuance Date disclosed on page 2 of Form A, the FTC Cover Page and the Auditor’s Consent;

• Expenditures disclosed in the Item 7 Table compared with required expenses that surface in Item 11;

• Number of outlets disclosed in Item 19 compared to outlets claimed in Item 20 – Table No. 1; and

• System-wide outlets disclosed in Item 20 – Table No. 1 contrasted with outlet representations made in Item 20 - Table Nos 3 & 4.

While objective, black-and-white examination of the text of a disclosure document dominates the review process, franchise regulators enjoy significant discretion in their role as compliance officers, as well. Regulators exercise discretion as they identify risk factors, evaluate financial statements, impose financial assurance requirements, exclude disclosures not required by law, judge statements that disavow required disclosures, gauge exemption eligibility, and untangle state-specific addenda language…to name a few. In Illinois, for example, discretionary authority is granted under the Illinois Act⁵ and under the Illinois Administrative Rules.⁶

Opportunities to employ discretion exist throughout the review process, as regulators must routinely discern the plain meaning of words. For instance, in Item 7, the amended FTC Rule permits footnotes, which “include remarks, definitions, or caveats that elaborate on the information” disclosed within the Item 7 Table itself.⁷ A regulator uses discretion to ascertain whether a “caveat” disclosed within a footnote is actually a disclaimer. A common “caveat” nearly universally included within a long Note at the end of the Item 7 Table typically reads, “These figures are estimates only. There are many factors that may be unique to your location and business acumen that will affect your costs.” An experienced regulator will require either removal of such a “caveat”, as a warning applicable to all businesses generally, and not explicit to the business being offered, or else allow revisions to tailor the footnote to the nature of the franchised business being offered.

Regulator discretion is instrumental in weighing the conditions of a franchise opportunity perceived to be drawbacks or risks. The infancy of a franchise, less-than-healthy financial statements, the absence of a training program, limited training schedules, trademark disputes, required purchase thresholds and mandatory guarantors are a sample of factors weighed in the crucial assessments made by franchise regulators. Once appraised, regulators alone determine the Risk Factors to be included on the State Cover Page and added to a state-specific addendum.

Discretion is certainly at work when regulators work through differences with franchisors and franchise counsel during the application process. A franchise regulator addresses franchise-specific considerations within the parameters of federal, state and administrative disclosure


⁶ 14 Ill. Admin. Code §§ 200.201(a), (c) and (d); 200.500(a) and (c); 200.600(c); and 200.603(e)(1999).

⁷ 16 C.F.R. § 436.6(g)(1)(i).
requirements in order to address conflicts. Despite the common (and dreaded) argument, "No other regulator has required/denied that", issues are ultimately resolved by each individual regulator's thoughtful judgment.

The role of a franchise regulator extends beyond document reviews; it varies from state to state, and can be as diverse as regulator personalities themselves. While some regulators enjoy the opportunity to mentor new franchise counsel or paralegals through the application process, others may not. Some regulators are process-oriented; others expect a wholly compliant product (document) from the start. Regardless, franchise regulators all work toward the common goal of uniformity. Regulators involved in the franchise industry for many years coach those with less experience. Regulators consult and support one another across state lines, and rely upon each other's distinct strengths. While their role as regulators at times compels backbone, it is collaborative effort and a spirit of cooperation that makes a regulator's work most enjoyable.

III. COMPLIANCE ISSUES

Franchisors with calendar fiscal year ends typically update their franchise disclosure documents in accordance with the requirements of state and federal franchise law during the first four months of each year. As a result, March through June have become the busiest time of year for franchise regulators and the time during which regulators see trends in problems with compliance with applicable law. 2019 has been a banner year for franchise renewal registration applications as well as for new registration applications. Set forth below are some of the common errors that can delay the effectiveness of an application. Also discussed below is an analysis of some of the issues that have been prevalent among the applications filed in 2019.

A. Common Filing Issues

1. **Disclaimers Throughout Franchise Disclosure Document ("FDD")—Items 7 and 19**

As a preliminary matter, it is important to note that disclaimers may not be included throughout the FDD. Section 436.6(d) of the FTC Rule instructs as follows:

"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."\(^8\)

Despite this mandate, filers continue to include disclaimers throughout FDDs especially in Item 7 (Estimated Initial Investment) and Item 19 (Financial Performance Representations). The only admonition that is permitted, indeed required, is the following one described in 19.3 of the NASAA Franchise Commentary on Financial Performance Representations ("FPR Commentary").\(^9\) That section concludes with the following statement:

."... franchisors may not include additional language that serves to disclaim the financial performance representation they have just made or state that a

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\(^8\) 16 C.F.R. § 436.6(d).

franchisee may not rely on the information presented.\textsuperscript{10}

2. Item 3 - Litigation

Item 3 disclosure can be complicated and often requires judgment calls on what may or not be material. There are, however, a couple of recent issues on which we can provide guidance.

a. Eliminating Orders After Ten Years

The FTC Rule requires disclosure applicable to the franchisor and certain related parties of the following:

"\ldots a currently effective injunctive or restrictive order or decree resulting from a pending or concluded action brought by a public agency and relating to the franchise, or a Federal, State, or a Canadian franchise, securities, antitrust, trade regulation, or trade practice law."\textsuperscript{11}

One common misreading of this disclosure requirement is that disclosure is no longer required after ten years. That is incorrect. As long as an order is currently effective it must be disclosed.

b. Voluntary Assurance Orders

The question whether Voluntary Assurance Orders and Assurances of Discontinuance ("AODs") must be disclosed in Item 3 has also been raised recently. By way of example, a number of these orders resulted from the inquiry by various state Attorneys General into anti-poaching provisions in many franchise systems. Anti-poaching provisions restrict franchisees from soliciting the employees of the franchisor or other franchisees in the system. Many franchisors targeted by state Attorneys General for this practice, which the FTC and the U.S. Department of Justice have decreed are anti-trust violations, have agreed to delete them from their Franchise Agreements and entered into Voluntary Assurance Orders to this effect. Illinois has also agreed to Voluntary Assurance Orders to settle enforcement actions.

These orders typically state that a franchisor will do something specific like taking a provision out of a contract or offering rescission to a franchisee. Once that action has occurred, the order is no longer "currently effective". Desist and refrain orders, on the other hand, continue in effect as a continuous prohibition. Therefore, under the FTC Rule, disclosure is not required for Voluntary Assurance Orders or AODs that are limited to an agreement to take certain actions. However, at least one state (Washington) has, in some instances, decided to require disclosure of AODs.

\textsuperscript{10} Id. at 19.3.

\textsuperscript{11} 16 C.F.R. § 436.5(c)(2).
3. **Item 5 – Initial Fees**

A franchisor is not required to disclose use of proceeds for initial fees paid by franchisees. Yet, regulators continue to see this disclosure include in Item 5 of FDDs and require filers to remove it.

4. **Item 7 – Estimated Initial Investment**

   a. **Clarification on Additional Funds**

   The FTC Rule includes a number of typical categories of initial costs franchisees incur and a franchisor includes these categories for its FDD disclosure of the estimated initial investment, if applicable. A franchisor can also use categories of costs that more specifically apply to a franchise in a particular industry or in the franchisor’s system. The estimates for each of these categories is the amount the franchisor anticipates a franchisee will spend before and up to opening for business. Therefore, including disclosure for three months’ worth of rent under the category “Leasehold Expenses” would not be compliant with the FTC’s disclosure requirements unless the landlord would typically require this payment in advance.

   The exception to this time period is the Additional Funds category. This category is for any amounts not included in the previous categories which are paid before the franchise is open for business plus other required expenses during the initial period of operations. The initial period of operations is at least three months or a reasonable period of time for the industry. Of note is the following statement in footnote 443 to the Statement of Basis and Purpose:

   “A franchisor seeking to apply an initial phase other than three months has the burden of showing the reasonableness of the phase selected.”

   b. **Additional Funds Disclosure Basis**

   Pursuant to section 436.5(g)(iii) of the FTC Rule, the franchisor is required to disclose in general terms the factors, basis and experience that the franchisor considered or relied on in formulating the amount required for additional funds. Note that this disclosure is only required for the Additional Funds category and not for the entirety of Item 7. Franchisors frequently mistakenly disclose the factors, bases and experience for all the information in Item 7 and this will lead to comments from regulators.

   c. **Breakeven Analysis**

   Contrary to some practitioners’ understanding, Item 7 is not intended to present a breakeven analysis. All of the disclosure categories except Additional Funds (discussed above) must be limited to the estimated costs before and up to the time the franchisee’s business begins operations. But the inclusion of the Additional Funds category is not intended to communicate to a prospective franchisee how long it will take to break even or what it will cost. Indeed, the instructions for preparation of Item 7 demonstrate this. The FTC acknowledged that real estate

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12 16 C.F.R. § 436.5(g).


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expenses can vary so widely that franchisors can merely disclose the factors a franchisee should consider rather than disclose actual dollar estimates.\textsuperscript{14}

The FTC was concerned that requiring a breakeven analysis would create an opportunity to franchisors to provide a financial performance representation without complying with the requirements of Item 19. The Statement of Basis and Purpose states:

"Several commenters opposed the . . . intention to capture working capital and a break-even point; they pointed out that such an approach . . . could be misleading without more detailed earnings information, such as in an earnings claims statement. Indeed, one commenter argues persuasively that the . . . proposal could create a ‘back door’ mandatory earnings claim, a position contrary to the Commission’s view that earnings claims should be voluntary. The Commission finds these arguments persuasive."\textsuperscript{15}

5. **Item 12 – Territory**

A perennial issue with registration filings is compliance with the requirement to include Item 12’s warning language if the territory granted to a franchisee is not “exclusive”. There is no definition of exclusivity in the FTC Rule. The specific instruction under Item 12 is:

"If the franchisor does not grant an exclusive territory, state: ‘You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we open, or from other channels of distribution or competitive brands that we control.’"\textsuperscript{16}

Most franchise systems do not provide for complete exclusivity. For example, a franchisor may exclude non-traditional locations from its grant of rights to a franchisee. These include airports and other transportation hubs, sports arenas, casinos, convention centers, military bases, amusement parks and similar venues with a relatively sequestered set of consumers. Many franchise systems also exclude alternative channels of distribution from any territorial rights a franchisee receives. These can include the right to internet sales, mail order and wholesale product sales.

The guidance the FTC provides is an interpretation based on the sample Item 7 answer included in the FTC Rule Compliance Guide (“FTC Compliance Guide”).\textsuperscript{17} The sample answer is labeled as one in which an exclusive territory is granted, and it, therefore, does not include the warning. Yet, it discloses that the franchisor retains the rights to conduct business through other

\textsuperscript{14} 16 C.F.R. § 436.5(g)(2).
\textsuperscript{15} 72 Fed. Reg. at 15487.
\textsuperscript{16} 16 C.F.R. § 436.5(l)(5)(i).
\textsuperscript{17} Federal Trade Commission, Franchise Rule Compliance Guide 85 (2008).
channels of distribution. The conclusion is that the FTC does not consider that restriction to render a territorial grant non-exclusive. By negative implication, on the other hand, the franchisor's ability to operate the business in a non-traditional location in the franchisee's territory would render the territory non-exclusive, and the warning would have to be included.

6. **Risk Factors**

Risk factors are a mechanism commonly used by state regulators to highlight a fact the regulator finds particularly important for the prospective franchisee to know. They are frequently imposed in the registration process, especially for initial franchise applications. Yet, there continue to be misunderstandings about the use of risk factors.

a. **Regulator – Mandated Risk Factors**

A filer must include a risk factor on the appropriate state cover page if required to do so by a franchise regulator. This should not be done blindly, however. If a filer feels that the risk factor language is not accurate or does not reflect the actual facts, the filer should initiate a conversation with the regulator and discuss whether different language would be more appropriate. In some cases, a filer can convince the regulator that the risk factor is not really needed. However, statements such as "no other state makes me do this" will not go very far in convincing a regulator of anything.

i. **Financial Condition**

One of the most common types of risk factors are those that pertain to a franchisor's financial condition. These may be used in conjunction with a financial assurance condition on the registration or as stand-alone warnings.

Examples of situations in which risk factors may be required are inadequate owners' equity, imbalances in debt-equity ratios, operational losses, and excessive receivables.

ii. **Operating History**

A short or nonexistent operating history will likely result in the imposition of a risk factor. In such circumstances, state authorities are concerned about the viability of the franchise system, as well as the possibility that the franchisor will not be successful and be unable to fulfill its obligations to franchisees. The State of Washington will almost always impose a financial assurance condition on the initial franchise registration of a start-up franchisor or one with a short operating history in addition to requiring the inclusion of a risk factor.

iii. **Other Circumstances**

There are other circumstances under which franchise examiners impose risk factors. One common example is when the guarantee of the spouse of a franchisee or its owners is required. Such a guaranty places the family's assets such as their home at risk and can jeopardize the separate property of the spouse. Some other examples include:

- Many franchises have been sold but few have opened for business
- The franchised business requires a license in some jurisdictions
b. **Conflicting Comments on Risk Factors**

What happens when a filer receives conflicting comments from multiple states? What about receiving the same substantive comment, but states require different wording of the risk factor? These can usually be resolved by communicating to each of the franchise regulators what the other is requiring and reconciling the language.

c. **Franchisor Initiated Risk Factors**

In what often is a good-faith effort to highlight the risks of a franchise purchase or an attempt to avoid receiving comments from regulators, some franchisors offer up risk factors themselves in their filings. Unlike securities offerings, this is not permitted. On occasion, a filer’s purpose in adding a risk factor is to incorporate a back door disclaimer.

Section 436.6(d) of the FTC Rule prohibits a franchisor from including information in the FDD that is not specifically required by the FTC Rule. The exception is for information required by states. There is no exception for additional information offered up by franchisors.

B. **State Cover Sheets**

A copy of the newly adopted State Cover Sheets is included as Attachment A to these program materials.

1. **Implementation**

   NASAA adopted the NASAA Guidelines as of July 1, 2008. The NASAA Guidelines adopted the form of Franchise Disclosure Document required under the 2007 amended FTC Rule, with the addition of a State Cover Page. The Franchise Guidelines also included new application forms and instructions for filing the Franchise Disclosure Document with the states that require registration. Those instructions require franchisors to disclose on the State Cover Page several standard risk factors and certain cautionary information about franchising. In addition, the instructions allow state regulators, in their discretion, to require that franchisors disclose additional risk factors specific to a franchise offering.

   NASAA issued a proposal and request for comments on these changes on March 26, 2018. Following the receipt of nine comments, the NASAA Franchise Project Group\(^{18}\) made some changes to the State Cover Sheets and NASAA approved the revised version on May 19, 2019. Franchisors are required to comply with these changes beginning January 1, 2020 for Franchise Disclosure Documents issued after that date.

2. **Contents**

   The new State Cover Sheets require the addition of a new page, titled “How to Use this Franchise Disclosure Document.” The NASAA Franchise Project Group understood that many prospective franchisees find the Franchise Disclosure Document overwhelming. As a result, some prospective franchisees never review the document in its entirety, and others do not review

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\(^{18}\) NASAA conducts its affairs through standing committees, one of which is the Corporate Finance Section. Project Groups are formed in each section to work on topical issues. The Franchise Project Group is one of the project groups under the Corporate Finance Section. The members of the Franchise Project Group are franchise regulators from a number of states that require disclosure and registration of franchise offerings. The Franchise Project Group works in a collaborative manner with the FTC.
it at all. This new page gives prospective franchisees clear and readable directions about how to use a Franchise Disclosure Document to find answers to common franchise questions.

Second, the new State Cover Sheets require a second page titled “What You Need to Know About Franchising Generally.” This page includes general information about franchising that many prospective franchisees do not appreciate until after they have entered into a franchise relationship. This information updates and supplements the cautionary information included on the current State Cover Page.

Third, the new State Cover Sheets include new instructions for a third page titled “Special Risks to Consider about This Franchise.” This page replaces the current State Cover Page. The NASAA Franchise Project Group has concluded that the new title of this page is more descriptive than the title “State Cover Page.” This page requires one standard risk factor if a franchisor requires that a franchisee resolve disputes outside of the franchisee’s home state. The NASAA Franchise Project Group concluded that provisions requiring out-of-state dispute resolution are among the most important risks of any franchise offering. The instructions to this page continue to allow states to require additional risk factors specific to a franchise offering.

Fourth, the new State Cover Sheets change the format of the information presented in the State Cover Sheets. Among other things, they require all risk factors and cautionary information to be written in lower case text, not capital letters, as is required under the Franchise Guidelines. Many sources agree that typeface written in all capital letters makes text difficult to read. In addition, the cautionary information includes explanatory captions, also to improve readability.

Finally, the new State Cover Sheets include new instructions and procedures for requiring risk factors. The new instructions promote uniformity and reduce repetition in the presentation of risk factors. Under current practice, some state cover pages include state specific risk factors that may not apply in all states. Other state cover pages include multiple risk factors on the same subject with slightly different wording. The instructions specifically allow states to include non-uniform risk factors on a state specific addenda to a Franchise Disclosure Document if the risk factor is state-specific, if it is required by only a single state, or if different states insist on different wording for substantially the same risk factor.

C. Financial Assurance Conditions

Every state that regulates the offer and sale of franchises and has a process to renew the application for franchise registration has the ability to impose a financial assurance condition to the registration. What does this mean and how is this determination made?

1. Purpose

In general, states have the authority to impose a financial assurance condition when a franchisor cannot demonstrate to the state’s franchise administrator that the franchisor has the financial resources to fulfill its obligations under the franchisor’s franchise agreement.19

19 For example, under section 14-216 of the Maryland Franchise Registration and Disclosure Law, the state has the authority to impose a financial assurance condition if the state franchise administrator “finds that it is necessary and appropriate for the protection of prospective franchisees ... because a franchisor has not made adequate financial arrangements to fulfill the franchisor’s obligations under an offering.”
2. **Factors for Decision Vary Widely**

Franchisee regulators have discretion to impose a financial assurances condition on a franchise registration. The rationale for the comment is not formulaic. There are certain general principles that come into play, but there is no black and white test or formula for imposing the condition. However, there are certain general parameters that factor into the analysis.

a. **Under-capitalization**

The application form “Franchisor’s Costs and Source of Funds”\(^\text{20}\) requires a franchisor to disclose its estimated out-of-pocket costs to perform pre-opening obligations to the franchisee. This information, in conjunction with the Item 20 disclosure of the number of franchises the franchisor estimates it will sell during the year, can be helpful to a franchisee regulator in determining whether the franchisor has the financial resources to perform its obligations without relying on the initial fee paid by the franchisee.

Franchise regulators also review audited financial statements to evaluate a franchisor’s ability to fulfill its obligations to franchisees. Regulators carefully review a franchisor’s audited financial statements, including the footnotes to those statements. Regulators typically will scrutinize a franchisor’s balance sheet to ensure that the franchisor has positive equity and sufficient current assets to meet its current liabilities. Regulators may discount assets that are intangible.

Additional factors that franchise regulators may explore in making this determination are:

- Is there positive working capital – do current assets exceed current liabilities?
- Is there sufficient owner equity?
- Is there an acceptable debt to equity capital?
- Amount of the initial franchise fee
- Number of years franchisor has been offering franchises under current management
- Franchisor’s litigation and bankruptcy history
- Number of franchisees franchisor estimates it will sell during next fiscal year
- Whether franchisor is responsible for obligations of a parent or affiliate whose financial statements are not included in the franchisor’s Disclosure Document.

b. **Operating History**

In some states such as Washington a franchisor will receive a financial assurances comment if it does not have a sufficient operating history even if its capitalization is quite high.

\(^{20}\) NASAA Guidelines, Form B.
3. Alternatives

If a regulator issues a financial assurances comment, the regulator may offer alternatives to comply. These alternatives may be mandated by the state’s law, but in some cases they are discretionary. Although options may be permitted in some circumstances, they may not be permitted in others. The available options vary by state and not every state allows all of the options described below.

a. Escrow

An escrow or impound of initial fees used to be the most common method of satisfying the requirements of a financial assurances condition. An escrow or impound agreement is put in place that satisfies state requirements. Although there are similarities in how the escrow or impound process works in different states, there are some differences. One of the biggest differences can be the degree of the regulator’s involvement. In California, the impound agreement is signed by the bank and the franchisor. The bank at which the separate account is established must be acceptable to the state. When the franchisee pays its initial fee, the franchisee receives a purchase receipt and the franchisor must deposit the funds in the impound account within 48 hours of receipt. Once the franchisor has fulfilled all of its pre-opening obligations to the franchisee and the franchisee opens for business, the franchisor submits a request for Release of Impound to the California Department of Business Oversight (“DBO”). After review, the DBO issues an order releasing the funds from impound and the franchisor can submit it to the bank.

Few franchisors currently use this method because of the delays in the process and the cost of setting up and maintaining the account. Some franchisors offering low cost/investment franchises still prefer to use this method, because the franchisee still pays the initial franchise fee and the franchisor has a procedure to obtain it. In other instances, the state authority may not permit the franchisor to use an alternative method. The state may require this because the franchisor has previously violated a financial assurances condition.

b. Fee Deferral

A fee deferral is currently the most common alternative to a financial assurances condition. Fee deferrals generally apply to all of the initial fees paid by a franchisee to the franchisor or the franchisor’s affiliate. Occasionally, a state will agree to exempt from the deferral amounts paid for goods or equipment. If not, the franchisor or its affiliate will have to wait to receive the money for these items until the franchisee begins to operate the business. The reason that this is the most common alternative chosen by franchisors is that it is relatively easy to set up and involves no upfront cost for the franchisor. The franchisor includes disclosure of the fee deferral, generally in the state-specific addenda to the Disclosure Document and the Franchise Agreement.

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21 Cal. Code Regs., tit. 10 §310.113.3.
22 Cal. Code Regs., tit. 10 §310.113.2
c. **Surety Bond**

Posting a surety bond is another alternative that is relatively easy to establish. However, a franchisor often needs to post cash collateral or pay fees for a bond, and the bonding company may not release the bond immediately after the registration period in case a claim is filed, even if the state no longer requires a financial assurance condition. Nonetheless, in the last few years, an increasing number of franchisors are choosing to post surety bonds to satisfy financial assurance conditions imposed by registration states. Still most franchisors prefer fee deferral.

d. **Guaranty**

A guaranty from a related entity is another alternative that might be preferable under some circumstances. However, in order for this to be a viable alternative, a franchisor must find a guarantor with the requisite net worth and audited financial statements. Moreover, the guaranty subjects that entity to potential liability for any claims against the franchisor, which the owners may be trying to avoid in the first place by setting up a separate entity to act as the franchisor.

e. **Additional Capital Contribution**

One avenue that is always worth exploring when a franchisor receives a financial assurance comment is offering to make an additional capital contribution and document it in a subsequent event note to the financial statements. Many states will accept this even if the initial comment letter does not mention it as an alternative.

f. **Owner or Affiliate Loans/Undertaking Not to Call**

Another alternative that will typically not be suggested by a state is to address the financial assurance comment with a loan by a related company or an owner of the franchisor coupled with an undertaking by the lender not to call the loan. If this is acceptable to a regulator, the regulator will generally require that the franchisor provide a written undertaking that the loan will not be repaid or called during the registration period and sometimes for an additional period of time after the registration expires.

IV. **ITEM 19 – FINANCIAL PERFORMANCE REPRESENTATION ISSUES**

A. **FTC Rule and NASAA Commentary**

A financial performance representation is defined in both the FTC Rule (at Section 436.1(e)) and the NASAA Guidelines (at Section VII(e)) as follows:

"[A]ny representation, including any oral, written or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables."
1. **Overall requirements of FTC Rule**25

Disclosure of financial performance representations is voluntary, but if a financial performance representation is not disclosed in Item 19, a franchisor is not permitted to communicate such information to a prospective franchisee. If a franchisor does wish to make a financial performance representation, it must have a reasonable basis for doing so.

2. **NASAA FPR Commentary**

There was not a lot of guidance on what constituted “reasonable basis.” Therefore, the NASAA Franchise Project Group formed a subcommittee in 2014 to address the issue of financial performance representations and to provide certain guidelines for this disclosure. The Franchise Project Group sought input on the FPR Commentary from the FTC Rule Staff in the process as well as from other state agencies that were not members of the NASAA Franchise Project Group. After two public comment periods, NASAA approved the Commentary at its Annual Spring Conference meeting in May 2017 in Washington, DC.

a. **General**

The FPR Commentary incorporates several issues and answers from its previously issued, more general Commentary26 in order to include all of the applicable in one source. In addition, the NASAA Franchise Project Group included definitions critical to properly interpreting the requirements, restrictions and prohibitions of the balance of the FPR Commentary. However, franchisors need not use the specific terms defined in the FPR Commentary. Franchisors can use other terms, so long as they properly define the terms they use.

b. **Company-Owned Outlets/Franchised Outlets**

This section of the FPR Commentary expands upon previous FAQs issued by the FTC and other interpretations of when a franchisor can present information from company-owned outlets either in lieu of or along with franchise outlet data.

i. **Gross Sales FPRs Disclosing Company-Owned Outlet Data**

If a franchisor has operational franchisees, it cannot disclose gross sales of company-owned outlets without data from franchised outlets. On the other hand, if there are no operational franchisees, disclosure of gross sales from company-owned outlets alone is permissible if the franchisor has a reasonable basis for making this disclosure. The franchisor must also include material financial and operational characteristics of the company-owned outlets that are reasonably anticipated to differ from franchise outlets. Whether or not a franchisor has a sufficient history to make this disclosure and whether or not company-owned outlet data is not misleading, is a determination a franchisor will have to make. There is no minimum number of units or length

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25 A comprehensive discussion of the issues concerning financial performance representations is beyond the scope of this paper. For a more detailed analysis, see Grueneberg and Kaufmann, “The New Item 19 Commentary and Other Advanced Financial Performance Representation Issues: The Devil is in the Details”, IFA 50th Annual Legal Symposium, May 7-9, 2017.

26 Commentary on 2008 Franchise Registration and Disclosure Guidelines issued by NASAA on April 27, 2009. The Commentary can be found at http://www.nasaa.org/content/Files/FranchiseCommentary_final.pdf
of operations that is specifically required as a prerequisite to make a financial performance representation.

ii. **Gross/Net Profit FPRs Disclosing Company-Owned Outlet Cost Information Alone**

A franchisor can utilize company-owned outlet cost data alone in making a financial performance representation of net profit or gross profit, whether or not there are operational franchises. However, when a franchisor is making a net profit or gross profit financial performance representation based on company-owned cost data alone, the franchisor must include all of the following: (A) gross sales data from operational franchise outlets (when the franchisor has operational franchise outlets); (B) actual costs incurred by company-owned outlets; and (C) supplemental disclosure or adjustments to reflect all actual and reasonably expected material financial and operational differences between company-owned outlets and operational franchise outlets.

In providing the supplemental disclosure or adjustments, the franchisor must include royalties, marketing fund contributions and other fees the franchisee must pay. In addition, any other reasonably expected differences must also be disclosed. This information must be presented clearly and in the same format as the information about company-owned outlet costs.

iii. **Merging Data from Franchise Outlets and Company-Owned Outlets**

If a financial performance representation includes data from both company-owned outlets and franchise outlets, the franchisor may not merge this data. This is not a new prohibition. The FTC Compliance Guide provides that "[[i]f a financial performance representation is based on both franchise and company-owned outlets the data for each type ordinarily should be separated to avoid potential misrepresentations."[27]

There is an exception based on privacy concerns. If there are so few units in the system that a prospective franchisee would be able to determine the identity of franchisees if the data from franchise outlets is separated from that of company-owned outlets, the franchisor may merge the data. On the other hand, a franchisor will be presumed to have enough to disclose the data separately if it has ten or more franchises.

c. **Subsets**

Disclosure of subsets is permitted under the FTC Rule. Subsets are a group of outlets that share one or more common characteristics such as type of location, geographic distribution or length of operation. Disclosure is required of those characteristics and how the outlets included in the subset might differ from the characteristics of franchisees’ outlets. Franchisors making subset disclosure must also include information on the nature of the universe of outlets measured, the total number of outlets in the universe measured and the number of outlets in that universe that were actually measured.[28]

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[28] Statement of Basis and Purpose at 15499.
Following is additional guidance on the use of subsets both generally and in specific circumstances.

i. **Use of Subsets Generally**

Information can be accurate while also being misleading. For example, a subset of based on the results of stores that sell golf equipment in sunbelt state locations alone may be accurately reported data, but it may be misleading to a prospective franchisee seeking to open a location in Alaska.

ii. **Best Performing Outlets**

Can a franchisor base a financial performance representation on the results of a subset of outlets consisting of the best performing outlets in the franchise system? In the Statement of Basis and Purpose issued by the FTC when it amended the FTC Rule in 2007, the FTC describes how it crafted Item 19 to prohibit cherry-picking the top performers:

"...Item 19 prevents franchisors from "cherry picking" their best locations as a basis for financial performance representations. Specifically, Item 19's substantiation requirements ensure that franchisors disclose how they derived the performance results of subgroups so that prospective franchisees can assess for themselves the sample size, the number of franchisees responding, and the weight of the results."

The FPR Commentary adds to this prohibition. If a franchisor discloses data from its best performing outlets, it must provide a corresponding sample of the worst performing outlets. For example, if the subset includes the top 20% of the system, there must be disclosure of the bottom 20% of the system. Disclosure of the entire system's performance alone is not enough.

Moreover, a franchisor cannot create the same result by substituting a different set of subset characteristics that has the same results – a subset that meets those characteristics but is also a grouping of the best performing outlets. On its face, this would not be "cherry picking" in the traditional sense because the subset was selected based on a definable criterion. From a policy perspective, however, allowing this type of reverse engineering would defeat the spirit of the FPR Commentary's requirement. If this is the result of the analysis behind the subset, the franchisor should also include a corresponding percentage/number of its worst performing outlets.

iii. **Small Number of Outlets**

If a franchisor crafts a financial performance representation from a sample size that is too small, the data may be misleading even if it is accurate. Therefore, if a franchisor has fewer than 10 substantially similar company-owned and franchise outlets as of the conclusion of its last fiscal year, the franchisor may not make a financial performance representation using subset data. Bear in mind that this only means that the franchisor cannot exclude any of the franchise outlets and company-owned outlets from the FPR. It can still make an FPR based on the performance of all of its operational franchises.
iv. **Geographic Subsets**

In an effort to encourage more franchise systems to include financial performance representations, the FTC eliminated the geographic relevance requirement. The FPR Commentary gives guidance on how to address differences based on geography. A financial performance representation based on a geographically determined subset must include disclosure on why and how the subset was selected.

d. **Averages/Medians**

Section 19.16 of the FPR Commentary provides that if a franchisor is disclosing an “average” of numbers in its FPR, it must also disclose the median of those numbers. Otherwise, outliers may skew an average thereby making it misleading even though the calculation itself is accurate. Correspondingly, whenever a franchisor discloses the “average” of gross sales, it must also disclose the median, as well as the highest and lowest numbers in the range. If the financial performance includes the median of gross sales, it must also disclose the highest and lowest numbers in the range.

The FPR Commentary also addresses the situation in which a company-owned or franchised outlet closed during the period measured. Section 19.18 of the FPR Commentary states that the information for that outlet may be excluded, provided that the franchisor discloses in its FPR the number of company-owned and franchised outlets closed during the time period. In addition, the franchisor must disclose how many excluded company-owned and franchised outlets closed after being open less than 12 months. The franchisor must include this information for every year covered by the financial performance representation.

e. **Disclaimers/Explanations**

The use of disclaimers in the Franchise Disclosure Document is a pernicious issue for regulators. The FPR Commentary does require a specific admonition that is slightly different for historic FPRs and for projections. These NASAA-required admonitions are relatively brief. The first, with respect to historic FPRs, states: “Some [outlets] have [sold] [earned] this amount. Your individual results may differ. There is no assurance that you’ll [sell] [earn] as much”. The second, for FPRs featuring projections, states: “These figures are only estimates of what we think you may [sell] [earn]. Your individual results may differ. There is no assurance that you’ll [sell] [earn] as much.”

A franchisor may not vary, supplement, change or modify this prescribed language unless the financial performance representation is based on something other than average unit sales or earnings. In that case, it may modify the language of the required admonition, but only to the extent necessary to fit the precise FPR being made. Moreover, the FPR Commentary also mandates that the above-quoted required admonition must be “clear and conspicuous,” defined as meaning that the admonition must be easily noticeable and easily understandable by a prospective franchisee. At the very least, the FPR Commentary makes clear, the admonition must be presented in a separate paragraph from the rest of the FPR and in bold type (but not in capital letters, underlined or in larger type than the rest of the FPR).

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29 These admonitions are somewhat different from those set forth in the FTC Compliance Guide at p. 92. Franchisors should use the admonition language contained in the NASAA FPR Commentary.
Section 19.3's carryover of the original Commentary FPR admonitions then states: "In either case (historic or projected FPRs), 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." Section 19.23 goes on to state: "The admonition required in FPR Commentary Section 19.3... is not intended to allow a franchisor to disclaim responsibility for the FPR or advise a franchisee that it may not rely on the FPR. Under the FTC Rule, a franchisor is prohibited from disclaiming or requiring a prospective franchisee to waive reliance on any representation made in the Franchise Disclosure Document. A franchisor, therefore, may not include in Item 19 or elsewhere in a Franchise Disclosure Document any disclaimers that contradict, mitigate, or are inconsistent with the admonition prescribed in FPR Commentary Item 19.3."

However, some FPRs require relatively extensive explanations, clarifications, variations and limitations to allow a prospective franchisee to understand the information being presented. Distinguishing between disclaimers and explanations is not always easy.

Regulators are careful to ensure that language franchisors include in Item 19 cannot be used by the franchisor later to disclaim the disclosure in that section. In many cases, franchisors seek to include a variety of explanations, clarifications and cautionary disclosures in Item 19 about an FPR that are not specifically required under Item 19 or the FPR Commentary and that may be viewed as disclaimers.

How, then, can one distinguish between permissible explanatory information that can be included in an FPR and prohibited disclaimers and limitations? One way is for the drafter to ask herself whether the explanation she has included relates to the specific type of business disclosed in the FPR rather than to all businesses, generally.

For example, if an ice cream shop franchisor prepares an FPR in a multistate FDD and includes results from the franchisor's operational outlets, some of which are located in Florida, the franchisor can note that a franchisee's results may vary based on the climate where the ice cream shops will be located. Contrast this explanation with the following, which is a typical cautionary disclosure that appears at the end of some FPRs: "your results will vary depending on the visibility and accessibility of a site; competition; traffic count; general economic conditions; your management skill, experience and business acumen, and your work ethic."

More and more regulators are commenting on cautionary disclosures in an FPR, like the example above. Regulators are doing so based on the fact that the language could be viewed as a disclaimer, but also because the cautionary disclosure is not required under the FTC Rule instructions for Item 19 preparation or any state franchise law. State regulators often hear franchise counsel argue that cautionary disclosures they have included, like the above example, may not specifically be required under the FTC Rule, but they are helpful to the reader. Franchisors cannot, however, simply include disclosures in an FDD because they believe the disclosures may be helpful to the reader. As discussed earlier in this paper, Section 436.6(d) of the FTC Rule prohibits franchisors from including in a disclosure document any information that is not required or expressly permitted, either by the FTC Rule itself or by state law. If the FTC Rule required cautionary disclosures stating that results in an FPR will vary depending on, for example, "competition, general economic conditions, and work ethic," that apply to virtually any business, this type of disclosure, and others like it, would have to appear in virtually every FPR and contribute to the increasing complexity of FDDs in general.
B. When Item 19 Disclosure is Mandatory

Under Item 19 of the Franchise Rule, a franchisor is free to not provide an FPR, if it chooses. If a franchisor does not make an FPR, the franchisor need only include, in addition to a universal preamble about FPRs, generally, an additional preamble stating that the franchisor does not make or authorize its representative to make an FPR. That disclosure also includes information about how a prospective franchisee can report an unauthorized FPR to the franchisor's management, the FTC, and the appropriate state regulatory agencies.

Some franchisors offer their franchise business based on an expected level of financial performance. The most common example is the janitorial cleaning franchise. In a typical janitorial cleaning franchise, a franchisee pays a fee for a “package” of cleaning accounts. The fee is based on the dollar value of cleaning accounts that the franchisor will make available. For example, a janitorial cleaning franchisor may charge an initial fee of $10,000 for cleaning accounts that the franchisor represents will generate $20,000 in gross income. The franchisor is required to offer the franchisee cleaning accounts that will produce the level of income represented in the package the franchisee purchased, although the parties can later adjust and recalculate the packages.

Janitorial cleaning franchises that base their fee on an expected level of financial performance, such as an expected amount of gross income, must include an FPR in Item 19. By basing a franchise fee on an expected level of financial performance, these types of franchises are already making a financial performance representation in Item 5 of their FDDs. They must therefore include an FPR in Item 19 that is commensurate with that Item 5 disclosure.

In the mid-1990s, the FTC filed complaints against two such janitorial cleaning franchisors and alleged, among other claims, that the franchisors made unlawful earnings claims, in part by, providing franchisees with packages for cleaning contracts with different levels of monthly gross sales at different franchise fees, but without complying with the then-applicable requirement under the FTC Rule for making an earnings claim. The FTC described the alleged violation as a contract-based earnings claim. The janitorial cleaning franchisors settled the claim by entering into a consent judgment in federal court, paying a fine, and agreeing to comply with the FTC Rule in the future.

Some janitorial cleaning franchises that offer contract-based FPRs may simply include in Item 19 disclosure of the number of cleaning contracts they have sold and the number or percentage of those contracts the franchisor has fulfilled. For example, regulators have encountered FPRs that disclose something like the following: "During Fiscal Year 2018, we sold 10 franchises [who purchased different packages of cleaning contracts]. Of those, 10 franchisees had their packages fulfilled in a timely period. Therefore, we complied with the amount, timeliness, and account substitution requirements for Gross Billings offered to our franchisees in 100% of cases." Most state regulators do not accept this type of disclosure in Item 19 and will require disclosure of what franchisees actually earned from the cleaning contracts they purchased. When a franchisor is required to make an FPR, it must include data regarding the actual financial performance of franchisees, which means a representation that states, expressly or by implication, a specific level or range of actual or potential sales, income gross profits, or net profits.

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30 Not all janitorial cleaning franchises offer franchisees packages of accounts based on an expected result.

General disclosure of the number of different sales level packages sold and fulfilled by the franchisor is not an FPR and is not permitted under the FTC Rule or any other part of an FDD. That form of disclosure provides no basis at all for a contract-based FPR, much less a reasonable basis.

C. Problematic FPRs

State regulators report that, in general, FPRs in state franchise filings have improved since the adoption of the FPR Commentary. Nevertheless, state regulators do encounter problematic FPRs on a regular basis and issue comments to franchisors that include those problematic FPRs in state franchise filings. The following are examples of some problematic FPRs.

1. Cherry Picking

   In the Statement of Basis and Purpose underlying the Franchise Rule, FTC Staff observed that franchisors may not “cherry pick” their best locations as a basis for an FPR. Item 19’s substantiation requirements are intended to prevent cherry picking by requiring franchisors to disclose how they derived the performance results of subgroups, so that prospective franchisees can assess for themselves the sample size, the number of franchisees responding, and the weight of the results. In addition, these provisions require franchisors to disclose the material differences between the subgroup-units tested and the units being offered for sale, so that prospects can avoid drawing unreasonable inferences from the representations.32

   The FPR Commentary includes several Items designed to address the problem of “cherry picking”. For example, FPR Commentary Item 19.15 states that franchisors that use a subset based on a geographic subset must describe why and how that subset was selected, and the information presented may not be misleading. In addition, FPR Commentary Item 19.13 prohibits a franchisor from basing an FPR solely on the performance of a subset of its best performing outlets without also disclosing the results of a corresponding subset of the lowest performing outlets.

   In recent years, state regulators have issued a number of comments to FPRs that disclose results based on a subset of franchisees that indirectly report the performance of results of the best performing outlets. One specific example will be discussed later in this paper.

2. Examples of Issues

   a. How Changes to Franchise Program Affect FPRs Based on Prior Franchise Program Terms

      When a franchisor makes significant changes to its standard franchise agreement in ways that can materially impact financial performance of future franchisees, e.g., by increasing fees or imposing additional costs for required purchases, franchisors should consider whether any FPR it makes based on data from an earlier form of franchise agreement should be revised or omitted entirely.

      A franchisor that has increased fees or otherwise materially changed the terms of its standard franchise agreement may not simply include an FPR based on the performance of existing franchisees that operated under a previous form of standard franchise agreement, even

if the FPR accurately reflects the performance of those existing franchisees. An FPR that is accurate still may lack a reasonable basis if that FPR is not relevant to the results that prospective franchisees can expect to achieve.

Although there is no specific guidance about how to handle this situation, Item 19.10 of the FPR Commentary addresses a comparable situation. That Item requires franchisors who based an FPR on company owned outlet data alone to "adjust or supplement" results from those company owned outlets to include costs that franchisees incur that company owned outlets do not pay. Therefore, when a franchisor makes material changes to its franchise agreement, the franchisor should consider whether it can supplement or adjust its FPR based on results from franchisees operating under an earlier form of agreement to reflect changes for franchisees who will operate under the new form of agreement. A franchisor cannot simply continue to disclose the FPR based on those existing franchise outlets and include a disclaimer or caveat stating that prospective franchisees may not achieve the same results because of changes in the terms of the franchise agreements under which future franchisees must operate.

b. **Restricting FPR to Units that Have Been Open a Longer Period of Time (e.g., 2 Years, 3 Years or Even More)**

The FTC Rule and the FPR Commentary do not directly address how franchisors should handle disclosure in an FPR of results from outlets open only a short time. The FPR Commentary does suggest, however, that franchisors need not disclose results of franchise outlets that have been in operation for one year or less. This position is based on the definition in the FPR Commentary of "operational franchise outlet," which states that an outlet that has not been fully operational for one full or, in the case of seasonal franchise systems, one full season, is not an operational franchise outlet.

May franchisors limit the disclosure in their FPRs to results from mature outlets alone? For example, may a franchisor make an FPR based on outlets open 10 years or more? How about five years or more? Or two or three years? Franchise regulators have encountered all of these scenarios. Franchisor counsel argues that there is nothing under the FTC Rule or the FPR Commentary that directly prohibits an FPR based on results from mature outlets alone. While this is true, FPR Commentary Item 19.12 does state that an FPR based on a subset of outlets still must have a reasonable basis and may not be misleading. In addition, Item 19.13 of the FPR Commentary prohibits a franchisor from making an FPR based solely on the performance of its best performing outlets.

An FPR based on mature franchise outlets alone that excludes results from newer franchise outlets can be potentially misleading to prospective franchisees. In addition, the disclosure almost certainly reports, albeit indirectly, results from best performing outlets, since more mature outlets generally perform better than newer outlets.

If franchisors are concerned about reporting results from newer outlets on the theory that those outlets have not fully realized their potential, the franchisor is free to disclose that fact and report results from newer outlets separately from results of the more mature outlets whose potential the franchisor considers fully realized. The franchisor should not, however, exclude results from newer outlets entirely and disclose results from only mature outlets.
c. Including an FPR Based on Unit Franchise Performance in an FDD Directed to Area Representatives

Franchisors that prepare FDDs for area representative franchises may question what type of FPR they should include in Item 19 of their area representation FDD. Although there is no specific answer to this question in the FTC Rule or the FPR Commentary, the NASAA Multi-Unit Commentary\(^{33}\) does provide guidance. Item AR 0.1 of the Multi-Unit Commentary states that an area representative franchise offering is different from a unit franchise offering, and, while some disclosure items may be identical in the 2 FDDs (such as Items 1-4), the relationships and agreements for these offerings are very different, and it can be confusing to combine disclosures for both area representative franchises and unit franchises in the same FDD. Based on this guidance, a franchisor that prepares an area representative FDD should not include an FPR based on result from unit franchise outlets.

d. Advertising Materials with FPRs That Do Not Include All of the Information in Item 19

FPRs included in advertising in the general media are subject to the same requirements that apply to FPRs, generally. That is, they must have a reasonable basis and be backed by substantiating documentation. In addition, the general media FPR must state the number and percentage of outlets from which supporting data for the representation were gathered that actually attained or surpassed the represented level of financial performance; the time period when the performance results were achieved; and a clear and conspicuous admonition that a new franchisee’s results may differ from the represented performance.\(^{34}\) Finally, a franchisor may not make an FPR in the general media without including a comparable FPR in its current FDD.\(^{35}\)

At least one state restricts a franchisor’s ability to include an FPR in an advertisement. Maryland Franchise Regulations provide that advertisements for a franchise offering under that state’s jurisdiction may not contain an “earnings claim” unless otherwise permitted by the Securities Commissioner.\(^{36}\)

A brief review of franchise advertisements appearing in national publications makes clear that some franchisors are violating the requirements for making FPRs in the general media. State franchise enforcement authorities have no jurisdiction over advertisements that appear in the national media, in general. The FTC has, in recent years, not pursued claims against franchisors for violating the rules involving general media claims, but there is no assurance that the current lack of enforcement initiative will continue.

Federal and state law and compliance guidance regarding franchise advertising has failed to keep up with historical trends involving advertisements. For example, there are no specific rules or guidance regarding advertisements that appear in social media, for example. Until there


\(^{34}\) 16 C.F.R. § 436.9(c); FTC Rule Compliance Guide p. 133.

\(^{35}\) FTC Rule Compliance Guide, pp. 133-134.

\(^{36}\) Code of Maryland Administrative Regulations (COMAR) Section 02.02.08.09.
is more specific guidance, franchisors should seek to apply the general media rules that do exist to other media, to the extent possible.

V. SOCIAL MEDIA AND FRANCHISE ADVERTISING

Technology frequently outpaces the law and social media is a prime example. Increasingly, franchisors' marketing gurus use social media to promote the core business to potential customers. But the line between traditional advertising for more business and recruiting potential franchisees is blurred. When tweets are highlighting the success of franchisees and are limited to followers attracted by the opportunity to make money, these communications can drift into the category of franchise advertising.

A. NASAA Statement of Policy

The threshold question is whether posts on social media are governed by the Statement of Policy Regarding Franchise Advertising on the Internet adopted September 9, 2001. The Statement of Policy was adopted to avoid the burden on both franchisors and states of having mountains of website printouts being filed as franchise advertising material in the states that require such filings. Since websites change on a fairly regular basis, the amount and frequency of the filings would have been overwhelming. The states that require such filings adopted versions of the Statement of Policy or acquiesced to it on a policy basis.

The conditions to the exemption from the requirement to file were twofold. The first was that the Uniform Resource Locator (URL) or similar address identifying the location of the advertising had to be listed on the cover page of the franchisor’s Disclosure Document included with the application for registration or exemption in the state or on a notice filed with the state’s administrator. The purpose of this condition was to allow the state regulator to check on the content posted on the website in order to monitor if there was anything to which the regulator would have objected had the advertising material been filed with the state.

The second condition was that the Internet advertising could not be directed to any person in the jurisdiction by or on behalf of the franchisor or anyone acting with the franchisor's knowledge.

In considering whether this Statement of Policy provides a safe haven for Facebook postings or tweets sent out by franchisors, it is primarily the second condition that is difficult to meet. A franchisor could always list its various social media addresses on the front page of its Disclosure Document. But the use of social media involving messages to “friends” or “followers” whose locations are difficult or at least impractical to verify means that each posting and tweet could very well be directed by the franchisor to someone in a jurisdiction that requires the filing of franchise advertising materials. Indeed, one of the main purposes of social media is reaching large numbers of people in widespread areas.

This Statement of Policy was preceded by the Statement of Policy on Internet Offers adopted on May 3, 1998. The Statement of Policy on Internet Offers was adopted to address the concern that a communication made on the Internet about a franchise offering might be


construed as an offer to sell a franchise, and therefore require the franchisor posting to register in all states whether or not the franchisor actually planned to sell franchises in that state.

That Statement of Policy's approach had been similar to the one later adopted to address franchise advertising. The Internet offer had to somehow indicate that the franchise was not being offered to residents of states that required franchise registration but in which the franchisor was not registered. Second, the Internet offer could not be directed to a person in the state by or on behalf of the franchisor or anyone acting with the franchisor's knowledge. Finally, the franchisor could not sell any franchises in the state before being registered and delivering the Disclosure Document to the prospective franchisee.

The concerns about Internet offers could also apply to some social media communications. As with the conditions for the exemption from the requirement to file advertising materials, there is an issue with the condition that the communication may not be directed to a person in a particular state. In addition, especially with Twitter, there are constraints on the amount of characters in each tweet. To require that the communication itself contain a statement that it is not directed to a person in a state in which the franchisor is not registered to sell franchises is highly impractical.

B. Possible Approaches to Regulation

It is clear that these safe harbors are not workable for today's methods of electronic communication. Creating a safe harbor for social media communications is critical. What would the conditions to a new policy statement take into account? There are more questions than answers.

First, the concept of "directing" a communication to someone is archaic in a medium in which a company is trying to amass as many "friends" and "followers" as possible. This requires that we consider whether there is a way to narrow what directing a communication to a specific person means for purposes of imposing a condition on the use of social media.

In addition, should there be more substantive conditions to exempting social media communications from the requirement to register or to file them as advertising materials? What about tweets that include financial performance representations or other information that is inconsistent with the information in a franchisor's Disclosure Document?

Finally, does the existence of social media make it even less likely that prospective franchisees will actually read and consider the disclosure contained in a franchisor's Disclosure Document? If readers nowadays prefer information fed to them in 280 character bites, why in the world would they sit down and read hundreds of pages of information contained in a Disclosure Document?

VI. ENFORCEMENT ACTIONS

A. Tips, Complaints and Media Coverage

1. Tips

State regulators encourage tips from all sources. Tips can prove to be an early warning that a franchise system needs to be scrutinized. Tips may come from competitors, industry experts, disgruntled franchisees, ex-employees and bitter ex-partners to name a few. Regulators
welcome tips and follow the facts presented. Even though it may be clear that the tipster harbors a grudge against the franchisor, if the information provided in the tip shows non-compliance an investigation will commence.

Some tipsters fear retaliation and wish to remain anonymous. Anonymous tips should provide as much detailed information as possible. Anonymous tips often cannot be pursued because the tipster alleges a violation but does not or cannot substantiate it or alleges an act that is not regulated by franchise law. A state may only take formal action if it can meet its burden of proof and has jurisdiction over the alleged bad act. Tipsters are therefore encouraged to identify themselves and make themselves available during the investigation process. Otherwise, anonymous tipsters may be disappointed that no formal action was taken on their “hot” tip.

2. Complaints

Each state has its own complaint process. In California, complainants are asked to fill out a two-page complaint. They may do so by mail or online. Tipsters are encouraged to use this process as it allows the state to track the complaint and be responsive.

Maryland will accept complaints in any format, as long as they are in writing, preferably with supporting documentation.

The Illinois Franchise Complaint form can be found at the Illinois Attorney General’s website.

Complainants are usually disenchanted franchisees that are disappointed with the franchise system either because it failed to live up to their expectations or because the relationship with the franchisor has soured. Franchisees are often unable to articulate a violation under the franchise law. Regulators must then follow-up with the complainant to determine whether the complaint is actionable.

Franchisee complainants should, at a minimum, be willing to identify themselves even if they wish to remain anonymous to the franchisor because they fear retaliation. The investigation will be expedited if the franchisee provides the disclosure document, the receipt, proof of payment of the franchise fee and the signed franchise agreement. If there are emails, advertisements or financial performance representations those should be included too. This will expedite the state’s investigation and formal enforcement action.

Franchisee complainants that are filed by franchisee counsel to gain leverage in a civil action are reviewed with caution. Many state investigations and formal enforcement actions have been closed because the complainant’s civil case settled, and the franchisee no longer wished to cooperate with the state and act as a witness in the state’s case. Franchisee counsel who file multiple complaints with the state as leverage against a franchisor to expedite a settlement may find the state will wait until the civil matter is resolved before proceeding with an investigation and formal enforcement action. This is especially so when the state’s case relies on the franchisee’s testimony.

39 http://docqnet.dbo.ca.gov/complaint/

40 http://www.illinoisattorneygeneral.gov/consumers/Franchise_Complaint_Form.pdf
3. **Media Coverage**

An exposé article in a newspaper,\(^{41}\) online blog or news release alleging fraud or non-compliance against a franchise system will often be the impetus for a regulatory investigation and even possibly a coordinated investigation among the registration states with jurisdiction. Negative publicity will often get a state politician’s attention and more resources will be allocated to scrutinize the issue. It may even be a politician’s or legislator’s first exposure to the franchise industry. In addition to enforcement action, it may create the political will to update or pass new legislation.

Media coverage that is used to sensationalize a dispute between franchisee and franchisor\(^{42}\) may not result in any action if it clear that the state does not have jurisdiction or the action, while unpopular with franchisees, does not violate state franchise laws. Regulators do not like to be used as leverage and do not appreciate counsel using the media to allege non-compliance when it is clear the claim cannot be substantiated.

**B. Self-Reporting Non-Compliance**

It is always best practices to report non-compliance. Even if a franchisor believes that unregistered sales were truly “licenses,” it is better to accurately identify existing outlets as franchises and not licensees. Franchisor counsel lose credibility when they are asked to demonstrate whether the “licenses” are really franchises and it becomes evident upon reviewing a “license” agreement that it is really a franchise agreement. It is hard to restore credibility with a regulator when trust is breached in this way.

In California, the franchisor may cure non-compliance by self-reporting. This is accomplished by filing a Notice of Violation application with the Department of Business Oversight. Practitioners are cautioned to read the rules to understand what is required.\(^{43}\) Generally, the franchisor must file a Notice of Violation application, pay a $675 filing fee and provide the franchisee Notice of Violation form with a disclosure document. The Department of Business Oversight must first approve the form of notice before it is sent to affected franchisees. The Department’s review of non-compliance includes a determination of whether the non-compliance was accidental and whether the franchisor is committed to complying with the law going forward. If the facts indicate a franchisor is abusing this process the Department may opt to take formal enforcement action instead.

**C. Examples of Recent Enforcement Actions**

States use different procedures to take formal enforcement actions against non-compliance under state franchise laws which include Desist and Refrain Orders (D&Rs), Consent Orders, Voluntary Assurance Orders or Assurances of Discontinuances (AODs) to name a few.

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\(^{43}\) Cal. Code Regs. at 10 §310.303 or §310.304.
In California, formal enforcement action is published on the Department's website.\textsuperscript{44} Maryland also posts copies of its formal enforcement actions online, although the franchise-related enforcement actions are combined with securities-related actions.\textsuperscript{45} Apart from that which is accessible on searchable public court record websites, Illinois does not publish enforcement actions.

The most common non-compliance violations are offering and selling in a state without an effective registration, failing to provide the currently registered FDD, or even, in some cases, any FDD failing to maintain a required financial assurance and failing to disclose a material fact or omitting to disclose a material fact which includes unlawful financial performance representations. One of the most typical franchise enforcement actions that states report involves the "inadvertent franchise," that often results when parties enter into some type of trademark license agreement.

Sample concluded enforcement actions in California:

- Best Western International Inc.\textsuperscript{46}
- Juicy Burgers Temecula, LLC a/k/a Juicy Burgers America
- Wellspring Industry, Inc
- ILTF, Inc. d/b/a Tutti Frutti
- OMB d/b/a O'My Buns!
- Pacific Equity Food and beverage, Inc. d/b/a Attibassi
- Slapfish Franchise, LLC
- Classic Rock Coffee Co. Franchising LLC
- Amada Franchise, Inc.
- Handel's Enterprises, Inc.
- Dental Support Plus Franchise, LLC
- Ringside Development Company d/b/a Bio-One, Inc.
- Smallcakes Franchise Systems, LLC
- Da Vi Nails Salon and Spa, LLC
- German Gourmet Kitchen, LLC

\textsuperscript{44} https://dbo.ca.gov/actions-orders-and-administrative-hearing-decisions/.

\textsuperscript{45} http://www.marylandattorneygeneral.gov/Pages/Securities/index.aspx.

\textsuperscript{46} https://dbo.ca.gov/enf-b/Best-Western-International-Inc/.
VII. CONCLUSION

2020 will no doubt bring more changes to franchise regulation. While change may be difficult, franchise regulators are always concerned with finding better ways to level the playing field between franchisors and prospective franchisees. That involves doing as much as possible to require that meaningful pre-sale disclosure be provided and that the parties comply with existing and new requirements. Of course, it also means enforcing those requirements and addressing failure to comply. Finally, regulators must also address technological developments and innovations in communications while trying to anticipate what will come next.
ATTACHMENT A

STATE COVER SHEETS
III. The Franchise Disclosure Document

B. *State Cover Sheets and State Effective Dates Page*

1. The Franchise Disclosure Document must include the following State Cover Sheets prepared according to the Instructions following Form G:
   a. "How to Use This Franchise Disclosure Document."
   b. "What You Need to Know About Franchising Generally."
   c. "Special Risk(s) to Consider About This Franchise."

2. The Franchise Disclosure Document also must include a page titled "State Effective Dates" with the following information prepared according to the Instructions following Form G:

   **State Effective Dates**

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

   This document is effective and may be used in the following states, where the document is filed, registered, or exempt from registration, as of the Effective Date stated below:

<table>
<thead>
<tr>
<th>State</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>[State]</td>
<td>[Date or pending]</td>
</tr>
<tr>
<td>[State]</td>
<td>[Date or pending]</td>
</tr>
</tbody>
</table>

   Other states may require registration, filing, or exemption of a franchise under other laws, such as those that regulate the offer and sale of business opportunities or seller-assisted marketing plans.

3. A sample of an FTC Cover Page, State Cover Sheets, and State Effective Date Page is attached as Form G showing where the pages are to appear in a Franchise Disclosure Document.

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1 Adopted by the NASAA Membership May 19, 2019
As a SUN VISION® franchisee, you will sell solar power-related equipment, training and supplies primarily to small and medium-sized businesses.

The initial investment necessary to begin operation of a SUN VISION franchised business ranges from $145,000 to $350,000. This includes $35,000 to $100,000 that must be paid to the franchisor or its affiliates.

This disclosure document summarizes certain provisions of your franchise agreement and other information in plain English. Read this disclosure document and all accompanying agreements carefully. You must receive this disclosure document at least 14 calendar days before you sign a binding agreement with, or make any payment to, franchisor or an affiliate in connection with the proposed franchise sale. Note, however, that no government agency has verified the information contained in this document.

You may wish to receive your disclosure document in another format that is more convenient to you. To discuss the availability of disclosures in different formats, contact Harry Earth at 2018 Mercury Avenue, Suite 1600, Venus, Texas 77666, (214) 777-2222, harry.earth@sunvision.com.

The terms of your contract will govern your franchise relationship. Don’t rely on the disclosure document alone to understand your contract. Read all of your contract carefully. Show your contract and this disclosure document to an advisor, like a lawyer or an accountant.

Buying a franchise is a complex investment. The information in this disclosure document can help you make up your mind. More information on franchising, such as “A Consumer's Guide to Buying a Franchise,” which can help you understand how to use this disclosure document, is available from the Federal Trade Commission. You can contact the FTC at 1-877-FTC-HELP or by writing to the FTC at 600 Pennsylvania Avenue, NW, Washington, 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.

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

Issuance Date: August 1, 2018
How to Use This Franchise Disclosure Document

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

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

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

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

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

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

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

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

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

**Some States Require Registration**

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

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

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

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

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

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

This document is effective and may be used in the following states, where the document is filed, registered or exempt from registration, as of the Effective Date stated below:

<table>
<thead>
<tr>
<th>State</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>Pending</td>
</tr>
<tr>
<td>Hawaii</td>
<td>May 17, 2020</td>
</tr>
<tr>
<td>Illinois</td>
<td>Pending</td>
</tr>
<tr>
<td>Indiana</td>
<td>May 20, 2020</td>
</tr>
<tr>
<td>Maryland</td>
<td>Pending</td>
</tr>
<tr>
<td>Michigan</td>
<td>May 10, 2020</td>
</tr>
<tr>
<td>Minnesota</td>
<td>May 23, 2020</td>
</tr>
<tr>
<td>New York</td>
<td>June 15, 2020</td>
</tr>
<tr>
<td>North Dakota</td>
<td>May 10, 2020</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>May 11, 2020</td>
</tr>
<tr>
<td>South Dakota</td>
<td>May 10, 2020</td>
</tr>
<tr>
<td>Virginia</td>
<td>May 31, 2020</td>
</tr>
<tr>
<td>Washington</td>
<td>Pending</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>May 9, 2020</td>
</tr>
</tbody>
</table>

Other states may require registration, filing, or exemption of a franchise under other laws, such as those that regulate the offer and sale of business opportunities or seller-assisted marketing plans.
Instructions for Preparing
State Cover Sheets and State Effective Date Page

1. Insert the State Cover sheets immediately following the FTC required Cover Page described in Part VII.

2. Include the page titled “How to Use This Franchise Disclosure Document” as illustrated in the Sample in Form G.
   a. Format the information on a single page, in at least 13 point type.
   b. Use bold text only as illustrated in the Sample.
   c. Do not add, modify, or delete any of the information in the Sample page, except as described below.
   d. Insert the name of the franchise business where indicated in the first column, and the appropriate Exhibit letters or numbers from the franchisor’s Franchise Disclosure Document where indicated in the second column.

3. On the page immediately following “How to Use this Franchise Disclosure Document,” include the page titled “What You Need to Know About Franchising Generally” as illustrated in the Sample in Form G.
   a. Format the information on a single page, in at least 13 point type.
   b. Use bold and underlined text only as illustrated in the Sample.
   c. Do not add, modify, or delete any of the information in the Sample, except as described below.
   d. Insert the appropriate Exhibit letter or number from the franchisor’s Franchise Disclosure Document where indicated in the second to last paragraph.

4. On the page immediately following “What You Need to Know About Franchising Generally” include the page titled “Special Risk(s) to Consider About This Franchise” as illustrated in the Sample in Form G.
   a. Unless otherwise directed to do so by a state, include this information on a single page, in at least 13 point type.
   b. If a franchisor requires any dispute resolution outside of a franchisee’s home state, include the risk factor captioned Out-of-State Dispute Resolution, conforming the disclosure to the franchisor’s requirements and inserting the applicable state or jurisdiction.
   c. Include additional risk factors if required by a state.
   d. Do not add, modify, or delete any risk factor unless specifically directed to do so by a state.
e. Number all risk factors if more than one risk factor is required.

f. Disclose any other risk factor or factors required by a State on the same page, unless the state allows the risk factor or factors to appear on a separate State Addendum under a heading captioned “Special Risk(s) to Consider About This Franchise.”

g. A risk factor may be allowed to appear on a State Addendum if it is state-specific, if it required by only a single state, or if different states insist on different wording for substantially the same risk factor.

h. A state required risk factor may include a short caption with the subject of the risk. If so, follow the format illustrated in the Sample, using bold and underlining for the caption only.

i. Do not use ALL CAPS, multiple fonts, bold face, or underlining of the text of a risk factor, unless specifically directed to do so by a state.

j. If any risk factors appear in a State Addendum, include the following statement at the end of the page titled Special Risk(s) to Consider About This Franchise: Certain states may require other risks to be highlighted. If so, check the “State Specific Addenda” pages for your state.

5. Insert a page titled State Effective Dates immediately before the acknowledgement of receipt pages required under Item 23 of Part VII.

a. Use the format illustrated in the Sample in Form G.

b. If a franchisor is filing for registration in only one state, the franchisor may insert the state effective date information on the same page as the Special Risks to Consider About This Franchise page, if the information will fit on a single page with text not less than 13 point type.

c. List an effective date or pending only for those states where a franchise registration, filing, or exemption application has been made or is pending.

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

e. As registrations are ordered and made effective, the State Effective Date page can be modified by the franchisor without any resubmitting or amendment applications with the states.
SPEAKERS BIOGRAPHIES

DALE E. CANTONE  
dcantone@oag.state.md.us

Dale Cantone is an Assistant Attorney General for the State of Maryland and the Deputy Securities Commissioner for the Maryland Securities Division. Dale is the chief of the franchise and business opportunity unit of the Maryland Securities Division. In addition, Dale serves as Chair of the Franchise and Business Opportunity Committee/Project Group of the North American Securities Administrators Association, Inc. ("NASAA").

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

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

SUSAN GRUENE BERG  
sgrueneberg@cozen.com

Susan Grueneberg is a partner at the law firm of Cozen O’Connor in Los Angeles and is certified as a specialist in franchise and distribution law by the State Bar of California. Ms. Grueneberg serves as chair of the Industry Advisory Committee to the North American Securities Administrators Association Franchise Project Group and is a past chair of the American Bar Association Forum on Franchising. She is also a member of the International Franchise Association’s Legal/Legislative Committee. She previously served as chair of the California State Bar Franchise and Distribution Law Commission, which oversees the certification of legal specialists in franchise and distribution law in California. Ms. Grueneberg was also a member of the California State Bar Business Law Section Executive Committee, chair of the California State Bar Franchise Law Committee, and a member of the Board of Governors of the Century City Bar Association. She has written and lectured extensively at programs conducted by the California State Bar, the ABA Forum on Franchising, the International Franchise Association, and California Continuing Education of the Bar. A graduate of UCLA Law School, Ms. Grueneberg also taught at the Chinese University of Hong Kong as a U.S. State Department Fellow and received a National Academy of Sciences Fellowship for post-graduate study in economics at the University of Beijing. Ms. Grueneberg served as the press interpreter for the Chinese National Basketball Teams at the 1984 Olympics. She is co-editor of the ABA publication The FTC Franchise Rule.
PATTY HAGNER
PHagner@atg.state.il.us

Patty Hagner. After a long career in counseling and corrections, Patty Hagner obtained her Master’s Degree in Legal Studies from the University of Illinois in 2002. She has been a paralegal with the Office of the Illinois Attorney General since 2012. Prior to her work in the Franchise Bureau, she was a personal injury paralegal for 10 years.

THERESA LEETS
Theresa.Leets@dbo.ca.gov

Theresa Leets is Assistant Chief Counsel for the California Department of Business Oversight's Securities Regulation Division. The Securities Regulation Division regulates the offer and sale of both franchises and securities in California. Theresa is a member of the NASAA Corporation Finance Franchise and Business Opportunities Project Group. In addition, she is licensed as a Real Estate Broker with an inactive MLO (mortgage loan originator) endorsement in California. Ms. Leets received her BA at the University of California at Santa Barbara and her JD at the University of California at Davis.