

**FUNDAMENTALS OF FRANCHISING**  
**FRANCHISE REGULATION, DISCLOSURE**  
**AND REGISTRATION ISSUES**

Margaret E. Narodick

**1. A STATUTORY/REGULATORY OVERVIEW**

**A. The California Franchise Investment Law (“CFIL”):** In 1970, California became the first state to enact legislation creating franchise disclosure and registration obligations. With its passage, the legislature declared:

*“...that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view in the State of California. Prior to the enactment of this division, the sale of franchises was regulated only to the limited extent to which the Corporate Securities Law of 1968 applied to such transactions. California franchisees have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between franchisor and franchisee, and the prior business experience of the franchisor.*

*It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law to prohibit the sale of franchises where such sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled, and to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship.”<sup>2</sup>*

The CFIL was a precursor to the federal and state regulatory schemes that soon followed, all of which were born of the same fundamental legislative purpose. The CFIL is discussed in more detail below.

**B. Federal Trade Commission Rule 436:** After years of hearings, comment periods and other proceedings, the Federal Trade Commission trade regulation rule titled, “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,” and commonly referenced as, “FTC Rule 436” or the “FTC Rule”, became effective in 1979<sup>3</sup>. Unlike the CFIL and other state disclosure laws, Rule 436 includes no filing requirements and no process for governmental review. The FTC Rule is discussed in more detail below.

**C. Other State Registration/Disclosure Legislation:** Numerous other states followed California’s lead in adopting franchise related statutes. Today, 14 states have some form of franchise disclosure/registration laws<sup>4</sup>:

---

<sup>1</sup> California Corporations Code, Division 5, Parts 1-6, §§31000 through 31516.

<sup>2</sup> CFIL, §31001

<sup>3</sup> Code of Federal Regulations, Title 16, Chapter I, Subchapter D, Part 436 (16 CFR 436)

<sup>4</sup> California Corporations Code, Division 5, Parts 1-6, Sections 31000 through 31516; Hawaii Revised Statutes, Title 26, Chapter 482E, Sections 482E-1 through 482E-5, 482E-8, 482E-9, 482E-11, and 482E-12; Illinois Compiled Statutes 1992, Chapter 815, Sections 705/1 through 705/44 (Illinois Franchise Disclosure Act of 1987); Indiana Code, Title 23, Article 2, Chapter 2.5, Sections 1-51; Annotated Code of Maryland, Article-Business Regulation, Title 14, Sections 14-

California	Hawaii	Illinois
Indiana	Maryland	Michigan
Minnesota	New York	North Dakota
Rhode Island	South Dakota	Virginia
Washington	Wisconsin	

(Oregon does not have a registration requirement, but it does have a disclosure statute which is met with the use of a Uniform Franchise Offering Circular (“UFOC”). See Section 2, below).

**D. Business Opportunity Laws and Franchise Exemption Filings:** The following states have enacted business opportunity legislation and require that franchisors file notices of exemption prior to the offer or sale of franchises within their jurisdiction.<sup>5</sup>

Florida	Kentucky	Texas	Utah	Nebraska
---------	----------	-------	------	----------

Additionally, there are a few jurisdictions in which the franchisor must register under business opportunity laws if it does not have a registered trademark. They include Connecticut, Georgia, Louisiana, Maine, South Carolina and North Carolina.

**E. Franchise Relationship Laws and other Relevant Statutes:** While outside the scope of this outline, practitioners should be aware that 18 states regulate various aspects of franchise termination/non-renewal/transfer activities, often imposing minimum notice provisions and/or good cause requirements, among other terms. California is among these states and seeks to address certain relationship requirements under the California Franchise Relations Act (Section 20000, et seq, of the Business and Professions Code). Some of the other jurisdictions are registration states, but a number are not.

## 2. Application of the CFIL and Federal Rule 436

**A. Disclosure Document Formats:** The Uniform Franchise Offering Circular (“UFOC”) Guidelines originally were adopted in the mid-1970’s by the Midwest Securities Commissioners Association and later modified by its successor organization, the North American Securities Administrators Association (NASAA). The UFOC Guidelines prescribe the information to be disclosed to prospective franchisees in 23 different subject areas, called “Items”. (Refer to Summary of Disclosure Contents, below). All registration states accept the UFOC format for disclosure compliance purposes.

---

201 through 14-233; Michigan Compiled Laws, 1979, Chapter 445, Sections 445.1501 through 445-1545; Minnesota Statutes 1996, Chapter 80C, Sections 80C.01 through 80C.22; New York General Business Law, Article 33, Sections 680 through 695; North Dakota Century Code Annotated, Title 51, Chapter 51-19, Sections 51-19-01 through 51-19-17; Oregon Revised Statutes, Title 50, Chapter 650, Sections 650.005 through 650.085; General Laws of Rhode Island, 1956, Title 19, Chapter 28.1, Sections 19-28.1-1 through 19-28.1-34; South Dakota Codified Laws and 1991 Pocket Supplement, Title 37, Chapter 37-5A, Sections 37-5A-1 through 37-5A-87; Virginia Code of 1950, Title 13.1, Chapter 8, Sections 13.1-557 through 13.1-574; 1989 Revised Code of Washington, Title 19, Chapter 19.100, Sections 19.100.010 through 19.100.940; Wisconsin Statutes, 1993-1994, Chapter 553, Sections 553.01 through 663.78.

<sup>5</sup> Florida Statutes, 1995, Chapter 559, Sections 559.80 through 559.815; Kentucky Revised Statutes and 1988 Supplement, Title XXIX, Chapter 367, Sections 367.801 through 367.819 and 367.990; Texas Business and Commerce Code, Title 4, Chapter 41, Sections 41.001 through 41.303; Utah Code Annotated 1953, and 1989 Cumulative Supplement, Title 13, Chapter 15, Sections 13-15-1 through 13-15-6; Revised Statutes of Nebraska 1943, Chapter 59, Article 17, Sections 59-1701 through 59-1761.

The FTC Rule includes a similar, but not identical, set of disclosure contents requirements. While the UFOC format is an acceptable disclosure document format alternative under Rule 436, franchisors must comply with the FTC requirements involving timing of disclosure, scope of transaction, contracts to be executed and delivered in advance of a transaction, certain refunds and persons covered by the rule. To the extent that any provision of a state franchise law is inconsistent with the Federal Rule, the provision, which affords the greater protection to the prospective franchisee, prevails.

As a practical matter, franchisors use the UFOC format almost universally. The Federal Trade Commission has been considering since 1995 possible changes to the disclosures currently required to be given by franchisors to prospective franchisees. That process is drawing to a conclusion, and it is generally anticipated that within the next year the FTC will implement its final changes. These changes will affect franchisors throughout the United States and are likely to require substantial revisions to disclosure documents currently in use, regardless of whether or not the franchisor files in registration states.

The “Proposed Rule” under final consideration by the FTC is based on the current UFOC. The disclosure document format contemplated by the Proposed Rule differs from the current UFOC form in certain substantial respects. Once adopted, this format is intended to become the standard form of disclosure document permitted in the U.S., subject to state-specific provisions where state law provides greater protections to franchisees.

**B. Transactions Covered by the CFIL and the FTC Rule:** State laws and the FTC Rule can vary regarding the kinds of transactions they seek to regulate. Exemptions from franchise disclosure under the FTC Rule exist in limited instances, as noted in the portion of the program materials titled, “What is a Franchise?”. Under the CFIL, exemptions from registration may exist for transactions involving fractional franchises, bank credit card plans, sales by a franchisee, experienced prospective franchisees, experienced franchisors meeting net worth and other requirements, out of state franchisees, etc.<sup>6</sup> Note that an exemption from registration does not eliminate the obligation to deliver a disclosure document to a prospective franchisee unless such an exemption is specifically available under both the FTC Rule and the CFIL.<sup>7</sup>

Internet offers are exempt from registration requirements in California if the following conditions are met:

1. the Internet offer indicates that the franchise is not being offered to residents of the state;
2. the Internet offer is not otherwise directed to any person in the state by the franchisor or anyone acting with the franchisor’s knowledge; and
3. franchises are sold only after state registration is complete and the UFOC properly delivered to the offeree.<sup>8</sup>

**C. CFIL Jurisdictional Requirements:** As noted previously, the FTC Rule will apply to every qualifying transaction in all 50 states, e.g., the requisite definitional elements are met and no exemption is available. The application of the CFIL is necessarily more limited in scope, and extends to an offer or sale of a franchise made in California<sup>9</sup>. Such an offer or sale exists if:

---

<sup>6</sup> CFIL, Sections 31100 through 31108.

<sup>7</sup> For a detailed treatment of exemptions, refer to, “A Scenic Tour of Exemptions and Exclusions to Franchise Registration Laws,” materials presented by Mary Beth Trice and Robin Day Glenn at the American Bar Association’s 24<sup>th</sup> Annual Forum on Franchising (October, 2001).

<sup>8</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.100.3

<sup>9</sup> CFIL, Section 31013.

1. An offer to sell is made in California  
*(an offer to sell is made in this state when the offer either originates from this state or is directed to and received and accepted in California)*  
or
2. An offer to buy is accepted in California  
  
or
3. the franchisee is domiciled in this state and the franchised business is or will be operated in this state.<sup>10</sup>

Any offer, sale, or other transfer of a franchise, or any interest in a franchise, to a resident of another state or any territory or foreign country is exempted from the registration requirements of the CFIL if all locations from which sales, leases or other transactions between the franchised business and its customers are made, or goods or services are distributed, are physically located outside this state.<sup>11</sup>

Note that each of the registration/disclosure states referenced in 1. C., above, have their own jurisdictional requirements which must be examined independently.

### 3. FRANCHISE REGISTRATION UNDER THE CFIL

**A. Initial Application:** An application for registration is filed with and reviewed by the Department of Corporations. California follows the UFOC Guidelines and requires the standard application form documents<sup>12</sup> which, along with the UFOC itself, include a cover page, notarized signature of an authorized officer, consent to service of process, Sales Agent disclosure forms, supplemental information concerning the other state registration applications filed or anticipated by franchisor, a supplemental information sheet, financial statements (and auditor's consent letter) and the application fee (currently \$675.00 in California).

The state department or agency responsible for overseeing the franchise registration process varies among the other registration states, and may be the Securities Divisions, Department of Commerce, Secretary of State, Attorney General or other state agency. The particulars of the application process also vary from state to state and should be reviewed as applicable.

**B. Review Process:** Once an application for registration has been submitted, the franchisor will receive notice of the receipt of the application. Under the CFIL, an initial application is effective on the 15th business day after filing.<sup>13</sup> However, it has become somewhat customary for applicants to receive a return document for execution, which requests that they waive the automatic effective date of the application and results in a "stop order" on the automatic effective date.

This practice may be a less frequent occurrence in the future due to the Department of Corporation's current consideration of a plan to implement a risk-based review process. Such a process would provide for an abbreviated review of those filings with a perceived low level of risk, based upon the examiner's review and assessment of certain criteria.

---

<sup>10</sup> See Part 1 of the CFIL for statutory definitions of certain of the terms included above.

<sup>11</sup> CFIL, §31105.

<sup>12</sup> CFIL, §§31111 through 31114.

<sup>13</sup> CFIL, §31116.

Franchise registration applications are not reviewed on a merit basis. The focus is on compliance with the UFOC requirements and on ensuring that all of the 23 items of disclosure have been met. Examiners will deliver any comments to the franchisor's counsel or other applicable representative. Any revisions are then resubmitted with a redlined copy to the examiner, who may issue an order of effectiveness or send additional comments. The examiner also may impose certain conditions on the registration, e.g., an escrow requirement, fee deferral, or other financial condition if he/she finds that one is warranted in the particular circumstances. Franchises may not be lawfully offered or sold in California before the initial registration is declared effective and all applicable conditions met.

**C. Amendment:** Once registered, a franchisor has an obligation under the CFIL to amend its disclosure document upon the occurrence of a material change in the information it contains.<sup>14</sup> Unlike some other registration states, California has not provided any regulatory guidance as to the meaning of "material" in this context. Other jurisdictions lend some assistance in this regard with regulations that point to various changes such as fee adjustments, territorial commitments, additional franchisee investment requirements and system changes, changes in franchisor ownership and executive leadership, relevant litigation and other factors. Any evaluation of the materiality of a given event or change should consider the FTC Rule, under which "material" information includes information or circumstances having a substantial likelihood of influencing or having a significant financial impact on a reasonable franchisee (or prospective franchisee) in the decision to buy the franchise.<sup>15</sup>

An amendment application and \$50.00 filing fee (in California) must accompany each "post-effective" amendment. Instructions for an amendment application are less detailed than for an initial registration, with fewer documents required.<sup>16</sup> Again, the process varies from state to state, and applicable statutes/regulations need to be consulted in connection with each filing.

**D. Registration Renewal:** Registrations in California expire 110 days after the franchisor's fiscal year end.<sup>17</sup> If the registration is allowed to expire, the franchisor's ability to lawfully offer and sell franchises in the state expires with it. To maintain an uninterrupted registration, a franchisor must file a registration renewal application at least 15 business days before the anniversary date.<sup>18</sup> The information submitted is similar to initial registrations, but includes a redlined UFOC marked to show changes from the previously filed document. Certain items of the UFOC Guidelines require annual updating of the prescribed information, including financial statements (generally audited) as of the applicant's most recent fiscal year end. The renewal application then goes through a similar review and comment process as described above. Currently, the Renewal Fee is \$450.00.

**E. Negotiated Sales:** The concept of negotiated sales is also addressed by regulation.<sup>19</sup> California is unique among the states in requiring a filing by the franchisor if the franchise agreement signed by the franchisor and franchisee proves to be different from the offer and sale then-registered with the Department of Corporations. In fact, the negotiated sale is a form of exemption from registration based upon the theory that if

---

<sup>14</sup> CFIL, §31123.

<sup>15</sup> Code of Federal Regulations, Title 16, Chapter I, Subchapter D, Part 436 (16 CFR 436), Section 436.2, ¶6182 (n).

<sup>16</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.123.

<sup>17</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.120.

<sup>18</sup> CFIL, §31121.

<sup>19</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.100.2.

discussions follow the agreement presentation to the franchise candidate, the negotiated outcome is an iteration of the franchise agreement which has not yet been approved by the state and would, therefore, be unlawful absent the availability of this exemption. This analysis (and the regulation) applies regardless of whether or not the negotiated change favors the franchisee and/or is at the franchisee's behest.

To qualify for the exemption, the franchisor must file a form Notice of Negotiated Sale within 15 days of the applicable transaction.<sup>20</sup> Additionally, an amendment must be made to the appropriate UFOC item indicating that the terms described in that particular item have been negotiated with other franchisees, and copies of all completed Notices of Negotiated Sale must be included with the UFOC for a period of 12 months. An amendment limited to these purposes is effective upon filing. The amendment must be made before any sales can occur after the negotiated sale.

In spring, 2003, the Department of Corporations extended an invitation for comments from interested persons regarding whether changes should be made to the negotiated sales provisions and asked that such comments be received by August 1, 2003. The invitation may be the beginning of a rethinking of California's position on negotiated sales. In the interim, however, this requirement remains a compliance issue unique to our state.

#### 4. TIMING OF DISCLOSURES

**A. 10-Business Day Rule:** Under the FTC Rule the disclosure document must be delivered to the prospective franchisee at the earlier of the first personal meeting for the purpose of discussing the sale of a franchise or 10 business days prior to signing any binding agreement or paying any money or other consideration.<sup>21</sup> The rationale for the timing and delivery requirement is to enable a prospective franchisee sufficient time for review of the UFOC (along with any professional advisors) and to create a 'cooling off' period to distance the candidate from any sales pressure. California's delivery requirement mirrors the 10-business day provision of the FTC Rule. States may have differing rules, such as Illinois with a 14-day requirement.

**B. 5-Business Day Rule:** The FTC Rule requires that a copy of the franchise contract (ready for signature and with all terms completed) and related agreements be delivered at least 5 business days prior to signing.<sup>22</sup>

#### 5. RELATED DISCLOSURE AND REGISTRATION REQUIREMENTS

**A. Earnings Claims:** The term, "Earnings Claim" in the disclosure context is something of a misnomer. Oral or written information delivered by the franchisor or an agent that enables a recipient to establish a specific level or range of actual or potential sales, costs, income or profit is an "earnings claim" in the meaning of franchise laws. The use of earnings claims is addressed both in item 19 of the Uniform Franchise Offering Circular Guidelines and under the FTC Rule.

---

<sup>20</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.100.2 (a) (4).

<sup>21</sup> Code of Federal Regulations, Title 16, Chapter I, Subchapter D, Part 436 (16 CFR 436), Section 436.2, ¶6172 (g).

<sup>22</sup> Code of Federal Regulations, Title 16, Chapter I, Subchapter D, Part 436 (16 CFR 436), Section 436.2, ¶6149 (g).

Under both the FTC Rule and UFOC Guidelines a franchisor may elect to make an earnings claim so long as it complies with the applicable disclosure requirements. To comply with UFOC Item 19 requirements, an earnings claim must be included in full in the Offering Circular and have a “reasonable basis” at the time it is made. It must:

1. Include the factual basis for the claim. The factual basis is meant to include all significant matters upon which a franchisee’s results are expected to depend, such as economic and market conditions affecting sales, costs of goods and services sold, operating expenses and other aspects of the unit operation. If a franchisor does not have adequate franchisee data upon which to rely, it may base a claim on the operating results of similar units (e.g., company owned units). However, it then is charged with describing all of the material differences between the models used and the franchise concept (e.g., royalty payments and other fees, etc.); and
2. State all of the material assumptions underlying the claim and the precise basis of the claim (e.g., % of franchisees that have obtained the described results, etc.); and
3. Include a conspicuous admonition that a franchisee’s results are likely to differ from the stated result; and
4. Offer to provide substantiation used in preparing the claim upon request.

Since terms such as “material”, “reasonable basis” and “precise basis” are all open to interpretation, earnings claims must be carefully drafted to comply with these UFOC requirements and to minimize exposure to subsequent claims of fraud and/or misrepresentation. There is no “safe harbor” afforded the franchisor’s compliance efforts. This is one of the principle reasons that most franchisors have chosen not to make earnings claims, and, therefore, include a negative disclosure in their item 19, as required by the Guidelines (e.g., the franchisor does not furnish, or authorize others to furnish, oral or written earnings claims-type information).

Amendments to the CFIL regulations effective July 10, 2003, require that franchisors making earnings claims related to gross revenue or sales include a statement of whether or not sales or operating expenses must be deducted from the reported amounts to arrive at a net income/profit figure.<sup>23</sup>

**B. Advertising Filings:** The CFIL requires that all franchise advertisements be filed with the Department of Corporations 3 days prior to publication unless exempted.<sup>24</sup> Such exemptions are provided for ads placed in a newspaper with a general, regular circulation which has had more than two-thirds of its circulation outside the state during the past 12 months, or a radio or television program originating outside this state received in the state.

It should be noted that the definition of “advertisement” in the CFIL is quite broad. “Advertisement” means any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with an offer or sale of a franchise.<sup>25</sup>

---

<sup>23</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.114.1

<sup>24</sup> CFIL, §31156.

<sup>25</sup> CFIL, §31003.

Internet advertising has been included within the ambit of this definition. However, an exemption from the filing requirement exists for franchisors if the Internet ad is not directed to any specifically named person or group of persons in California and if all of the franchisors URL's are disclosed in accordance with the regulations adopted by the DOC in July, 2003.<sup>26</sup>

Other registration states define advertisement even more broadly than California, and most do require filing within a set period of time prior to publication in the applicable state.

**C. Material Modification – Changes in an Existing Franchise Relationship:** It is unlawful in California to solicit the agreement of an existing franchisee to a proposed material modification of an existing franchise unless a registered, written disclosure document in a form set by the state is first delivered 5 business days before signing the modified agreement, or the disclosure contains a statement that the franchisee may rescind the modified agreement no less than 5 business days after signing. An exemption is available if the modification is the result of a bona fide dispute due to a franchisee default, the written modification is received by the franchisee at least 5 business days before signing (with some additional requirements) and the change is not systemwide.<sup>27</sup> California stands alone among the states in having such a post-sales registration and disclosure requirement.

## 6. NON-COMPLIANCE

**A. Federal Rule:** No private right of action is available under the FTC Rule, despite earlier FTC urging on this issue. However, the FTC may impose both civil and criminal penalties for violation of the Rule.

**B. State Registration/Relationship Laws:** Unlike the FTC rule, individuals do have private rights of action under applicable state laws, including in California. Of course, the state may also bring an action for non-compliance. The range of remedies and penalties is broad, generally including rescission, damages, attorneys' fees, civil penalties, and criminal penalties (all subject to various conditions).<sup>28</sup>

Refer to the Enforcement portion of the Program Materials for a more extensive review of remedies and other enforcement aspects of the CFIL.

## 7. UFOC CONTENTS REQUIREMENTS

**A. Summary of Items:** The following is a brief outline of the various UFOC subject areas addressed in the UFOC Guidelines and related instructions.

Item 1: The Franchisor, its Predecessors and Affiliates. The identity, business and experience of the franchisor (as well as defined affiliates and predecessors) must be explained, along with a description of the franchised business, including information about the market for the goods or services offered and the competition and regulations that apply to the franchisor's specific industry.

Item 2: Business Experience. The identities and last 5 years' business experience of the franchisor's officers, directors, general partners, trustees, and others who will have management responsibility relating to the franchise.

---

<sup>26</sup> California Administrative Code, Title 10, Chapter 3, Subchapter 2.6, Section 310.156.3

<sup>27</sup> CFIL, §31125 (c) (1) (2) (3).

<sup>28</sup> CFIL, §§31404, 31405, 31410, 31411.

Item 3: Litigation. Specified types of pending and concluded material litigation against the franchisor, persons disclosed in Item 2, predecessors and certain affiliates (as defined) must be disclosed.

Item 4: Bankruptcy. Information concerning bankruptcy proceedings by or involving the franchisor, its affiliates, predecessor, officers or general partners during the 10-year period immediately before the date of the UFOC.

Item 5: Initial Franchise Fees. All initial fees charged in connection with the purchase of the franchise and for goods or services received from the franchisor before the franchise opens.

Item 6: Other Fees. The recurring and non-recurring fees paid by the franchisee, i.e., royalties. (in chart form)

Item 7: Initial Investment. The franchisee's initial investment for items such as real property, furniture, fixtures, equipment, inventory and business licenses, and additional funds necessary to open the franchise and operate it for an "initial period". (in chart form)

Item 8: Restrictions on Sources of Products and Services. Franchisors may set certain restrictions on the goods and services that the franchisee will need in the business. If the franchisor receives any remuneration from any such vendor, the details of such payments must also be disclosed.

Item 9: Franchisee's obligations. The item requires information regarding various franchisee obligations, including site selection, training, compliance with manuals and standards established by the franchisor, advertising, post-termination non-competes and confidentiality, and others.

Item 10: Financing. Whether or not the franchisor, its affiliate or agent offers financing of all or any part of the fees paid by the franchisee must be disclosed, with a copy of all notes, contracts, etc., attached.

Item 11: Franchisor's Obligations. Commitments relating to sites, training programs, required computer systems and advertising programs must be disclosed.

Item 12: Territory. Rights and restrictions to any exclusive or non-exclusive area are described here. Also included are franchisor's reserved rights, such as any rights to establish another franchise or company-owned unit using the names and marks and rights to alternative distribution channels.

Item 13: Trademarks. The principal trademarks licensed to franchisee are described and applicable registration information listed. Non-registered trademarks require that a specific disclaimer be made. Any limitations on a franchisor's use of the marks or material determinations must also be discussed.

Item 14: Patents, Copyrights and Proprietary Information. Descriptions of these rights and their relationship to the franchise are required, including Confidential Information and Trade Secrets.

Item 15: Obligation to Participate in the Actual Operation of the Franchise Business. Disclosures as to whether or not the franchisor will require that the Franchisee

participate directly and personally in the actual operation of the franchise business or will permit a trained manager to do so.

Item 16: Restrictions on What the Franchisee May Sell. Restrictions or conditions on the goods or services that the franchisee may sell or that limit the customers to whom the franchisee may sell are disclosed here.

Item 17: Renewal, Termination, Transfer and Dispute Resolution. Summaries of the contractual provisions, including the term, renewal, termination, transfer, and dispute resolution terms. Table is required to permit cross-reference to sections in the franchise agreement and other contracts.

Item 18: Public Figures. Compensation for endorsement of the franchise (not the goods or services sold), management involvement of public figure and investments made in the franchisor by the public figure must be disclosed.

Item 19: Earnings Claims. As noted under Section 5 A., above, a franchisor must either provide information on financial performance that is substantiated by considerable data and in the required format, or provide no such information at all, and make a disclosure to such effect.

Item 20: List of Outlets. Most recent three years' statistics on franchise units, including units terminated, transferred or otherwise leaving the system, and on company-owned units and projected openings of new units for next fiscal year. Names, addresses and phone numbers of franchisees are listed. (in chart form)

Item 21: Financial Statements. Normally audited statements for the last two fiscal years are required, which must be prepared according to U.S. GAAP. Unaudited statements may only be used for interim periods. Some registration states allow franchisors to "phase-in" audited financials, permitting the submission of reviewed financials for the first year of registration under very limited circumstances. Alternatively, a franchisor may submit the financial statements of a parent or other affiliated company if the parent or affiliate absolutely and unconditionally guarantees (in writing) to assume all obligations of the franchisor under the franchise agreement.

Item 22: Contracts. Each UFOC delivered to a prospective franchisee must include copies of all agreements to be offered. These include, the franchise agreement, leases, subleases, guaranties of performance, financing agreements and other documents attached to the UFOC.

Item 23: Receipt. The last page of the UFOC is a detachable document acknowledging receipt of the UFOC by the prospective franchisee and must contain certain information and statements.<sup>29</sup>

---

<sup>29</sup> The author extends her appreciation to Lori Lofstrom, Holmes & Lofstrom, for the use of her related presentation materials, portions of which have been used in compiling this program.