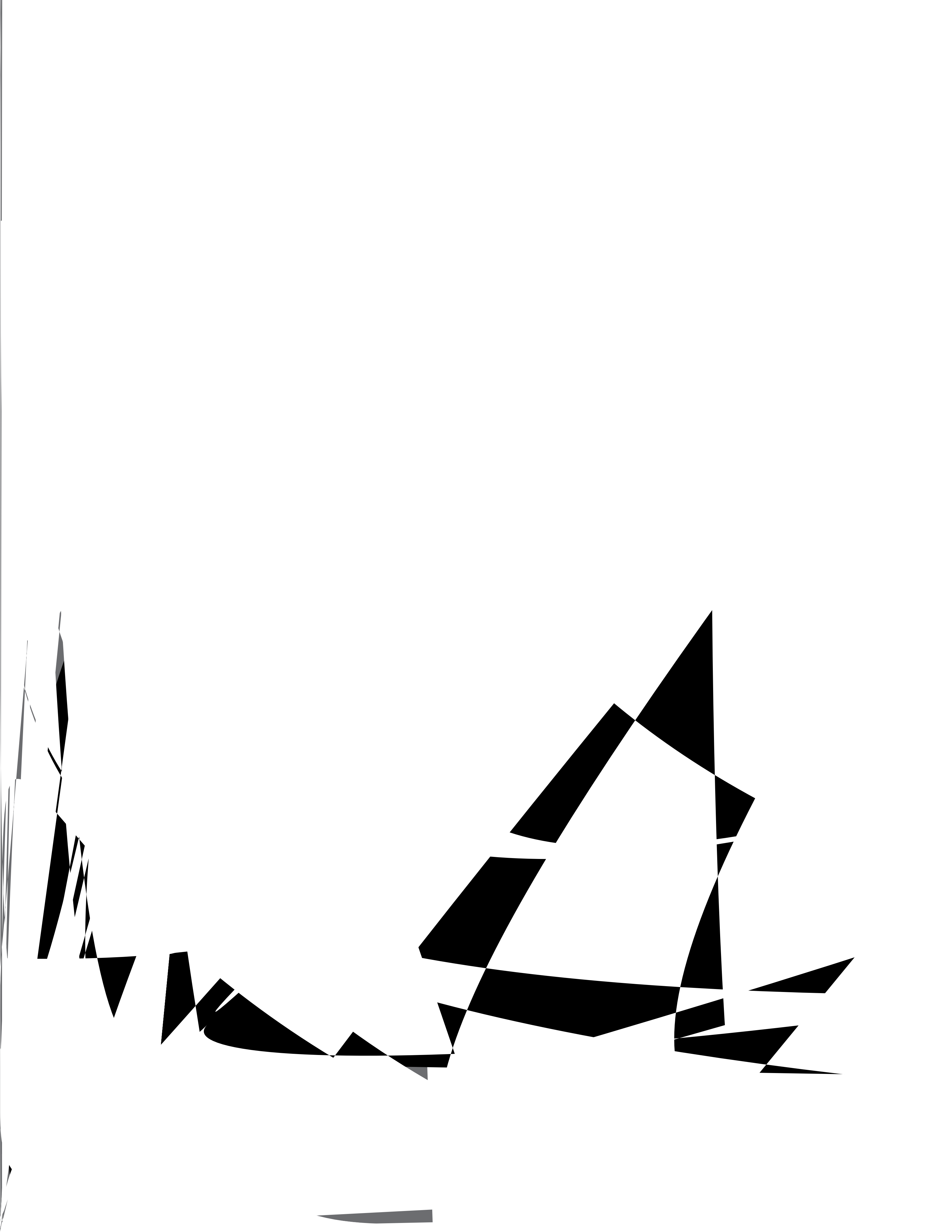

FEDERAL TRADE COMMISSION

16 CFR Parts 436 and 437

Disclosure Requirements and Prohibitions Concerning Franchising

Disclosure Requirements and Prohibitions Concerning Business Opportunities

AGENCY: Federal Trade Commission.

ACTION: Final rule.

SUMMARY: The Federal Trade Commission (the ''Commission'' or ''FTC'') amends its Trade Regulation Rule entitled ''Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures'' (''Franchise Rule'' or ''Rule'') to streamline the Rule, minimize compliance costs, and to respond to changes in new technologies and market conditions in the offer and sale of franchises. Part 436 sets forth those amendments to the Franchise Rule pertaining to the offer and sale of franchises. Part 437 sets forth a revised form of the original Franchise Rule pertaining solely to the offer and sale of business opportunities. This document provides background on the Franchise Rule and this proceeding; discusses the public comments the Commission received; and describes the amendments the Commission is making based on the record. This document also contains the text of the final amended Rule and the Rule's Statement of Basis and Purpose (''SBP''), including a Regulatory Analysis.

EFFECTIVE DATES: The effective date of the final amended Rule is July 1, 2007. Permission to use the original Franchise Rule, however, will continue until July 1, 2008. After that date, franchisors and business opportunity sellers must comply with the final amended Rule only.

ADDRESSES: Requests for copies of the final amended Rule and the SBP should be sent to: Public Reference Branch, Room 130, Federal Trade Commission, 600 Pennsylvania Avenue, NW,

[1] *See* 16 CFR Part 436. Provisions of the original Rule are cited in this document as 16 CFR 436.[ ]. Citations to the final amended Rule are cited simply as 436.[ ] or 437.[ ], respectively. The text of the final amended Rule is set forth in Section VII.

[2] The specific definition of the term ''franchise'' is discussed below in connection with section 436.1(h).

[3] We were assisted in the effort to reduce inconsistencies between the original Rule and UFOC Guidelines by NASAA's submission of a document entitled ''Comparison of UFOC and Proposed FTC Disclosure Requirements'' (''NASAA Comparison'') (Jan. 8, 2002). A copy of this document is on the public record in this proceeding.

[4] The definition of ''business opportunity'' is discussed below in connection with section 437.2(a).

[5] 71 FR 19054 (Apr. 12, 2006).

[17] 64 FR 57294 (Oct. 22, 1999).

[18] 16 CFR 1.13.

[19] Franchise NPR, 64 FR at 57324.

[20] Franchise NPR comments are cited as: [Commenter] NPR [comment number].

[21] Many commenters enthusiastically supported the Commission's overall approach to revising the Rule. *E.g.*, IL AG, NPR 3, at 10; PMR&W, NPR 4, at 1; Holmes, NPR 8, at 1; H&H, NPR 9, at 2; Baer, NPR 11, at 1; NFC, NPR 12, at 2; Lewis, NPR 15, at 1; IFA, NPR 22, at 3; AFC, NPR 30, at 3; J&G, NPR 32, at 1; Tricon, NPR 34, at 1; Marriott, NPR 35, at 2.

[22] Accordingly, no Presiding Officer was established in this proceeding. *See* Rules of Practice, 16 CFR 1.13(c).

[23] *See* Bureau of Consumer Protection, *Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule* (16 CFR Part 436) (Aug. 2004) (''Staff Report''). The Staff Report is available at: www.ftc.gov/os/2004/08/0408franchiserulerpt.pdf. In September, 2004, the Commission published a notice in the **Federal Register** announcing the availability of, and seeking comment on, the Staff Report. *See* 69 FR 53661 (Sept. 2, 2004). The announcement is also available at: www.ftc.gov/os/2004/08/040825franchiserulefrn.pdf.

[24] Staff Report comments are cited as ''[Commenter], at ______ .'' These comments simply refer to the commenter and not to a specific comment number. After the Franchise NPR, the Commission's Secretary's Office discontinued the practice of assigning a specific comment number to each comment.

[25] *E.g.*, Bundy, at 1; Cendant, at 1 (representing Ramada, Days Inn, Howard Johnson, Travelodge, Knights Inn, Super 8 Motel, Wingate Inn, AmeriHost, Century 21, Coldwell Banker, ERA, Sotherby's Intl Realty, Avis, and Budget); IFA, at 1; IL AG, at 1; J&G, at 1; Kaufmann, at 2 (representing Kaufmann, Feiner, Yamin, Gildin & Robbins; YUM! Brands [Pizza Hut, KFC, Taco Bell, Long John Silvers, and A&W]; 7-Eleven, Inc.; and Arby's [Arby's and T.J. Cinnamons Classic Bakery]); Marriott, at 2; NASAA, at 2; Piper Rudnick, at 1; Spandorf, at 1; Starwood, at 1 (representing Four Points Hotels, Sheraton Hotels,Westin Hotels, and Luxury Collection Hotels); Wiggin and Dana, at 1.

[26] Fourteen comments focused solely on a single issue. For example, eight comments addressed only the original Rule's exclusion for cooperatives (Affiliated Foods; CHS; Graber; IDC; NCBA; NCFC; NGA; Riezman Burger). Additional one-issue comments were received on: the disclosure of franchisee associations (AAFD); the single trademark exclusion (Pillsbury Winthrop); the sophisticated investor exemptions (NADA); the Petroleum Marketing Practices Act (Chevron); the disclosure of parent information (PRKaf;0T3nullsegrnt infclamene

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[30] As of the date of this Notice, the Commission has filed more than 210 suits against more than 650 defendants (both franchises and business opportunities) for Franchise Rule violations since the Rule was promulgated in 1978. *See also* Business Opportunity NPR, 71 FR 19054 (Apr. 12, 2006) (discussing the Commission law enforcement history in combating business opportunity covered by the Franchise Rule).

[31]

outweighed by the alleged harm to franchisees. Commenters advocating that the Rule include unfairness remedies have asserted injury, but have failed to bring forth evidence that such injury outweighs potential countervailing benefits that arise from the alleged acts or practices. Therefore, the Commission declines to impose industry-wide provisions mandating substantive terms of private st recentadfeld, NPR 23,

[45] The Commission notes that it has voiced concern that government-mandated contractual terms may result in affirmative harm to consumer welfare. Contractual terms that are driven by market forces and forged by private parties acting in their own self-interest are the ones most likely to result in products being brought to market quickly and efficiently. The Commission therefore has authorized its staff to file a number of advocacy comments recommending against proposed state bills that would have unduly limited manufacturers in managing their distribution systems, such as by requiring exclusive territories, prohibiting or seriously burdening wholesaler terminations, or limiting the ability to reorganize a distribution system in response to changing competitive conditions. *See, e.g.*, Letter from Maureen Ohlhausen, Dir., Office of Policy Planning, et al., to the Hon. Wesley Chesbro, Cal. State Senate (Aug. 24, 2005) (comment on proposed beer franchise act); Letter from C. Steven Baker, Dir., Chicago Regional Office, to the Hon. Dan Cronin, Ill. State Senate (Mar. 31, 1999) (comment on proposed legislation on wine and spirits distribution); *cf.* Testimony of Jerry Ellig, Deputy Dir., Office of Policy Planning, before joint committee hearings of the Haw. state legislature (recommending against gasoline price control legislation, in part on grounds that repeal of anti-encroachment statute would be a more effective means of reducing prices (Jan. 28, 2003)).

[46] Authorization to use the UFOC Guidelines to comply with the original Rule's disclosure requirements was first granted by the Commission in the Interpretive Guides, 44 FR at 49970–71, on the grounds that the UFOC Guidelines, taken in their entirety, provide equal or greater consumer protection as the original Rule. The Commission ratified this position following subsequent amendments to the UFOC requirements by the NASAA, most recently in 1993, 58 FR 69224 (Dec. 30, 1993).

Beginning on July 1, 2008, however, franchisors may use part 436 of the final amended Rule only. Permission to use the UFOC Guidelines will be withdrawn on that date because those Guidelines will no longer afford prospective franchisees equal or greater protection as part 436. This would not preclude consideration of any new or revised UFOC Guidelines promulgated by the states in the future.

[47] *E.g.*, H&H, ANPR 28, at 5–6; Kaufmann, ANPR 33, at 3; Kestenbaum, ANPR 40, at 1; WA Securities, ANPR 117, at 1.

[48] *E.g.*, IFA, NPR 22, at 4–5; Stadfeld, NPR 23, at 2; Karp, ANPR, 19 Sept. 97 Tr., at 90.

[49] NASAA, ANPR 120, at 2. *See also* WA Securities, ANPR 117, at 1.

[50] *E.g.*, PMR&W, NPR 4, at 1; H&H, NPR 9, at 2; 7-Eleven, NPR 10, at 2; Lewis, NPR 15, at 5; NASAA, NPR 17, at 2–4; Bundy, NPR 18, at 6; Gurnick, NPR 21, at 2; IFA, NPR 22, at 4–5; Stadfeld, NPR 23, at 2; J&G, NPR 32, at 2; Marriott, NPR 35, at 2; Brown, ANPR 4, at 1; Duvall, ANPR 19, at 1; Baer, ANPR 25, at 2; Kaufmann, ANPR 33, at 3; SBA Advocacy, ANPR 36, at 3; Kestenbaum, ANPR 40, at 1; AFA, ANPR 62, at 2; IL AG, ANPR 77, at 1; WA Securities, ANPR 117, at 1; Selden, ANPR 133, at 1; Zarco & Pardo, ANPR 134; at 1; Cendant, ANPR 140, at 2.

[51] A decision to retain any portion of the original Rule may be based upon evidence gathered during the original rulemaking and the Commission's subsequent enforcement experience, as well as evidence adduced during the current rulemaking. Indeed, to the extent that nothing supplements evidence from the initial rulemaking, there is a presumption that the existing rule should be retained. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983).

[52] The Commission's Rules of Practice prescribe procedures to follow in seeking such advice. 16 CFR 1.3.

[53] Throughout the Rule amendment proceeding, commenters have requested that the Commission explain or interpret various provisions in Compliance Guides. The Commission anticipates that staff will respond affirmatively to those requests. Compliance Guides on part 437 (the business opportunity section) will be issued after the conclusion of the business opportunity rulemaking proceeding.

[54] The Commission also recognizes that over the course of the years, franchisors have developed specific language approved by the states for compliance with the UFOC Guidelines. The Commission anticipates that part 436 of the final amended Rule will be interpreted, where consistent with the public interest, in a manner that conforms with historic industry practices.

[55] 15 U.S.C. 57a(d)(2)(B). The Commission's rulemaking standards applicable to the promulgation and amendment of a Section 18 rule require a preponderance of reliable evidence. *See* Statement of Basis and Purpose, Funeral Rule, 59 FR 1592 (Jan. 11, 1994); Credit Practices Rule, 49 FR 7740 [illegible]

may increase if he or she must incur hidden costs in the form of compliance with various industry-specific regulations governing the particular field. Part 436 of the final amended Rule also adopts the UFOC Guidelines' required disclosure of fees that the franchisee is expected to pay within the first three months of operation (or other reasonable time for the industry), as well as more details about payments, such as to whom a payment is to be made and whether a payment is refundable. At the same time, part 436 of the final amended Rule updates cost disclosures by requiring, for example, additional information about any required computer systems, based upon the UFOC Guidelines. Each of these UFOC provisions is designed to prevent misrepresentation of the costs required to commence operation of a franchised outlet.

c. Misrepresentations about contractual terms

Another area of deception identified in the original rulemaking record concerns the underlying franchise or business opportunity contract. For example, the Commission found that franchisors may misrepresent the extent of promised assistance, or fail to disclose restrictions and other obligations imposed on the franchisee. Accordingly, the original Rule specified a number of disclosures pertaining to

a poor financial history, or even facing bankruptcy. Obviously, a franchisee's investment, for example, is at risk if the franchisor is not able to perform its contractual obligations as promised. To remedy these practices, the original Rule required franchisors and business opportunity sellers to disclose bankruptcy information, as well as to provide audited financial information. The final amended Rule continues to require these disclosures.

3. The economic effect of the rule

At every stage of the Rule amendment proceeding, the Commission solicited comment on the economic impact of the Rule, as well as the costs and benefits of each proposed Rule amendment. In finalizing the final amended Rule, the Commission has carefully weighed these costs and benefits, reducing compliance costs wherever possible. Thus, for example, part 436 reduces compliance costs by limiting the Rule's scope of coverage to the sale of franchises to be located in the United States and its territories.[61]

In the same vein, part 436 of the final amended Rule reduces compliance burdens where the record establishes that the abuses the Rule is intended to address are not likely to be present. Thus, part 436 of the final amended Rule retains the exemptions in the original Rule as the ones for fractional franchises and leased departments. Part 436 of the final amended Rule also incorporates the Commission's long-

[61] In so doing, the Commission specifically rejected the suggestion that franchisors should prepare individual disclosure documents tailored to each specific foreign market. Not only would such a requirement put American franchisors at a competitive disadvantage with franchisors from countries lacking comparable disclosure regulations, the minimal benefits of such a requirement would not likely outweigh the extraordinary costs and burdens involved.

[62] The Commission is also considering amendments to the original Rule as they pertain to business opportunity sales. *See* Business Opportunity NPR, 71 FR 19054 (Apr. 12, 2006).

[63] Multiple franchisor-initiated suits could indicate franchisees' inability to comply with royalty payment obligations, or possibly a royalty boycott by franchisees. Suits to enforce system standards, on the other hand, could show active involvement by the franchisor in maintaining standards for the benefit of all franchisees within its system. In either case, this is information material to prospective franchisees attempting to determine the nature of the franchisor's relationship with its franchisees.

[64] *See* 16 CFR 436.2(f).

[65] *See* 16 CFR 436.2(g).

[66] *See* 16 CFR 436.2(o). The original Rule required franchisors to provide disclosure documents at the earlier of the first ''personal meeting'' or ''the time for making disclosures,'' which generally meant 10 business days before the prospective franchisee paid any fee or signed any contract in connection with the franchise sale. The final amended Rule streamlines this requirement by eliminating those timing provisions in favor of a clear, bright-line 14 calendar-day provision. Accordingly, the terms ''time for making disclosures,'' ''personal meeting,'' and ''business day'' are obsolete.

[67] *See* 16 CFR 436.2(l). Cooperative associations are one of four non-franchise relationships that the Commission has excluded from the final amended Rule. Unlike Rule exemptions (which are substantive limitations on the Rule's scope), the original Rule exclusions are explanatory, helping the public better distinguish between franchise and non-franchise relationships. Accordingly, the
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[69] This definition is also consistent with the Commission's interpretation of the term ''action,'' as discussed in the Interpretive Guides to the Franchise Rule. Interpretive Guides, 44 FR at 49973.

[70] *See* UFOC Guidelines, Item 3 Definitions, ii.

[71] NFC, NPR 12, at 25.

[72] Lewis, NPR 15, at 7.

[73] *E.g.*, *FTC v. Joseph Hayes*, No. 4:96CV02162SNL (E.D. Mo. 1996).

[74] IL AG, at 2.

[75] *E.g.*, Sections 436.5(a) (Item 1); 436.5(c) (Item 3); 436.5(d) (Item 4); 436.5(h) (Item 8).

[76] 16 CFR 436.2(i).

[77] *See* NASAA Commentary on the Uniform Franchise Offering Circular Guidelines (1999), Bus. Franchise Guide (CCH), ¶ 5790, at 8466 (''NASAA Commentary'' or ''Commentary''). The Commentary notes that this general definition of affiliate should be used throughout a UFOC, unless a particular disclosure Item defines it differently or limits its use. The record contains no indication that the UFOC Guidelines' narrower definition is deficient or would impede the Commission's ability to target affiliates in law enforcement actions, where warranted.

[78] *See* Triarc, NPR 6, at 2. The Staff Report recommended that the term ''affiliate'' mean ''controlled by, controlling, or under common control with, the *franchisor or a franchisee*.'' *See* Staff Report, at 21 (emphasis added). While this version was intended to capture franchisee affiliates, for purposes of the ''large franchisee'' exemption, it also had the unintended consequence of broadening affiliate disclosures generally. For example, section 436.5(d) (Item 4) requires a franchisor to disclose a prior bankruptcy of an affiliate. Defining ''affiliate'' expressly to include ''franchisee'' would arguably require a franchisor to list in wunless a particular

former franchisees and, for example, the media.

After carefully considering the
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comments, the Commission has rejected suggestions to limit the definition of confidentiality clause to cover only broad clauses that prohibit *all* communications by current or former franchisees[83] or only circumstances where all or at least 20% of franchisees are under speech restrictions.[84] These suggestions are narrower than necessary
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[83] PMR&W, NPR 4, at 15.

[84] NFC, NPR 12, at 33.

[85] *E.g.*, Baer, ANPR 25, at 3; AFA, ANPR 62, at 3; Zarco & Pardo, ANPR 134, at 4.

[86] Bundy, NPR 18, at 3.

[87] *See* UFOC Guidelines, General Instruction 150. The phrase ''plain English'' is defined separately in section 436.1(o), consistent with the UFOC Guidelines.

[88] This presentation requirement would be consistent with the Commission's approach in the original Rule. *See* 16 CFR 436.1(b)(4).

[89] Gust Rosenfeld, at 2–3; Wiggin & Dana, at 6–7.

[90] J&G, at 2.

[91] IL AG, at 2.

[92] Bundy, at 3; Cendant, at 3; IL AG, at 3. The Staff Report recommended deletion of this definition based on use of the term in the Rule text in at least two distinguishable ways, creating unnecessary confusion. Staff Report, at 68–9.

[93] *See* Cendant, at 3.

[94] 16 CFR 436.2(n).

[95] *See generally Federal Trade Commission Policy Statement on Deception*, appended to *Cliffdale Assocs.*, 103 FTC 110 (1984).

[96] The part 436 definition is nearly identical to the definition as proposed in the Franchise NPR, with slightly modified language in some places to improve clarity and precision. No commenter raised any concerns about the basic ''financial performance representation'' definition. Nevertheless, IL AG posed a number of questions about how the definition would be applied in various situations, such as representations based upon earnings of a franchisor's affiliates or representations based upon industry data. IL AG, at 2. Questions such as these are best addressed in the Compliance Guides or in staff advisory opinions, where they can be analyzed in the context of specific facts.

[97] The final amended Rule uses the broad term ''financial performance representation,'' rather than the original Rule's more limited term ''earnings claim.'' This modification recognizes that some industries, such as hotels, use variables other than earnings to measure performance, such as room occupancy rates.

existing franchisees, especially if no additional franchise sales are contemplated. If the franchisor contemplates an additional franchise sale under materially different terms and conditions than the franchisee's original purchase, then the existing franchisee, like any prospective franchisee, could be misled and therefore should receive financial performance disclosures in the form of an Item 19 disclosure. For example, an Item 19 disclosure will assist an existing franchisee operating in a shopping mall or urban area in the northeast to understand an earnings projection for an additional stand-alone outlet or outlet to be located in a rural section of the southwest.

[109] Interpretive Guides, 44 FR at 49982.

[110] At any rate, according to NASAA, franchisors do not routinely disseminate individualized expense information geared to a specific offering that might be used to insinuate an earnings level. NASAA, 17 NPR, at 2.

[111] *See* 16 CFR 436.1(b)(5)(i); 436.1(c)(6)(i); 436.1(e)(5)(ii). Unlike other financial performance claims, a claim made in the general media need not be geographically relevant to the market in which franchises are being offered for sale.

[112] Although the UFOC Guidelines do not address general media claims, many of the states with disclosure laws require franchisors to register their advertisements in advance of their use. *E.g.*, Cal. Corp. Code § 31156 (1997) (franchisor must register advertising at least three business days before first publication); Md. Code Ann., Bus. Reg. § 14–225 (1998) (franchisor must register advertising at least seven business days before publication).

[113] In the proposed Rule, the term ''financial performance representation'' expressly included ''a representation disseminated in the general media *and Internet*.'' Franchise NPR, 64 FR at 57297, 57332. (emphasis supplied.) In accordance with the discussion in this section of the SBP, the Commission has deleted this phrase to dispel potential readings that financial information posted on the Internet is *per se* a financial performance representation.

[114] *E.g.*, PMR&W NPR 4, at 16; H&H, NPR 9, at 14; NFC, NPR 12, at 23–24.

[115] *E.g.*, Gust Rosenfeld, at 7; Quizno's, NPR 1, at 3; PRM&W, NPR 4, at 16; NFC, NPR 12, at 24; BI, NPR 28, at 9.

[116] *E.g.*, Quizno's, NPR 1, at 3. *See also* BI, NPR 28, at 9.

[117] *E.g.*, Quizno's, NPR 1, at 3; PMR&W, NPR 4, at 16; H&H, NPR 9, at 14; BI, NPR 28, at 9.

[118] Quizno's, NPR 1, at 3.

[119] Interpretive Guides, 44 FR at 49984–85. The Commission excluded, however, ''communications to financial journals or the trade press in connection with bona-fide news stories, or directly to lenders in connection with arranging financing for the franchisee.1im29 TD-0.0028 Tw(28, at 9.)TjA(See also)Tj/I

Interpretive Guides, ''the required experience may be in the same business selling competitive goods or in a business that would ordinarily be expected to sell the type of goods to be distributed under the franchise.''[132] This approach is reasonable because a prospective franchisee who is already familiar with the goods or services of the franchise can better assess the financial risk involved in entering into a relationship with the franchisor.

Our reluctance to expand the fractional franchise exemption also holds true with respect to the sale of ''complementary goods.'' What may be viewed as ''complementary goods'' in any particular line of business may be quite subjective. For example, reasonable minds may differ whether the introduction of ice cream sales at a donut/coffee shop is ''complementary.'' While certain products may make complementary sales combinations—such as ice cream and donuts—it does not necessarily follow that a donut shop franchisee is experienced with the risks involved with marketing and selling ice cream.

While the Commission declines to revise the Rule to broaden the types of experience needed to qualify for the fractional franchise exemption, we agree that the exemption should be expanded with respect to the types of individuals whose experience can qualify for the exemption.

The original definition specified that, in determining whether a relationship qualified as a the fractional franchise exemption, a franchisor could consider the prior experience of the franchisee ''or any of the current directors or executive officers thereof.''[133] Marriott recommended that the prior experience of an officer or director of an affiliate or parent of the franchisee should also be deemed a sound basis for the ''experience'' prong of the definition. Marriott noted that the Staff Report recommended the same approach in connection with the prior experience prerequisite of the ''large franchisee'' exemption.[134]

We are persuaded by Marriott's arguments that a broad reading of the fractional franchise exemption is warranted when determining which individuals may qualify as having the requisite prior experience. The principal factor in applying the fractional franchise exemption of part 436 is whether the business seeking to expand can obtain practical guidance and direction from someone within the business with prior experience. It makes little difference whether the business can call upon its own directors or officers for guidance or whether the business can call upon those of a subsidiary, as long as those individuals have prior experience in the same line of business. As in the large franchisee exemption, we recognize that franchisors may establish subsidiaries for limited liability or tax purposes. In such instances, the operations of the franchisor and its subsidiaries are likely to be close, such that the prior experience of one is available to help direct the business decisions of the other. We believe the same is no less true in the fractional franchise context.

Finally, one commenter, focusing on the second prong of the fractional franchise exemption, argues that a broad reading of the 135 fractionalus, rduom gltionalus, e pral franchise4647 -1.0222 Tr

[132] Interpretive Guides, 44 FR at 49968.

[133] 16 CFR 436.2(h).

[134] Marriott, at 4.

[135] J&G, NPR 32.

[136] The Commission recognizes, however, that in some instances, prior experience or the ability to consult those with prior experience, can be assumed. That is the basis of the new large investment exemption from the final amended Rule, discussed below. *See* section 436.8(a)(5)(i). Where an investment is sufficiently large—$1 million excluding the cost of unimproved land and any franchisor financing—we believe that the prospective franchisee is sophisticated and can obtain the information necessary to assess the franchise offering without our mandating that it be provided.

[137] *See* 16 CFR 436.2(a)(1)(i) and 436.2(a)(2). The UFOC Guidelines do not define what constitutes a franchise. Rather, definitions of the term ''franchise'' are set forth in individual state statutes. For a discussion of state definitions of the term ''franchise,'' see Staff Report, at 37–41, available online at: www.ftc.gov/os/2004/08/0408franchiserulerpt.pdf.

[138] *See* 16 CFR 436.2(a)(1)(ii) and 436.2(a)(2).

[139] *See* Interpretive Guides, 44 FR at 49966. *See also FTC v. Morrone's Water Ice, Inc.*, No. 02–3720 (E.D. Pa. 2002). The staff has provided the same advice in several informal advisory opinions. *E.g.*, Con-Wall Corp. Bus. Franchise Guide (CCH) ¶ 6427 (1981).

[140] This is not a change of policy. The original definition of ''franchise'' added that ''[a]ny

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relationship which is represented . . . to be a franchise (as defined in the original Rule) is subject to the requirements of this part.'' 16 CFR 436.2(a)(5). However, this provision was set out in the original ''franchise'' definition *after* exemptions and exclusions, and, therefore, was largely overlooked or ignored. The final amended Rule makes the definition of ''franchise'' more precise by including this policy in the introductory part of the amended definition. *See also United States v. Protocol, Inc.*, Bus. Franchise Guide (CCH) [1996–97 Transfer Binder], ¶ 11184 at 29550, 29555 (D. Minn. 1997); *FTC v. Wolf*, Bus. Franchise Guide (CCH), ¶ 10401 (S.D. Fla. 1994); *FTC v. Int'l Computer Concepts*, No. 1:94cv1678 (N.D. Ohio 1994); *FTC v. Sage Seminars, Inc.*, No. C–95–2854–SBA (N.D. Cal. 1995). The staff of the Commission has provided the same advice in several informal advisory opinions. *E.g.*, Real America Real Estate Corp., Bus. Franchise Guide (CCH) ¶ 6428 (1982) (''the applicability of the rule will not be defeated by a franchisor's subsequent failure to live up to any such commitment'').

[141] Baer, NPR 11, at 7.

[142] *See* Staff Report, at 37–41.

[143] Holmes, NPR 8, at 1. *See also* Gurnick, NPR 21A; IL AG, NPR 3.

[144] *Id.*, at 2.

[145] 16 CFR 436.1 (''any relationship which is represented . . . to be a franchise''); 436.2(a)(5) (''Any relationship which is represented either orally or in writing to be a franchise [as defined in the Rule] is subject to the requirements of this part.'').

[146] With respect to required payments, the Commission will also consider any obligation to make a payment imposed by the franchisor post-sale, as long as the payment must be made within six months after the franchisee commences operation of the business. *See* section 436.8(a)(1) (minimum payment exemption).

[147] 16 CFR 436.2(d).

[148] The phrase ''granted a franchise'' is intended to be interpreted consistent with ordinary contract law principles. Accordingly, a prospective franchisee becomes a ''franchisee'' at the point when he or she enters into a valid and enforceab56 0 0n/ ej/F1 1 T

long-standing Commission policy, the definition also makes explicit that an individual franchisee seeking to sell his or her own outlet is excluded from Rule coverage:[152]

> *Franchise seller* means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

The definition incorporates several suggestions submitted during the Rule amendment proceeding. First, the definition expressly includes ''subfranchisors,'' a category of franchise sellers not mentioned in the Franchise NPR's proposed definition of ''franchise seller.''[153] The inclusion of subfranchisors in the definition is entirely consistent with current Commission policy[154] and the UFOC Guidelines.[155]

Second, the definition narrows the express exclusion of sales of a franchise by an existing franchisee. One commenter noted that this exclusion should apply only in those situations w328 0 TD-0.0.olicyco5e3u6d8b5blb the ots. Guhisrclusion of sale One Rule

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The term ''franchise seller'' streamlines the Rule by referencing all such individuals, where appropriate, through the use of a single term. *But see* Winslow, at 85 (suggesting that the term ''seller'' in the context of franchising is inappropriate).

[152] *See* Interpretative Guides, 44 FR at 49969.

[153] *See* Franchise NPR, 64 FR at 57298.

[154] Interpretive Guides, 44 FR at 49969.

[155] The UFOC Guidelines provide that ''[i]n offerings by a subfranchisor, 'franchisor' means both the franchisor and subfranchisor.'' UFOC Guidelines, General Instructions 240.

[156] Bundy, NPR 18, at 3.

[157] *See* IL AG, at 3.

[158] Tricon, NPR 34, at 3.

[159] J&G, NPR 32. *See also* IL AG, at 2; Michael Seid.

[160] *See also* Lewis, NPR 15, at 8 (''broker'' definition should not ''include a franchisee merely because the franchisee receives a payment from the franchisor or subfranchisor in consideration of the referral or a prospective franchisee to the franchisor or subfranchisor, if the franchisee does not otherwise participate in the sale of the franchise to the prospective franchisee. A franchisee does not participate in the sale of a franchise merely by participating in initial conversations or communications with a prospective franchisee about a franchise.'').

[161] J&G, NPR 32, at 10. *But see* Baer, NPR 11, at 9 (''If any party offers to sell a franchise on behalf of a franchisor, that person should be considered a franchise seller.'').

[162] Interpretive Guides, 44 FR at 49969.

[163] Moreover, the final amended Rule includes a separate definition of ''franchisor,'' to whom the affirmative disclosure requirements apply.

[164] Section 436.9(a).

[165] Frannet, NPR 2, at 1.

[166] 16 CFR 436.2(j).

[167] Original SBP, 43 FR at 59717 and nn. 176 and 178. Staff advisory opinions have interpreted the term ''arranges'' to include, for example, discussions with prospective franchisees about their specific business interests, pre-screening prospects through interest questionnaires, recommending specific franchise options, and assisting prospects in completing a franchisor's application form. These opinions are based upon the original SBP, in which the Commission stated that group discussions about franchising and pre-screening of prospects may constitute a first personal meeting that would require a franchisor or broker to furnish disclosure documents. *See* Informal Staff Advisories 99–6 and 99–7, Bus. Franchise Guide (CCH), ¶¶ 6503–04 (1999).

[168] *See generally FTC v. Entrepreneur Media, Inc.*, Bus. Franchise Guide (CCH), ¶ 10583 (C.D. Cal.

Continued

[179] J&G, NPR 32, Attachment at 6, 13. Two other commenters suggested that the Commission provide more guidance about co-branding generally, but not in the leased department context. Selden, at 3; Quizno's, ANPR 16, at 2. None of these commenters identified specific problems posed by co-branding arrangements—other than noting that co-branded arrangements can be complex—nor did they offer any solutions for the Commission's consideration.

[180] In the ANPR, the Commission noted its uncertainty as to whether the purchaser of a co-branded franchise acquires two individually-trademarked franchises (and thus should receive separate disclosures from each franchisor) or acquires a hybrid franchise arrangement that has its own risks and, thus, should receive a single unified document that discloses information specific to the co-branding arrangement. The ANPR asked whether franchisors have sufficient guidance under the Rule to determine their disclosure obligations with respect to the sale of co-branded franchises and whether new or different disclosures should apply to the sale of co-branded franchises. ANPR, 62 FR at 9122. Ten ANPR commenters addressed co-branding. Quizno's, ANPR 16, at 2; Baer, ANPR 25, at 7; H&H, ANPR 28, at 9; Kaufmann, ANPR 33, at 16; Kestenbaum, ANPR 40, at 2–3; IL AG, ANPR 77, at 4–5; IFA, ANPR 82, at 4; Kirsch, ANPR 98; Jeffers, ANPR 116, at 9; WA Securities, ANPR 117, at 4. With the exception of Quizno's, the ANPR commenters maintained that the Commission's current pre-sale disclosure approach is sufficient to address co-branded franchise arrangements.

[181] *E.g.*, Kirsch, ANPR, 18 Sept. 97 Tr., at 176; Wieczorek, *id.*, at 177–78; Kestenbaum, *id.*, at 178–79; Simon, *id.*, at 179.

[182] For example, Dale Cantone, of Maryland Securities, stated: ''We haven't had too many problems on the issue of co-branding. We've had franchisors file disclosures and we really haven't had too many issues with it.'' Cantone, ANPR, 18 Sept. 97 Tr., at 182.

[183]

franchisee is required to deal with either by contract or practical necessity or to any third party as a condition precedent to obtaining the Franchise Disclosure Document.''[220]

Mr. Bundy's suggestion generated one rebuttal comment. David Gurnick observed that defining ''required payment'' to include third-party payments would be: ''a radical departure from the Commission's long-standing policy regarding the definition of a franchise, would create a major inconsistency between the Franchise Rule and the state franchise laws, and would extend coverage to arrangements which the Rule was never intended to regulate.''[221] Observing that all businesses make payments to vendors and service providers, he also asserted that the Bundy proposal would be overbroad: ''For example, 'practical necessity' may dictate that a business use a Microsoft software product or that an employee of the business fly to an airport that is served by only one airline.''[222] Mr. Gurnick added that if a franchisor establishes a company to receive some monetary benefit from prospects, those funds would already fall within the ''required payment'' definition as a payment to an affiliate.[223]

It is true that the Commission has never considered ordinary business payments to third parties as a ''required payment'' under the Rule. Indeed, doing so could sweep very broadly. Ordinary business expenses paid to third parties, such as the cost of installing telephone lines, insurance, and occupancy fees—expenses typically incurred by all businesses—can hardly be deemed a precondition imposed *by the franchisor* for obtaining or commencing operation of a franchise. Rather, a third-party payment constitutes a required payment only if the third party collects and remits the payment on behalf of the franchisor.[224]

Nonetheless, a franchisor may direct or encourage a prospective franchisee to incur some costs in order to advance the franchise sale. The prospective franchisee may incur these costs and make these kinds of payments without the benefit of pre-sale disclosures. Encouraging a prospect to incur expenses to advance the franchise sale could conceivably increase the likelihood that he or she will go through with the deal without a thorough due-diligence investigation. Therefore, the Commission has incorporated into the final amended Rule an express prohibition barring a franchisor from failing to furnish a copy of its disclosure document to a prospective franchisee early in the sales process, upon reasonable request.[225] This prohibition enables a prospective franchisee to ask to see a copy of the franchisor's disclosure document before agreeing to travel to company headquarters or purchase demographic data, for example. The Commission believes this approach will better address concerns about pre-disclosure third-party payments than would an unworkable alteration of the definition of the term ''required payment.''

20. Section 436.1(t): Sale of a franchise

The part 436 disclosure obligations are triggered only when there is an offer for the sale of a franchise.[226] Section 436.1(t) defines the term ''sale of a franchise'' as follows:

> an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. It does not include extending or renewing an existing franchise agreement where there has been no interruption in the franchisee's operation of the business, unless the new agreement contains terms and conditions that differ materially from the original agreement. It also does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee. A franchisor's approval or disapproval of a transfer alone is not deemed to be significant involvement.

Like the original Rule provision, the final amended provision embodies the concept that franchisees extending or renewing an existing franchise agreement, where there is no interruption in business operations, will not be deemed to be entering into a sale, unless their new agreement contains terms and conditions materially different from their original agreement.[227]

The final amended Rule provision differs substantively from the provision as proposed in the Franchise NPR[228] because it incorporates the Commission policy, as stated in the Interpretive Guides, that the term ''sale of a franchise'' does not encompass the transfer of a franchise by an existing franchisee where the prospective purchaser has no significant contact with the franchisor.[229] Under long-standing Commission policy, a franchisor or subfranchisor must provide disclosures to *prospective franchisees*, but ''a person who purchases a franchise directly from an existing franchisee, without significant contact with the franchisor, is not a prospective franchisee.''[230] Where a franchisor is not involved in the private sale of an existing franchise, the franchisor makes no representations to the prospective new purchaser. If there is any fraud in the private sale, it could be only by the current franchisee owner, and pre-sale disclosure by the franchisor would not likely prevent it. Accordingly, section 436.1(t) of part 436 makes clear that a transfer without significant involvement of the franchisor is not the sale of a franchise within the ambit of the Rule. Further, the franchisor's mere approval or disapproval of the purchaser alone is not considered to be significant involvement.[231]

At the same time, the Commission declines to adopt several suggested narrowing modifications to the definition of ''sale of a franchise.'' H&H urged the Commission to exclude from the definition of ''sale of a franchise'' the modification of an existing franchise agreement where there is no interruption in the franchisee's business operation.[232] The firm observed that material modifications to existing franchise agreements typically arise in two situations: (1) a settlement of litigation or other disputes with franchisees, in which the franchisor makes concessions; and (2) management initiative with the involvement of independent franchisee associations or franchisee advisory councils.[233] According to H&H, these modifications typically entail no new investment and both sides are familiar with the

[220] *Id.*

[221] Gurnick, NPR Rebuttal 36, at 2.

[222] *Id.*, at 3.

[223] *Id.*, at 3–4. Mr. Gurnick also disputed the view that franchisors entice prospects to incur costs, such as airline tickets. ''No data is [sic] provided to support this claim, and frankly I question whether companies really have an interest in enticing prospects to buy, for example, airline tickets.'' *Id.*, at 4.

[224] *See* Interpretive Guides, 44 FR at 49967.

[225] *See* section 436.9(e).

[226] *See* section 436.2.

[227] 16 CFR 436.2(k). *See also* Interpretive Guides, 44 FR at 49969.

[228] Franchise NPR, 64 FR at 57333.

[229] *See* H&H, NPR 9, at 11.

[230] Interpretive Guides, 44 FR at 49969.

[231] *See* Interpretive Guides, 44 FR at 49969–70. In contrast, a franchisor who actively participates in a franchise transfer must make disclosures to a potential transferee, no less than to a prospective franchisee. In such an event, the prospective transferee may rely on the franchisor's representations in deciding to purchase the franchise, and therefore, should receive the benefit of pre-sale disclosure.

[232] H&H, NPR 9, at 9–10.

[233] H&H, NPR 9, at 10.

franchise terms: ''An offer to exchange different forms of agreement or add an addendum to existing franchise agreements does not establish a new franchise relationship—that relationship already exists and will continue regardless of the decision the franchisee makes.''[234]

The Commission agrees that disclosure is unwarranted where an existing franchisee and the franchisor merely seek to amend their ongoing contractual relationship. In such circumstances, the material information the franchisee needs is the actual revised franchise agreement itself that spells out the terms and conditions that will govern the parties' ongoing relationship. Requiring franchisors to furnish a new disclosure document whenever there may exist agreed upon material changes in a contract is likely to be an unwarranted formality, the cost of which is probably not outweighed by any tangible benefit to the existing franchisee. In any event, franchise agreement modifications, most obviously those without any new payment, would not constitute a ''sale.'' The definition of ''sale of a franchise,'' therefore, need not be revised to address this concern.

H&H further contended that disclosure is never warranted for renewals, asserting that a renewing franchisee makes no investment decision: ''His decision relates to whether to continue a relationship, with which he should be intimately familiar at that point, under the terms of a new form of franchise agreement. The UFOC does little to help him understand the terms of that agreement.''[235] After considering this suggestion, we are unconvinced that renewals should always be excluded from the definition of ''sale of a franchise.''

As discussed in greater detail below in connection with section 436.5(q)—Item 17's renewal disclosure—franchisees and their representatives have voiced concern about renewals,

[234] *Id.*

[235] *Id.*, at 11.

[236] See discussion of section 436.5(q) below. *See also* Staff Report, at 153–156; Franchise NPR, 64 FR at 57308–09.

[237] This assumes, of course, that there is a ''sale,'' meaning the existing franchisee makes a *required payment* for the right to enter into a *new* franchise agreement. Entering into a new franchise agreement without any required payment or extending an existing franchise agreement for a fee would not be deemed a ''sale of a franchise'' for Rule purposes.

[238] *See* Interpretive Guides, 44 FR at 49966–967. *See also* UFOC Guidelines, Item 13 Instructions, i.

[239] *See* section 436.6 of the final amended Rule.

[240] *See also* section 436.8(a)(7), which retains the original Rule's exemption for oral statements at 16 CFR 436.2(a)(3)(iv).

[241] 16 CFR 436.1(a).

[242] 16 CFR 436.1(g).

[243] Limitation of the geographic scope of part 436 of the final amended Rule is not intended to limit the FTC's jurisdiction, as set forth in section 5(a) of the FTC Act, 15 U.S.C. 45(a), and section 3 of the U.S. SAFE WEB Act of 2006, Pub. L. No. 109–455, 120 Stat. 3372.

[244] The Staff Report recommended limitation of the Rule's scope to sales of franchises to be located in the United States. Staff Report, at 72–5.

[245] *E.g.*, MSA, at 3–4; PMR&W, NPR 4, at 1; 7-Eleven, NPR 10, at 1; IFA, NPR 22, at 5; AFC, NPR 30, at 1–2; Duvall, ANPR 19, at 2–3; SBA Advocacy, ANPR 36, at 9; Tifford, ANPR 78, at 7; NASAA, ANPR 120, at 8–9. Five commenters, however, urged the Commission to enforce the Rule with respect to foruce the Commissiw5245

franchisor comment. *See* Duvall, ANPR 19, at 3; Baer, ANPR 25, at 6; Tifford, ANPR, 18 Sept. 97 Tr., at 158–59; Staff Report, at 76–8.

[256] *E.g.*, IFA, NPR 22, at 9; Stadfeld, NPR 23, at 4. Kennedy Brooks, for example, observed that franchise sales can occur entirely electronically ''where the contact is made over the Web, where E-mail is exchanged, where telephone [calls] are exchanged, where documents are sent out by Federal Express, and where, in fact, there never is a face-to-face meeting.'' Brooks, ANPR, 18 Sept. 97 Tr., at 160. *See also* NCL, ANPR 35, at 4–5; SBA Advocacy, ANPR 36, at 9; IL AG, ANPR 77, at 3–4.

[257] Karp, NPR 24, at 5–6. *See also* Bundy, NPR 18, at 5–6; Turner, NPR 13, at 1.

[258] In the Interpretive Guides, the Commission acknowledged that the term ''first personal meeting'' is imprecise:

''Even where a face to face meeting occurs, it is not necessarily a ''first'' personal meeting. In interpreting this term, the Commission will consider such factors as whether the franchisor clearly indicated at the outset of the discussion that it was not prepared to discuss the possible sale of a franchise at that time, whether the meeting was initiated by the prospective franchisee rather than the franchisor, whether the meeting was limited to a brief and generalized discussion and whether earnings claims were made. The Commission believes that by using common sense precautions, franchisors can defer the first personal meeting until such time as they are prepared to provide the to

[274] *See* Gust Rosenfeld, at 3. Gust Rosenfeld noted, however, that while the original Rule referred to franchise and related agreements, the Staff Report's

As an initial matter, franchisors always have the burden of proof to show that they have complied with the Rule's obligation to furnish disclosures. We also believe that the Rule should be as flexible as possible, allowing franchisors to keep records and to offer proof, in the format that is most convenient to them. Nonetheless, to prevent any potential abuse in this area, the final amended Rule sets forth several safeguards. Among other things, a franchisor must notify the prospective franchisee in advance of any prerequisites for obtaining a disclosure document. Section 436.6(g). That would include any unusual bandwidth requirements. In addition, the franchisor must ensure that its disclosures not only can be downloaded, but preserved for future use. Section 436.6(b). Finally, the final amended Rule retains a receipt requirement, which will effectively prove delivery. Section 436.5(w).

[281] For example, where the Franchise NPR version said ''has been delivered,'' the final Rule provision says ''was hand-delivered, faxed, emailed, or otherwise delivered,'' to remove any doubt that the alternative modes of delivery are acceptable. Similarly, where the Franchise NPR version said ''if a copy has been sent . . . by first class mail,'' the final amended provision states ''a paper or tangible electronic copy (for example, computer disk or CD–ROM) was sent . . . by first-class United States mail'' to make it clear that a disclosure document in an electronic format is considered equivalent to paper.

[282] 16 CFR 436.1(a)(21).

[283] Franchise NPR, 64 FR at 57302.

[284] In addition, some non-substantive refinements have been made to improve the clarity, consistency, and organization of the Rule's text. For example, the text now specifies that the various required elements of the cover page are to be presented ''in the order and form as follows.'' Similarly, section 436.3(a) now specifically instructs franchisors that the title is to appear ''in capital letters and bold type,'' not merely giving franchisors a model that depicts the words ''FRANCHISE DISCLOSURE DOCUMENT'' in capitals in the Rule's text, as proposed in the Franchise NPR. In addition, the cover page disclosure informing the prospective franchisee that he or she must be given 14 days to review the document has been conformed to the

[291] BI's concern would be valid if the cover page

that a franchisor identify any parent, therefore, is necessary to ensure that any parent not falling within Item 1's limited use of affiliate will be disclosed.

Moreover, the Item 1 parent disclosure is significantly limited: franchisors must simply *identify* a parent.[315] In contrast with the Item 1 disclosures for affiliates and predecessors,[316] a franchisor need not disclose, for example, the parent's business background, length of time selling franchises or engaging in other lines of business.[317] The Commission concludes that this limited disclosure will, at most, impose a minor burden for most franchise systems that is outweighed by the potential benefit to prospective franchisees.

b. Predecessor disclosures

Part 436 of the final amended Rule adopts the UFOC Guidelines' requirement that franchisors disclose background information about any predecessors for 10 years.[318] During the rulemaking process, no commenters objected to the basic principle that predecessor information should be disclosed.[319] A few commenters,

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[315] Section 436.5(a)(1).

[316] Section 436.5(a)(7).

[317] Despite the narrow Item 1 parent disclosure in section 436.5(a)(1), one commenter asserted that the parent disclosure could be a significant burden on some franchisors with elaborate corporate structures. Spandorf, at 3. She contended that the final amended Rule would require a franchisor to disclose ''all non-affiliate parents, including all intermediate parents, not just the ultimate parent.'' *Id.* Accordingly, she urged the Commission to limit the parent disclosure to those parents with ultimate control ''and any intermediate parent that guarantees the franchisor's obligations to franchisees.'' *Id.* The Commission rejects these suggestions. Item 1 requires franchisors to disclose the identity of parents to ensure that a prospective franchisee understands who may control or influence the franchisor's operations. As noted above in the example of Pearle Vision, it is highly material to a prospective Pearle Vision franchisee that Pearle Vision is owned and controlled by a competing system—Cole Vision. That information would escape disclosure, however, if Cole Vision did not guarantee Pearle Vision's performance or if Cole Vision were, in turn, a subsidiary of a larger corporate parent.

[318] One commenter suggested that the Commission address in the Compliance Guides an inconsistency between the Item 1 disclosure set forth in the Staff Report and the UFOC Guidelines' Item 1 disclosure. Whereas the UFOC Guidelines clearly limit the predecessor disclosures—the predecessor's name and address and prior experience—to a 10-year reporting period, the Staff Report's proposed revised Rule could have been read as limiting the application of the time period to only the predecessor's name and address. Piper Rudnick, at 5. The Commission agrees that the 10-year reporting should also limit the reporting of a predecessor's experience, and the final amended Rule is revised accordingly by adding a cross-reference that limits the applicability of the experience disclosures in section 436.5(a)(7) to only those predecessors covered by section 436.5(a)(2). The commenter also suggested that the prior experience of affiliates should similarly be limited to 10 years. *Id.* This suggestion goes too far and would introduce an unnecessary inconsistency between the final amended Rule and the UFOC Guidelines, which does not so limit affiliate disclosures.

[319] As noted above, this provision prevents franchisors from hiding prior misconduct and avoiding disclosure obligations simply by assuming a new corporate identity. *See FTC v. Morrone's Water Ice, Inc.*, No. 02–3720 (E.D. Pa. 2002) (company allegedly reincorporated as a ''licensor'' following an adverse arbitration decision); *FTC v. Inv. Dev., Inc.*, Bus. Franchise Guide (CCH), ¶ 9326 (E.D. La. 1989) (company allegedly reincorporated after filing of Commission law enforcement action).

[320] H&H, NPR 9, at 16.

[321] GPM, NPR Rebuttal 40, at 4.

[322] IL AG, at 4.

[323] IL AG, at 4.

[324] IL AG, at 4.

[325] *See* 16 CFR 436.1(a)(2). In the original SBP, the Commission explained that a franchisor's failure to disclose its business experience violates Section 5 because ''it (1) misleads the prospective franchisees as to the business experience of the parties with whom they are dealing, and (2) could readily result in economic injury to franchisees due to their heavy dependence upon the experience of those persons associated with the franchisor.'' Original SBP, 43 FR at 59642. *See* Buckley, ANPR 97, at 1 (''franchisor represented his company as highly trained in all phases of the business and capable of supporting a franchise system''); *FTC v. Nat'l Consulting Group, Inc.*, Bus. Franchise Guide (CCH) ¶ 11335 (N.D. Ill. 1998) (claims regarding medical billing expertise and contacts with medical community are material); *FTC v. Richard L. Levinger*, No. 94–0925–PHX RCB (D. Ariz. 1994) (earnings claims tied to purported expertise in the restaurant industry are material); *FTC v. Car Checkers of Am., Inc.*, No. 93–623 (mlp) (D.N.J. 1993) (claims regarding car inspection business expertise are material). *Cf. FTC v. Goddard Rarities, Inc.*, No. CV93–4602–JMI (C.D. Cal. 1993) (representations of expertise in coin investments are material).

[326] *See* UFOC Guidelines, Item 2 and Instructions, v.

of any parent of the franchisor. Each of these issues is discussed in detail below.

a. Brokers

The original Rule did not require disclosure of brokers. The proposed Rule, however, tracking the UFOC Guidelines, required that franchisors ''list all brokers.''[327] As noted above, based upon the comments, the final amended Rule does not include the UFOC Guidelines' provision that franchisors identify its brokers in Item 2.[328] During the Rule amendment proceeding, a few commenters asserted that such disclosure is unnecessary.[329] For example, Frannet, a franchise broker, voiced concern that the proposed inclusion of brokers in Item 2 would require franchisors to disclose immaterial information about ''literally hundreds of business brokers each of whom will receive a commission in the event that a prospect referred by any such person ultimately purchases a franchise,'' resulting in a ''voluminous'' UFOC, with ''no value to the prospective franchisee.''[330]

On the other hand, Michael Seid, a franchise industry consultant, strongly objected to the deletion of broker information from Item 2 because prospective franchisees often rely on statements made by brokers in deciding whether to purchase a franchise. In his view, prospective franchisees perceive brokers as being independent, third-party experts. He opined that listing them in a disclosure document would dispel that notion, making it clear that brokers are authorized agents of the franchisor.[331]

Some prospective franchisees may rely on a broker's statements in the course of purchasing a franchise, and some brokers may make false claims—such as false financial performance representations. Nonetheless, the Commission is not convinced that broker disclosures are warranted in a franchise disclosure document.

Item 2 appropriately requires franchisors to disclose the background of those individuals who *control* the franchisor and those who actually *manage* franchisees. That information is material because prospective franchisees need to know the identity and business experience of the individuals in command of the franchisor in order to assess whether these individuals are likely to be able to perform as promised under the franchise agreement. Unlike franchisors, brokers do not create or implement franchisor policy, nor do they oversee performance of post-sale obligations to the franchisee. Accordingly, prospective franchisees are less likely to give decisive weight to an individual broker's expertise or background in assessing the merits of purchasing a franchise.

Moreover, even if a broker were to make false claims, the prospective franchisee has the benefit of the franchisor's disclosure document to assess those claims before purchasing a franchise. For example, a franchisor statement in Item 19 that it does not authorize the making of financial performance claims should raise doubts about a broker's veracity if the broker were to make his or her own performance claims. Similarly, a franchisor's statement in Item 3 that it has been sued by franchisees would dispel any claim by a broker that the franchisor has not been previously sued. The counteractive effect of the disclosure document gives the Commission reason to doubt that the inclusion of broker information among the required Item 2 disclosures would yield more than a scant benefit to prospective franchisees. Further, the disclosure of brokers would also be cumbersome, especially for large franchise systems that may employ hundreds of brokers nationally. Thus, the Commission concludes that this benefit would not likely outweigh the corresponding compliance costs and burdens.

Finally, the deletion of brokers from Item 2 as had been proposed in the Franchise NPR obviously does not curtail brokers' liability for false claims. Franchise brokers, like virtually all other individuals conducing interstate commerce, remain liable under Section 5 of the FTC Act for their own misrepresentations. In short, while the Commission favors adopting UFOC Guidelines approach to the fullest extent possible, we believe this is one area where an exception is warranted.

b. Individuals with management responsibility

Section 436.5(b) of part 436 requires a franchisor to disclose not only the background of the franchisor's directors and executives, but also ''individuals who will have management responsibility relating to the sale or operation of franchises offered by this document.''[332] Individuals listed in Item 2 must also disclosure their litigation (Item 3) and bankruptcy (Item 4) histories as well. This provision ensures that franchisors cannot conceal a manager's lack of experience, prior litigation, or bankruptcy history by simply avoiding giving the manager a formal title.[333] Although the language has been revised to achieve greater clarity and specificity, this aspect of this provision is conceptually very similar to the rule as proposed in the Franchise NPR.[334] The breadth of this provision is intended to leave no doubt that franchisors must disclose all individuals who in fact exercise management responsibility over the sale or operation of franchises being offered for sale, regardless of any formal title.[335]

[327] Franchise NPR, 64 FR at 57334.

[328] Franchisors, of course, would still be required to include broker information, if mandated by state law.

[329] *E.g.*, Gust Rosenfeld, at 4; J&G, NPR 32, at 10.

[330] Frannet, NPR 2, at 2. In this regard, it is noteworthy that, had the broker disclosure requirement been retained in the final amended Rule, broker information also would have been required in Items 3 and 4 disclosures. *See* Staff Report, at note 320.

[331] Seid, at 5–7. *See also* IL AG, at 4.

[332] One commenter voiced concern that Item 2 could be misinterpreted to include owners with a controlling interest and asked the Commission to clarify this point in the Compliance Guides. Gust Rosenfeld, at 3–4. We note that neither the original Rule nor the final amended Rule focuses on ownership. Rather, the determining factor is control over the franchise operations. Accordingly, an owner/investor in a franchise system would not ordinarily have to be disclosed in Item 2, unless that owner/investor also manages or otherwise exercises control over the franchise operation.

[333] *See FTC v. P.M.C.S., Inc.*, No. 96–5426 (E.D.N.Y. 1996) (franchisor failed to disclose control figure with prior bankruptcy); *FTC v. The Building Inspector of Am., Inc.*, No. 93–10838Y (D. Mass. 1993) (alleging that the franchisor failed to disclose the franchisor's current executive officers and their business experience, litigation history concerning fraud or misrepresentation, and bankruptcy history); *FTC v. Why USA, Inc.*, No. 92–1227–PHX–SMM (D. Ariz. 1992) (alleging that franchisor failed to disclose officers and their prior litigation). During the Chicago public workshop, a former franchisee related that his franchisor did not disclose that the franchisor's director of franchising (who was not a titled corporate officer) had been discharged in bankruptcy. The franchisee stated that, because the franchisor was small, operated by only five or six people, such a disclosure was ''critical, even though this person was not formally an officer.'' Lay, ANPR, 22 Aug. 97 Tr., at 6. *See also* NASAA, NPR 17, at 3 (''The law enforcement experience of some members of the [NASAA] Franchise Project Group reflects that franchisors and sellers of business opportunities have attempted to avoid litigation disclosures

. . . by purposefully not giving the title 'officer' to individuals who, in fact, exercise significant management responsibility over a business.''). *Cf. FTC v. Netfran Dev. Corp.*, No. 05–CV–22223 (S.D. Fla. 2005) (failure to disclose that executive was subject to a Commission order involving fraud or deceptive practices); *FTC v. Int'l Bartending Inst.*, No. 94–1104–A (E.D. Va. 1994) (franchisor failed to disclose that chairman was subject to a Commission order involving fraud or deceptive practices).

[334] The Franchise NPR's version of Item 2 also referenced subfranchisors. As one commenter noted, however, a reference to subfranchisors is unnecessary because the term ''franchisor,'' as set forth in the Rule's definitions (and the UFOC Guidelines' definition), already includes the term ''subfranchisor.'' Gust Rosenfeld, at 4. Therefore, that reference has been deleted.

[335] *See* Staff Report, at 101–02. In the Franchise NPR, the Commission proposed achieving this goal by including within the definition of ''officer,'' any

''*de facto* officer,'' ''namely any individual with significant management responsibility for the marketing and/or servicing of franchisees whose title does not reflect the nature of the position.'' Franchise NPR, 64 FR at 57332. Some commenters agreed with the Commission that it is necessary to capture individuals who, without an appropriate title, in fact function as officers or directors. *E.g.*, NASAA, NPR 17, at 3. Others asserted that the term ''*de facto* officer'' is ''nebulous,'' creating more problems than it would solve. *E.g.*, Snap-on, NPR 16, at 2; Gurnick, NPR 21, at 3–4; J&G, NPR 32, at 8; Marriott, NPR 35, at 12. Another voiced concern about application to large corporations, where there may be many directors or managers, each of whom would now have to be disclosed. Tricon, NPR 34, at 3. Based upon the Franchise NPR comments, the Commission has determined to delete the term and description of ''*de facto* officer'' from the final amended Rule. At the same time, Item 2 requires a franchisor to identify all individuals who have management responsibility over the franchises, regardless of any formal title. This is true even if

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[352] 16 CFR at 436.1(a)(4)(ii).

[353] Footnote 4 in the proposed Rule stated, in relevant part: ''If a settlement agreement must be disclosed in this Item, all material settlement terms must be disclosed, whether or not the agreement is confidential.'' Franchise NPR, 64 FR at 57334. *See also* NASAA Commentary, Item 3.

[354] Footnote 2 in the proposed rule stated: ''Franchisors are not required to disclose actions that were dismissed by final judgment without liability or entry of an adverse order. However, franchisors must disclose dismissal of a material action in connection with a settlement.'' Franchise NPR, 64 FR at 57334. As explained in the text above, this footnote has been deleted from the final amended Rule.

[355] UFOC Guidelines, Item 3 Definitions, iv.

[356] PMR&W, NPR 4, at 10; Lewis, NPR 15, at 13. According to Mr. Lewis, without such a limitation, the Rule would penalize franchisors and subfranchisors who achieve favorable settlements, thereby discouraging settlement of litigation. *See also* Snap On, NPR 16, at 3.

[357] Section 436.5(c)(1)(iii)(B) of the final amended Rule specifies that ''held liable'' as used in Item 3 means that ''as a result of claims or counterclaims, the person must pay money or other consideration, must reduce an indebtedness by the amount of an award, cannot enforce its rights, or must take action adverse to its interests.'' In other words, a franchisor need not disclose a settlement if the franchisor neither pays any material consideration, nor is bound by obligations that are materially adverse to its interests.

[358] Gurnick, NPR 21, at 4. *.8855TrT*(t Tm2 Tf5.2(J&G(Gurn32, words,7.093)Tj-2.572 -1., NPRnterests.)Tj0 020 Tf4.8852*

[364] Piper Rudnick, at 1; Duvall, at 1.

[365] Additionally, H&H opined that Item 3 of the proposed Rule published in the Franchise NPR seemed to suggest that a franchisor must disclose all material civil litigation in which the defendant was held liable in the 10-year time period, but only the enumerated list of actions if named in civil litigation. H&H suggested that the disclosure of civil litigation should be limited to the enumerated list regardless of whether the franchisor was named or was held liable in a prior suit. H&H, NPR 9, at 17

[388] Baer, NPR 11, at 11. *See also* Lewis, NPR 15, at 12; BI, NPR 28, at 11; Tricon, NPR 34, at 6. NASAA stated that if the Commission were to limit the disclosure by imposing a threshold, it would support a 5% threshold. NASAA, NPR 17, at 4. Not everyone agreed, however, on the proposal to establish a threshold. Eric Karp, for example, stated: ''the prospective franchisee should make his or her own determination as to whether the number of lawsuits is at a level that indicates a problematic franchise system.'' Karp, NPR 24, at 19–20. According to Howard Bundy, the imposition of a threshold number of cases before an obligation to disclose arises ''invites abuse.'' Bundy, NPR 18, at 7. Seth Stadfeld also argued that a threshold prerequisite would ''

[401] *See* Staff Report, at 117–18. The Staff Report proposal permitting franchisors to limit the description of each disclosed suit generated no comment.

[402] Under the original Rule, a counterclaim must be disclosed for 10 years and the franchisor must provide more detailed information about the nature and status of the action. 16 CFR 436.1(a)(4)(ii) (actions ''brought by a present or former franchisee or franchisees and which involves or involved the franchise relationship'').

[403] Wiggin & Dana, at 1–2.

[404] *See* Wiggin & Dana, at 2.

[405] *See* 16 CFR 436.1(a)(5). In the original SBP, the Commission found that bankruptcy information is material because it bears directly on the ''integrity and managerial ability of the parties with whom [the franchisee] is dealing and . . . could readily result in drastic economic injury to the franchisee because it could lead him or her to invest substantial amounts of money in a bankrupt business.'' Original SBP, 43 FR at 59650–51.

[406] *See* UFOC Guidelines, Item 4.

[407] UF by a presenjfieshe

[413] J&G, NPR 32, at 11; Marriott, NPR 35, at 15;

[423] Bundy, NPR 18, at 7.

[424] NFC, NPR 12, at 10–11.

[425] Gurnick, NPR 21, at 6.

[426] BI, NPR 28, at 6.

[427] *Id.*

[428] The Commission has decided not to adopt various suggested revisions to Item 5 offered by the IL AG. For example, IL AG suggested that the Rule require franchisors to disclose specific information about the amount of fees that are refundable. IL AG, at 5. The Commission believes that Item 5 adequately covers this by requiring a franchisor to state ''any conditions under which these fees are refundable.'' Clearly, this language is flexible enough to permit a franchisor to state in its Item 5 disclosure whether it offers a full or partial refund.

[429] In the original SBP, the Commission noted that the failure to disclose continuing costs violates Section 5 because it ''(1) misleads or at least confuses the franchisee as to the required amount of his or her total investment; and (2) could readily result in economic injury to the franchisee unable to meet such continuing obligations.'' Original SBP, 43 FR at 59654–55.

[430] Lewis, NPR 15, at 14; NASAA, NPR 17, at 4.

[431]

[436] Gust Rosenfeld, at 4–5. *See also* Wiggin & Dana, at 2 (questioning whether the proposed disclosure of payments to third parties in Item 6 would cover employee wages, uniform dry cleaning, or accountant fees to prepare taxes).

[447] *Id.*

[448] Franchise NPR, 64 FR at 57305.

[449] Lewis, NPR 15; Snap-On, NPR 16, at 3; Holmes, NPR 8, at 6.

[450] Homes, NPR 8, at 6. *See* Staff Report, at 159–62.

[451] *See* 16 CFR 436.1(a)(9)–(11). In the original SBP, the Commission noted that buying restrictions are common in franchise agreements and are material because they will ''have a significant impact on the sources of supplies and prices which a franchisee will pay for his or her supplies and thus also on the profitability of the franchise.'' Original SBP, 43 FR at 59655. Similarly, required purchases ''limit the independence of the franchisee, affect the profitability of the franchisee, and constitute a potential source of hidden profit for the franchisor.'' *Id.*, at 59656–57.

[452] In the Franchise NPR, the Commission proposed that franchisors disclose the actual criteria for evaluating, approving, or disapproving of alternative suppliers. Franchise NPR, 64 FR at 57336. Two Franchise NPR commenters voiced concern that this proposal goes well beyond what the UFOC Guidelines require, forcing franchisors to disclose proprietary information. PMR&W, NPR 4, at 1; NFC, NPR 12, at 29. *See also* Staff Report, at 130–31. The Commission agrees. Consistent with the UFOC Guidelines Item 8, the final amended Rule requires franchisors to disclose only a general description of its selection criteria.

[453] *E.g.*, Manuszak, ANPR 13; Weaver, ANPR 17; Mueller, ANPR 29; Colenda, ANPR 71; Gagliati, ANPR 72; Buckley, ANPR 97; Haines, ANPR 100; Myklebust, ANPR 101; Rafizadeh, ANPR, 7 Nov. 97, at 288–89; Slimak, ANPR, 22 Aug. 97 Tr., at 26. *See also* Kezios, ANPR 64.

[454] *E.g.*, Brickner, ANPR 128; Buckley, ANPR 97, at 3; Myklebust, ANPR 101. A few franchisees reported that their franchisor failed to approve alternative suppliers or made it difficult for franchisees to find alternative sources of supplies. *E.g.*, Chiodo, ANPR, 21 Nov. 97 Tr., at 308; Hockert-Lotz, *id.*, at 325–27.

[455] Selden, ANPR 133, Appendix B, at 1.

[456] Zarco & Pardo, ANPR 134, at 2. In the same vein, the AFA asserted that it is insufficient to require a franchisor to disclose whether a franchisee can purchase products from unaffiliated suppliers.

element in determining whether to enter into a franchise relationship. Accordingly, it concluded that it is both unfair and deceptive for a franchisor to fail to disclose or misrepresent financing terms and conditions, and to fail to disclose rebates received in connection with franchise financing. Original SBP, 43 FR at 59659–60.

[469] The disclosures required by Item 10 are modeled on the disclosures lenders make under the Federal Reserve's Regulation M (Consumer Leasing),12 CFR Part 213, and Regulation Z (Truth in Lending), 12 CFR Part 226. Because these regulations cover personal property leases and credit transactions that are ''primarily for personal, family, or household purposes,'' however, they generally do not apply directly with respect to lease and financing transactions undertaken in connection with the purchase of a franchise. Sales of franchises generally are not undertaken to advance personal, family, or household purposes. The version of Item 10 proposed in the NPR, following Item 10 in the UFOC Guidelines, expressly referenced the Consumer Credit Protection Act's Truth in Lending (''TILA'') provisions, 15 U.S.C. 1605–1606. While not intending to depart unnecessarily from the UFOC Guidelines, the Commission believes that this reference is potentially confusing, because the TILA likely does not apply to transactions within the scope of the amended Rule. Nevertheless, franchisors can look to TILA and to the Consumer Leasing Act for guidance in crafting their disclosures under Item 10. The Commission anticipates that staff Compliance Guides will illuminate this topic further.

[470] It is worth noting that interest rates or finance charges may fluctuate between the time when the prospective purchaser receives the disclosure document and the time when he or she actually executes the financing agreement. Section 436.5(j)(1)(iv) requires disclosure of what the rate of interest, plus finance charges, expressed on an annual basis, was on a specified recent date. In situations where the rate may change during the life of the loan, disclosure of this fact would be required under the catch-all requirement of section 436.5(j)(x), which calls for disclosure of ''other material financing terms.'' Of course, Item 22—section 436.5(v)—requires that any financing agreement be attached to the disclosure document, and the Item 10 disclosures merely summarize key terms.

[471] The introduction to UFOC Item 10 makes clear that franchisors are permitted to provide this information in summary table format, and Appendix A to the final amended Rule offers a sample table.

[472] H&H, NPR 9, at 18.

[473] Gurnick, NPR 21, at 6–7.

[474] The Commission will ensure that the Compliance Guides reiterate the point made here: nothing in Item 10 restricts the parties' ability to negotiate over financing terms.

[475] *See* 16 CFR 436.1(a)(17) and (18). The offer of business assistance is one of the hallmarks of a franchise system. In the original SBP, the Commission stated that promises of assistance made to induce prospective franchisees to purchase a franchise are material, especially to those prospects with ''little or no experience at running a business.'' Original SBP, 43 FR at 59676–77.

[476] *See* UFOC Guidelines, Item 11.

[477] Our law enforcement experience demonstrates that misrepresentation about the level of support and assistance is one of the most common problems in franchise cases. *See* Staff Program Review, at 24–26 (next to earnings claims, support problems are the second most frequent issue raised by franchisee complainants). *E.g., FTC v. Car Wash Guys Int'l, Inc.*, No. 00–8197 ABC (RNBx) (C.D. Cal. 2000); *FTC v. Indep. Travel Agencies of Am., Inc.*, No. 95–6137–CIV Gonzalez (S.D. Fla. 1995); *FTC v. Sage Seminars, Inc.*, No. C–95–2854–SBA (N.D. Cal. 1995); *FTC v. Skaife*, Bus. Franchise Guide (CCH) ¶ 9555 (C.D. Cal. 1990).

Indeed, misrepresentations about support and assistance continue to be a source of numerous franchisee complaints. For example, one franchisee-commenter reported that her outlet failed, in part, because the franchisor did not adhere to its own criteria in selecting a store. Based upon her experience, she asserted that it is very important to have full disclosure on site selection criteria. Lundquist, ANPR, 22Aug. 97 Tr., at 45. *See also* Dady & Garner, ANPR 127, at 4; Mousey, ANPR, 29 July 97 Tr., at 4–7.

[478] *See, e.g., FTC v. Car Checkers of Am., Inc.*, No. 93–623 (mlp) (D.N.J. 1993) (misrepresenting that advertising expenses would be minimal or low); *United States v. Fed. Energy Sys., Inc.*, Bus. Franchise Guide (CCH) ¶ 8180 (C.D. Cal. 1984) (misrepresenting extent of company advertising assistance); *United States v. Ferrara Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 7926 (W.D. Mo. 1983) (misrepresenting availability of national media advertising). The issue of advertising funds continues to generate concerns on the part of franchisees and their advocates. *E.g.*, Brown, ANPR 3 Tf7.0467 0S Tf1.)

any franchisee-generated funds, such as advertising cooperatives.'').

[479] In response to the ANPR, a few commenters voiced concerns about obligations to purchase computers or related equipment. *E.g.*, Fetzer, ANPR, 19 Sept. 97 Tr., at 42 (needed to purchase a computer converter, an additional $7,000 expense); Rafizadeh, ANPR, 7 Nov. 97 Tr., at 292 (GNC unilaterally forcing franchisees to pay a new $80 monthly maintenance fee on computer equipment purchased from GNC).

[480] *See* NCA 7-Eleven Franchisees, ANPR 113, at 2 (noting 7-Eleven's use of ''point-of-sale'' cash registers, which enable headquarters to monitor sales).

[481] Franchise NPR, 64 FR at 57338.

[482] Baer, NPR 11, at 13; J&G, NPR 32, at 11.

[483] Marriott, NPR 35, at 15–16.

[484] Kestenbaum, ANPR 40, at 2. In response to the Franchise NPR—which proposed adopting the UFOC Item 11's detailed computer systems disclosures—H&H suggested that a franchisor should be required to disclose the specifications of any mandatory computer system to the extent

[487] Gust Rosenfeld, at 5 (*citing* UFOC Guidelines, Item 11, at B. vii.).

[488] *See* 16 CFR 436.1(a)(13). In the original SBP, the Commission recognized that sales restrictions and limited territories affect a franchisee's ability to conduct business and are, therefore, material. Original SBP, 43 FR at 59662. *See, e.g., FTC v. Am. Legal Distrib., Inc.*, Bus. Franchise Guide (CCH) [1987–

a whole,[494] not just from a few franchise systems.[495] Second, assuming a regulatory regime of full and truthful pre-sale disclosure on the issue of territories, prospective franchisees can avoid potential harm from encroachment by shopping for a franchise opportunity that offers an exclusive territory. Finally, the record does not support a finding that harm to franchisees resulting from encroachment necessarily outweighs potential benefits (expansion of markets and increased consumer choice) to consumers or to competition. For these reasons, the Commission has determined that the criteria for an industry-wide prohibition on encroachment has not been met. Thus, the Commission declines to mandate specific contractual terms regarding territories.

b. Scope of the Item 12 disclosures

A few commenters urged the Commission to require franchisors to disclose more information about their past practices with regard to expansion into franchisees' areas or their future plans to do so.[496] For example, Andrew Selden, a franchisee representative, suggested that ''Item 12 should be elaborated to require full disclosure of past practice, current intention or future possibility of franchisor-sponsored competitive activities that have the prospect of impacting the franchisee's business.''[497]

Franchisors addressing current development plans uniformly opposed any disclosure. H&H's comment is typical. Most franchisors consider current development plans to be proprietary information ''that would place them at a competitive disadvantage if they were to be made publicly available.''[498] The firm also stressed that franchisors need flexibility to adapt development plans to market realities. ''Disclosure of development plans could lead to possible claims by franchisees who anticipated greater or lesser franchise development in a particular area.''[499]

Based on review of the record as a whole, the Commission has determined that requiring disclosure of past and planned future expansion is unwarranted. With respect to past expansion, prospective franchisees arguably can discover such information on their own by directly observing the number and location of outlets in their community and by speaking with current and former franchisees. Moreover, past practices are not necessarily a predictor of future intent. It is also unreasonable to require franchisors to disclose hypothetical possibilities about their future expansion. Indeed, by not granting an exclusive territory, the franchisor has effectively reserved to itself the unrestricted right to expand into new or existing locations or to sell its products or services via alternative channels of distribution.

The UFOC Guidelines require a franchisor to disclose only if the franchisor ''may establish'' other outlets in the area; it does not require the franchisor to disclose its specific plans for the franchisee's territory. Franchisors need to elaborate on their expansion plans only if they have ''present plans to operate or franchise a business under a *different trademark* and that business sells goods or services similar to those to be offered by the franchisee.''[500] Moreover, the Commission is inclined to the view that a franchisor's development plan is proprietary information that a franchisor should not be required to make public.[501] It could also subject franchisors to future liability for fraud or misrepresentation should the franchisor alter, abandon, or delay its stated expansion plans. Further, requiring a franchisor to disclose plans to develop a territory may be costly and burdensome because the franchisor conceivably would have to prepare multiple Item 12 disclosures to focus on each franchise location. The disclosures already contained in Item 12 are sufficient to warn prospects about likely competition because any prospective franchisee who buys a franchise without any protected territory is essentially taking the risk that the franchisor will further develop the market area. For these reasons, we have determined not to deviate from the UFOC Guidelines on this point.

c. Terminology

The final amended Rule fine-tunes the terminology and organization of Item 12. As proposed in the Franchise NPR, Item 12 would have required that franchisors disclose information ''concerning the franchisee's market area with or without an exclusive territory.'' It also referred to the franchisee's ''defined area.''[502] Several commenters raised concerns about the use of these terms.

First, BI opposed the use of the term ''exclusive territory'' in the Franchise NPR, urging the Commission to use the term ''protected territory'' instead. It asserted that the term ''protected territory'' is more descriptive of a franchisee's typical contractual rights

[494] As discussed above in the overview of the final rule above (section I.D. of this document), the Commission has voiced concern that government-mandated contractual terms may result in affirmative harm to consumer welfare. Accordingly, the Commission has authorized staff to file a number of advocacy comments recommending against proposed state bills that would have unduly limited manufacturers in managing their distribution systems, such as by requiring exclusive territories.

[495] *See* Staff Program Review, at 59.

[496] One commenter in the Rule amendment proceeding advocated broadening the scope of the Rule to require more expanded disclosures covering competition by affiliates, the franchisor's officers, and franchise sellers. Bundy, NPR 18, at 9. In the absence of persuasive record evidence that competition by franchisor officers or sellers is a prevalent problem, however, the Commission has determined not to deviate from the UFOC Guidelines on this issue.

[497] Selden, ANPR 133, Appendix B. *See also* Dady & Garner, ANPR 127, at 4 (''Explicit statements about the nature and extent of protection against same-brand competition that will or will not be provided is essential to an informed buying decision.'').

[498] H&H, NPR 9, at 23.

[499] *Id. See also* Wendy's, NPR 5, at 2; Baer, NPR 11, at 13 ; Lewis, NPR 15, at 15; BI, NPR 28, at 11; J&G, NPR 32, at 12; GPM, NPR Rebuttal 40, at 6.

[500] UFOC Item 12C (emphasis added).

[501] *E.g.*, Wendy's, NPR 5, at 2.

[502] Franchise NPR, 64 FR at 57339.

[503] BI, NPR 28, at 6 (''[E]xclusive . . . is ambiguous and often misleading.'').

[504] *Id.*

[505] NFC, NPR 12, at 19.

[506] NFC, NPR 12, at 19. *See also* J&G, NPR 32, at 12.

[507] *Id. See also* J&G, NPR 32, at 12.

[520] UFOC Guidelines, Item 13B Instructions, v.

[521] Franchise NPR, 64 FR at 57339.

[522] Arguing that many prospective franchisees would not understand the standard disclosure prescribed in the Franchise NPR's proposed Rule— particularly the phrase ''presumptive legal rights''—

ANPR 37; Rich, ANPR 65; Orzano, ANPR 73; Geiderman, ANPR 131; Karp, ANPR, 19 Sept. 97 Tr., at 83; Chiodo, ANPR, 21 Nov. 97 Tr., at 303–04.

[535] NFC, NPR 12, at 30.

[536] J&G, NPR 32, at 13.

[537] Tricon, NPR 34, at 6–7.

[538] Baer, NPR 11, at 13. *See also* IL AG, NPR 3, at 7.

[539] Stadfeld, NPR 23, at 15–16. *See also* NaturaLawn, NPR 26, at 2.

[540] IL AG, NPR 3, at 7. Similarly, the AFA urged the Commission to adopt the following warning:

''You do not own your own business. You are leasing the rights to sell our goods/services to the public under our trade name. At the end of your initial [number of years] term, your current contract will expire [terminate]. You will have the choice of signing a new contract written by us at the time of expiration [termination]. The new contract will be written by us with no input from you and will contain materially different financial and operational terms.''

AFA, NPR 14, at 5. *See also* Bundy, at 7; Bundy, NPR 18, at 5 (urging the Commission to require franchisors to disclose the consequences of renewal).

[541] In response to the Staff Report, Spandorf opined that Item 17 as recommended by staff was still confusing, asserting that it could mean that a franchisor would have to make the statement about renewal even if the franchisor does not offer renewals. Spandorf, at 7. We do not believe this is a serious concern. Item 17 clearly states that franchisors need only address those issues listed in Item 17 if applicable. ''If a particular item is not applicable, state 'Not Applicable.'''

[542] One example of a renewal expla [illegible]

[561] *E.g.*, AFA, at 2; Bundy, at 7–8; Karp, at 3; Selden, at 2; Haff, at 2; Blumenthal, at 1.

[562]

[570] Item 19B ii of the UFOC Guidelines instructions requires ''a concise summary of the basis for the claim including a statement of whether the claim is based upon actual experience of franchised units and, if so, the *percentage of franchised outlets in operation for the period covered by the earnings claims that have actually attained or surpassed the stated results*.'' The original Rule did not include any counterpart

[580] NASAA, NPR 17, at 5. *See also* Bundy, at 7; Gust Rosenfeld, at 6; PMR&W, NPR 4, at 12; H&H, NPR 9, at 13; NFC, NPR 12, at 31; Lewis, NPR 15, at 15; Snap-On, NPR 16, at 3; J&G, NPR 32, at 7; Marriott, NPR 35, at 12; IL AG, Rebuttal NPR 38, at 5. Based on the comments, particularly those submitted by NASAA, the Staff Report recommended elimination of the GAAP requirement. Staff Report, at 166–67.

[581] Franchise NPR, 64 FR 57311 and 57341. Slight wording changes have been made to improve overall clarity and consistency, and the sentence ''If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet,'' to conform with the Rule's substantive liberalization on this point.

[582] *E.g.*, Bundy, at 7; CA BLS, ANPR 124, at 1; Lagarias, ANPR 125, at 4. *See also* H&H, ANPR 28, at 8; SBA Advocacy, ANPR 36, at 8; AFA, ANPR 62, at 5; Purlin, ANPR 79, at 2; Jeffers, ANPR 116, at 5.

[583] *E.g.*, *FTC v. Minuteman Press, Int'l*, No. 93–CV–2494 (DRH) (E.D.N.Y. 1998). *See also* Franchise NPR, 64 FR at 57311; ANPR, 62 FR at 9118.

[584] The first preamble reads:

''The FTC's Franchise Rule permits a franchisor to provide information about the actual or potential financial performance of its franchised and/or franchisor-owned outlets, if there is a reasonable basis for the information, and if the information is included in the disclosure document. Financial performance s
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At the same time, the Commission has rejected various suggestions to require more strongly worded preambles. For example, Eric Karp would amplify the second preamble to warn prospects that, although the franchisor collects financial information, it does not disclose any, and he suggested including the phrase, ''Consider why we are unwilling to do so.''[588] In effect, these commenters would turn the absence of a financial performance claim into a risk factor. The Commission rejects this approach. It does not necessarily follow that the absence of a financial performance disclosure necessarily signals a riskier investment. It could well be that a company bent on defrauding prospective franchisees would manipulate its numbers to create a stronger success image, while a successful but punctilious system might choose not to disclose numbers because it may not believe that it can make a reasonable disclosure that would be applicable to all potential buyers. In addition, any concern that prospective franchisees need to see actual earnings figures in order to judge success is mitigated by Item 20, which compels the disclosure of franchise turnover rates, as well as the names and addresses of current and former franchisees, who can be contacted for information.

22. Section 436.5(t) (Item 20): Outlets and franchisee information

Section 436.5(t) of the final amended Rule retains the original Rule's requirement that franchisors disclose the number of franchised and franchisor-owned outlets; the names, business addresses, and business telephone numbers of current franchised outlets, and statistical information on franchise turn-over rates, in particular the number of franchises voluntarily and involuntarily terminated, not renewed, and reacquired by the franchisor.[589] To align the final amended Rule more closely to the UFOC guidelines, it also extends the original Rule by requiring franchisors to disclose the names, business addresses, and business telephone numbers of at least 100 current franchised outlets (as opposed to the original Rule requirement of at least 10 franchised outlets).[590] It also requires the disclosure of some contact information for former franchisees59andgs4nt
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prospective franchisees to notify the FTC and an appropriate state agency of an unauthorized earnings claim seems a bit excessive).

[588] Karp, at 3. In the same vein, Howard Bundy would strengthen the second preamble to read:

''Financial Performance Information is material to any decision to invest. [Franchisor] does not provide you with Financial Performance Information. The absence of such information makes it very difficult for you to estimate your prospects of success in the business. You should proceed with caution and consult your franchise attorney and other business advisors.''

Bundy, NPR 18, at 10.

[589] *See* 16 CFR 436.1(a)(16). In the original SBP, the Commission explained that the required statistical information gives prospective franchisees material information about the size of the franchise system they are contemplating joining and goes to the prospect's likelihood of success. ''Providing a prospective franchisee with an accurate statement of the number of units operated by his or her franchisor will convey information relating to the financial success of the particular franchise business since the franchisee's ultimate success depends in large measure on public recognition of the franchisor's name.'' Original SBP, 43 FR at 59670. *See also* ANPR,

62 FR at 9118. In addition, the disclosure of contact information for current franchisees prevents fraud by arming prospects with a valuable alternative source of information with which to verify franchisor's representations. *Id.*

[590] UFOC Guidelines, Item 20B.

[591] Current and former franchisees often have widely different experiences. For that reason, in *Blenheim Expositions, Inc.*, 120 FTC 1078 (1995), the Commission challenged as a violation of Section 5, franchisee success claims based upon a Gallup Poll study of current franchisees only.

[592] The UFOC Guidelines require the disclosure of names, last known home address, and telephone number of each franchisee who left the system within the last fiscal year. UFOC Guidelines, Item 20E. The purpose of the disclosure is to reduce fraud by enabling prospective franchisees to learn about the nature of the franchise system and, most important, the nature of the franchise relationship from those who recently exited the system, voluntarily or involuntarily. To reduce inconsistencies between with the UFOC Guidelines, the Franchise NPR followed the same approach. Franchise NPR, 64 FR at 57343. As explained below, however, Item 20, as proposed in the Franchise NPR, would require the disclosure of personal information, raising privacy concerns. For that reason, the Commission has adopted a more limited approach in the final amended Rule.

[593] The provision does not require franchisors to disclose the existence of broad-based organizations that represent franchisee interests generally, such as the American Franchisee Association, the American Association of Franchisees & Dealers, or the International Franchise Association.

[594] The problems with the UFOC Guidelines' Item 20 first surfaced during the Rule review that preceded initiation of the rule amendment proceeding. Simon, RR Tr., at 223–24; Maxey, RR Tr., at 224–25. To develop a record on this issue, the ANPR solicited comment on whether UFOC Guidelines Item 20 accurately reflects franchisees' performance history and, if it does not, how the Commission could modify the Item 20 disclosures to reflect performance history more accurately. ANPR, 62 FR at 9116. In response to the ANPR, several commenters confirmed that Item 20 results in ''double-counting'' of franchise turnover rates. *E.g.*, H&H, ANPR 28, at 6; AFA, ANPR 62, at 3; IL AG, ANPR 77, at 2; Tifford, ANPR 78, at 4; IFA, ANPR 82, at 2; Cendant, ANPR 140, at 3; Karp, 19 Sept. 97 Tr., at 91. Accordingly, in the Franchise NPR, the Commission attempted to address the identified problems with the UFOC version. Franchise NPR, 64 FR at 57342–44. However, commenters criticized proposed Item 20 of the Franchise NPR as inadequate to solve the problem. *E.g.*, IL AG, NPR 3, at 7; PMR&W, NPR 4, at 13–14; H&H, NPR 9, at 19; Snap-On, NPR 16, at 4; NASAA, NPR 17, at 5; Karp, NPR 24, at 11; Frandata, NPR 29, at 10. At that time, NASAA, in consultation with an Industry Advisory Committee, developed a comprehensive revamping of Item 20, which it submitted in its Franchise NPR comments. NASAA, NPR 17, at 5–10. Several additional commenters either submitted the same proposal or endorsed the NASAA proposal. PMR&W, NPR 4, at 14–66 and Exhibit A; NPC, NPR 12, at 31–32; Frandata, NPR 29, at 11. The Staff Report recommended adoption of NASAA's suggested revamping of Item 20. Staff Report, at 180. No Staff Report comments offered further criticism of the staff's recommendation for revising Item 20.

[595] *E.g.*, H&H, ANPR 28, at 6; AFA, ANPR 62, at 3; IL AG, ANPR 77, at 2; Tifford, ANPR 78, at 4; IFA, ANPR 82, at 2; Cendant, ANPR 140, at 3; Karp, ANPR, 19 Sept. 97 Tr., at 91; Simon, RR, Sept.95 Tr., at 223–24.

[599] Staff Report, at 48–53. The definitions of the terms ‘‘transfer’’ and ‘‘reacquisition’’ ar/F7.1same

[596] *See* UFOC Item 20D. *See also* Wieczorek, ANPR, 18 Sept. 97 Tr., at 31.

[597] For a detailed discussion of this issue, see Franchise NPR, 64 FR at 57312; Staff Report, at 173–77.

[598] While the UFOC Item 20 instructions provide that the franchisor can add footnotes to clarify the numbers, the use of multiple explanatory footnotes removes the benefit of presenting information in a readily accessible tabular format. In addition, prospective franchisees may not read or fully appreciate the import of the footnotes. *See* Zarco & Pardo, ANPR 134, at 6–7 (‘‘If the [Item 20] information becomes too complicated, the potential franchisee will not know how to interpret the data and thus, derive no benefit from the increased efforts at meaningful disclosure.’’).

[604] NASAA, NPR 17, at 8.

[605] To reduce double-counting, Item 20 specifies that multiple events are to be reported using a ''last-in-time'' approach. *See* PMR&W, NPR 4, at 13–14. *See also* NASAA, NPR 17, at 5–10; Frandata, NPR 29, at 11. During the Rule amendment proceeding, other commenters offered other options, such as a ''first-in-time'' approach, or establishing an order of priority among events. We are persuaded that a last-in-time approach is appropriate, for the reasons noted in the PMR&W comment: ''A last-in-time prioritization is appropriate for at least three reasons: (1) it allows for an easily ascertainable confirmation of the event; (2) it represents a fact, rather than an intention (*e.g.*, a termination notice) or a proposal (*e.g.*, a transfer rather than request); (3) in dispute situations, it labels the event in a manner consistent with the parties' settlement of their dispute.'' PMR&W, NPR 4, at 13–14.

[606] The instructions accompanying Table No. 3 include the statement that the franchisor must, in column 8 of the table, ''state the total number of outlets in each state not operating as one of the franchisor's outlets at the end of each fiscal year for reasons other than termination, non-renewal, or reacquisition by the franchisor.''

[607] Karp, at 4; Karp, NPR 24, at 14-19.

[612] This modifies slightly the version of Item 20 set forth in the Staff Report, which stated: ''If a franchisor is selling an existing franchised outlet, disclose the following additional information . . .'' Staff Report, at 181 and proposed revised Rule, 64 FR at 57342–44. Two commenters correctly noted that this language is ambiguous because ordinarily a franchisor does not sell an existing franchised outlet. Rather, a franchisor may sell an outlet in its control that was previously owned by a franchisee. Wiggin & Dana, at 3; J&G, at 6. We agree. This provision applies only where the franchisor has reacquired or otherwise gained control of an outlet. It would not apply where an existing franchisee merely asks for the franchisor's assistance in transferring an outlet to a new owner.

[613] As discussed in the previous section in connection with the disclosure of contact information for former franchisees, the disclosure of contact information for former franchisees of a specific outlet differs from the Franchise NPR proposal to address privacy issues. To protect the privacy of former franchisee-owners of a specific outlet, the amended Item 20 requires the disclosure of only the name, city and state, business telephone number, or, if unknown, last known home telephone number of the former franchisee-owners.

[614] IL AG, NPR 3, at 7. *See also* Singler, at 1. This provision also complements Item 19 provision that permits a franchisor to provide supplemental financial performance information about a specific unit being offered for sale. In order to prevent misrepresentation, a prospective franchisee should be able to speak with former owners of a specific unit being offered for sale when a franchisor provides financial performance information about that specific unit.

[615] We note that the Staff Report urged the Commission to adopt a three-year reporting period, while the text of the proposed revised Rule attached to the Staff Report stated a five-year reporting period. *Compare* Staff Report, at 181 *with* proposed revised Rule, at 56. Some commenters urged the Commission to adopt a three year reporting period, Wiggin & Dana, at 3, while others said that even a five-year period is insufficient to ''discern the most egregious trends''). Singler, at 2. We are convinced that a three-year reporting period is too short to expose a trend of specific unit sales. For example, a single unit could be resold three times: once immediately before a three-year reporting period, a second time during a three-year period, and a third time immediately after the three-year period. In such a scenario, a three-year reporting period would capture only one resale. We believe a five-year reporting period strikes the right balance between ensuring material disclosure and reducing compliance burdens.

[616] Wiggin & Dana, at 4; J&G, at 6.

[617] Wiggin & Dana, at 4.

[618] Indeed, this approach is consistent with UFOC Guidelines Item 19, which permits franchisors who have made an Item 19 financial performance disclosure to provide prospective franchisees with supplemental data ''directed to a particular location or circumstance, apart from the [disclosure document.]'''UFOC Guidelines, Item cumen Tw0.5540

[630] Marriott, NPR 35, at 16. *But see* Karp, at 8 (''It incorrectly implies that the franchisee that signed the confidentiality provision had a choice whether to do so or not.'').

[631] *See* AFA, at 3; Karp, at 8. *See also FTC v. Orion Prods.*, Bus. Franchise Guide (CCH) ¶ 10970 (N.D. Cal. 1997) and *United States v. Tutor Time Child Care Sys., Inc.*, No. 96–2603 (N.D. Cal. 1996). While in these two cases the Commission did not challenge the defendants' use of confidentiality clauses as either a Rule or Section 5 violation in its complaints, it did obtain fencing-in provisions in settlements that prohibited the defendants from enforcing or entering into confidentiality provisions for a limited time.

[632] Bundy, ANPR, 6 Nov. 97 Tr., at 249. *See also* AFA, at 3; Gee, at 2; Pu, at 1–2; Selden, ANPR 133, Appendix B; Zarco & Pardo, ANPR 134, at 4; Jeffers, ANPR, 6 Nov. 97 Tr., at 251–52; Wieczorek, ANPR, 6 Nov. 97 Tr., at 260. *But see* Singler, at 2 (permitting disclosure, but accepting that individuals may be contractually forbidden to discuss the franchisor makes m 4l.44eopermM dants from 630

[639] The growth of trademark-specific system franchisee associations is a recent development in franchising. These associations are comprised of franchisees who operate a franchisor's particular brand. In some instances, these associations are franchisor sponsored or endorsed councils, where franchisee-participants are either selected by the franchisor or are elected by franchisees themselves. In other instances, the associations are independent of the franchisor. The emergence of independent franchisee associations is not always well-received by the franchisor. *See* Winslow, at 141 (''I believe franchisors ought to be allowed to put in the contract that if any franchisees get together and form a franchise association to use as a collective bargaining power against the franchisor, other than

this statement makes clear that the franchisor is not necessarily endorsing or supporting the associations listed. This statement, coupled with the requirement that only an organized independent association must be disclosed and only upon the association's request, strikes the right balance between pre-sale disclosure and compliance burdens.

At the same time, the Commission has rejected the suggestion offered by some commenters that independent franchisee associations seeking inclusion in the franchisor's disclosure document should be representative of a significant number of franchisees in the franchise system.[651] These commenters urged the Commission to apply a threshold qualification test whereby a franchisor would not have to disclose an independent franchisee association unless the association represented a portion of system franchisees, such as 25% of system franchisees.[652]

The Commission recognizes that Item 20 may result in the disclosure of independent franchisee associations that are not necessarily representative of franchisees as a whole. However, we believe there is value in enabling prospective franchisees to speak with an association representing similar interests, even if not representative of the entire system. For example, a small independent association of franchisees in Anchorage, Alaska, might provide prospective franchisees with valuable information about local labor costs, financial performance data, as well as information about third-party suppliers. For this reason, we reject the notion that an independent association should be forced to establish that they represent a specific percentage of franchisees in a system. Rather, prospective franchisees can determine for themselves whether to contact independent franchisee associations and what weight to give any information such associations provide.

23. Section 436.5(u) (Item 21): Financial statements

Section 436.5(u) of the final amended Rule retains the original Rule's basic requirement that franchisors disclose three years of audited financial statements prepared according to generally accepted accounting principals (''GAAP'').[653] To maximize consistency with the UFOC Guidelines, it expands the original Rule by incorporating the UFOC Guidelines' requirement that financial disclosures be in a tabular format that compares at least two fiscal years. This provides prospective franchisees with information with which to assess financial trends, rather than just an isolated snap-shot of the franchisor's finances.

The final amended Rule provision differs from UFOC Guidelines Item 2, however, in three respects. First, while it requires the use of GAAP, it also recognizes that what currently is ''GAAP'' may change by federal TDlara

commenters also noted that the proposed additional sentence is unnecessarily negative in tone. It should suffice that a franchisor simply notes that the independent associations have asked to be included, without implying that the independent association is a renegade group. AFA, at 3–4; Blumenthal, at 1–2; Bundy, at 9; Karp, at 5. While we are persuaded that an introductory statement may be warranted before listing independent associations—to distinguish them from franchisor endorsed or sponsored associations—the statement should be neutral and not imply any opinion on the merits of the independent associations. This is the same approach taken with respect to franchisor-endorsed or sponsored associations, where no such disclaimer is required. Accordingly, Item 20 of the final amended Rule deletes the last sentence from the Staff Report's version of the trademark-specific franchisee association voluntary disclaimer.

[651] *See* PMR&W, NPR 4, at 15; BI, NPR 28, at 13.

[652] Stadfeld, NPR 23, at 14–15. *See also* H&H, NPR 9, at 20–21 (if the organization represents 30% of franchisees); NFC, NPR 12, at 33 (if the organization represents 20% of the franchisees); BI, NPR 28 (unspecified threshold). *But see* IL AG, NPR Rebuttal 38, at 4 (''Setting a minimum percentage of franchisees to be a qualified association is virtually unworkable.'').

[653] 16 CFR 436.1(a)(20). In the original SBP, the Commission noted that a franchisee is purchasing, ''along with the franchise itself, some assurance of the financial stability of the franchisor, of the franchisor's ultimate ability to meet its obligations to its franchisees.'' Original SBP, 43 FR at 59679. For that reason, the Commission concluded that the disclosure of basic financial information by all franchisors ''is essential.''

[654] ''Without the auditing requirement, the financial statements remain nothing more than the franchisor's own representation of its financial condition.'' Original SBP, 43 FR at 59679-680. Nonetheless, the costs associated with preparing audited financial statements might create a barrier to entry by start-up franchisors. In the original SBP, the Commission made it clear that, as a matter of policy, franchisors can use unaudited financials during a phase-in period. *Id.*, at 59681.

[655] Franchise NPR, 64 FR at 57344. *See* 16 CFR 436.1(a)(20); UFOC Item 21. *See also* Advisory 02–4, Bus. Franchise Guide (CCH), ¶ 6515 (Nov. 18, 2002).

[656] H&H, NPR 9, at 13. *See also* NFC, NPR 12, at 33.

[657] H&H, NPR 9, at 13. Warren Lewis suggested that the Commission permit foreign franchisors to ''use financial statements prepared according to their countries' GAAPs, provided that those GAAPs are comparable to US GAAP.'' Lewis, NPR 15, at 17. Mr. Lewis, however, provided no criteria or examples that would help us determine what GAAP are or are not ''comparable.''

written guarantee is included in the disclosure document. Bundy, NPR 18, at 11 (emphasis in original).

[667] Two commenters voiced concern about the ''post-sale performance obligation'' language set forth in the Staff Report. Specifically, they contended that sections 436.5(u)(1)(ii) and 436.5(u)(1)(iv) of the Staff Report are inconsistent. In their view, section 436.5(u)(1)(iv) requires a franchisor to furnish financial statements if the franchisor has post-sale performance obligations. They then noted that is it highly unlike that a franchisor would ever enter into a franchise relationship without some post-sale obligations to the franchisee. The commenters concluded therefore that section 436.5(u)(1)(iv) requires franchisor financials in all instances. This interpretation is in direct conflict with section 436.5(u)(1)(ii), however, that expressly permits a franchisor to use the financials of an affiliate-guarantor. Piper Rudnick, at 3–4; Spandorf, at 8–9. The commenters misread section 436.5(u)(1)(iv) of the Staff Report. Under that section of the Staff Report, a franchisor must provide financial statements ''for the franchisor, subfranchisor, and any parent . . . that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations.'' The reference to ''post-sale obligations'' refers to ''parent,'' not to the ''franchisor.'' If the commenter's reading of section 436.5(u)(1)(iv) were correct, then the section would have the following absurd meaning: ''a franchisor must provide financial statements for the franchisor . . . that commits to perform post-sale obligations for the franchisor.'' To avoid any confusion on this point, section 436.5(u)(1)(iv) of the final amended Rule has been revised to read: ''Include separate financial statements for the franchisor and subfranchisor, as well as for any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations.''

[668] Where a parent guarantees performance, Item 21 also requires a franchisor to attach a copy of the guarantee to the disclosure document. Although the UFOC Guidelines are not clear on this point, we believe that Item 21, Instruction v. contemplates this requirement. Moreover, it is sound policy. Before a prospective franchisee is asked to invest in a franchise, he or she should be able to assess the extent of any performance or financial guarantees.

[669] Bundy, at 9; H&H, NPR 9, at 21; Lewis, NPR 15, at 17.

[670] This approach parallels the UFOC Guidelines, which require subfranchisor financial statements only when the subfranchisor is the applicant for franchise registration.

[671] There is no comparable provision in the UFOC Guidelines. The extent to which any state may permit a phase-in of audited financial statements is a matter of individual state law. For example, California and Illinois permit a phase-in of audited financial statements under limited conditions set forth in their franchise regulations. On the other hand, Virginia and Minnesota, for example, always require audited financial statements.

[672] 16 CFR 436.1(a)(20)(ii).

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[673] *Id.*

[674] *See* Franchise NPR, 64 FR at 57315.

[675] No comments were submitted on this modification of the original Rule's phase-in of audited financial statements.

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[676] *E.g.*, Duvall, ANPR 19, at 1; Baer, ANPR 25, at 4; Kaufmann, ANPR 33, at 6; Kestenbaumw : 0 0 7H9.9147 Tm0 Tv unavail1.12.'

signatures, passwords, security codes, and other devices that enable a prospective franchisee to easily acknowledge receipt, confirm his or her identity, and submit the information to the franchisor.[691]

Item 23 of the final amended Rule also incorporates several suggestions offered by commenters. For example, Warren Lewis advised that the title of Item 23 should be ''receipts,'' observing that the current industry practices is to have two receipts at the end of the disclosure document, one the franchisee retains as part of the disclosure document and the other returned to the franchisor.[692] He also urged the Commission to replace ''franchisee's 8.0999 Tmscreaing 0 039 70Mamen0b this the

[691] Item 23 also provides that franchisors may include specific instructions on how prospects should submit the receipt, such as via facsimile or email. This enables the parties to determine for themselves the most efficient and cost-effective way for the prospective franchisee to transmit the acknowledgment.

[692] Lewis, NPR 15, at 18.

[693] Lewis, NPR 15, at 18.

[694] NASAA, NPR 17, at 11.

[695] H&H, NPR 9, at 21.

[696] At the same time, the final amended Rule prohibits a franchisor from failing to furnish disclosures earlier in the sale process, upon reasonable request. *See* section 436.9(e).

[697] The version of Item 23 proposed in the Franchise NPR referenced ''any subfranchisor or broker.'' Staff recommended instead ''franchise seller,'' and the Commission has adopted this approach.

[698] Wiggin & Dana, at 4; Piper Rudnick, at 4; J&G, at 7; Duvall, at 2.

[699] This does not mean that a franchisor must create individualized disclosure documents for each franchise sale. Clearly, a franchisor could create a receipt with a fill-in-the-blank for the seller's information. The company or its agent could fill in the blank with the appropriate information prior to furnishing the disclosure document.

[700] Franchise NPR, 64 FR at 57345.

[701] The Staff Report proposed the same general instructions. Staff Report, at 208–09.

[702] Franchise NPR, 64 FR at 57345.

[703] 15 U.S.C. 7001.

[704] 15 U.S.C. 7006(1).

[705] 15 U.S.C 45(a); 53(b); 57b.

[706] Franchise NPR, 64 FR at 57301, 57333. A showing of knowledge is necessary when seeking to hold an individual liable for redress for a corporation's law violations in Section 5 matters, as discussed further below.

[707] Baer, NPR 11, at 10.

[708] *Id.*

[709] Tricon, NPR 34, at 6. *See also* Baer, NPR 11, at 10.

[710] NASAA, NPR 17, at 3.

[711] *E.g., FTC v. Amy Travel Servs., Inc.*, 875 F.2d 564, 573 (7th Cir.), *cert denied*, 439 U.S. 954 (1989); *FTC v. Atlantex Assocs.*, 1987–2 Trade Cas. (CCH), ¶ 67788 at 59255 (S.D. Fla. 1978), *aff'd*, 872 F.2d 966 (11th

[714] J&G, at 3–4.

[715] Bundy, at 2.

[716] *FTC v. Publ'g Clearing House, Inc.*, 104 F.3d 1168, 1170 (9th Cir. 1997). *See also FTC v. J.K. Publ'ns, Inc.*, 99 F. Supp. 2d at 1203; *FTC v. Am. Standard Credit Sys., Inc.*, 874 F. Supp. 1080, 1087 (C.D. Cal. 1994). Authority to control the company can be evidenced by active involvement in business affairs and the making of corporate policy, including assuming the duties of a corporate officer. *FTC v. Amy Travel Serv., Inc.*, 875 F.2d at 573. Similarly, an individual's status as a corporate officer and authority to sign documents on behalf of the corporate defendant can be sufficient to demonstrate the requisite control. *FTC v. Publ'g Clearing House, Inc.*, 104 F.3d at 1170.

[717] *See FTC v. Five*-Star Auto Club, Inc., 97 F. Supp. 2d 501 (S.D.N.Y. 2000) (individual defendant participated directly in the deceptive acts or practices by, among other things, drafting and/or approving marketing materials); *FTC v. Atlantex Assocs.*,1987–2 Trade Cas. (CCH), ¶ 67788 (individual defendant liable because he had the authority to control the company's actions, including the authority to control representations made by salespeople).

[718] *FTC v. Amy Travel Serv., Inc.*, 875 F.2d at 574. *See also FTC v. J.K. Publ'ns, Inc.*, 99 F. Supp. 2d 1176 at 1204; *FTC v. Atlantex Assocs.*, 1987–2 Trade Cas. ¶ 67788; *FTC v. Kitco of Nevada, Inc.*, 612 F. Supp. at 1282. For the Commission to obtain civil penalties against a defendant, the standard of knowledge is even higher: ''actual knowledge or knowledge fairly implied on the basis of objective circumstances that [the] act or practice is unfair or deceptive and is prohibited by such rule.'' 15 U.S.C.
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[726] Franchise NPR, 64 FR at 57345. *See* 16 CFR 436.1(a)(21). The Franchise NPR referred to ''any materials or information other than that required by this Rule or by state law not preempted by this Rule.'' One commenter noted that because some of the proposed Rule's disclosures are optional (such as the Item 19 financial performance disclosures), the prohibition on additional information should read ''any materials or information other than that required or permitted by this Rule . . .'' Lewis, NPR 15, at 19. We agree, and the final amended Rule reflects this change.

[727] *See* Original SBP, 43 FR at 59682. Accordingly, franchisors may include information expressly required or expressly permitted by state law or information requested by a state franchise examiner. This provision is not intended to permit franchisors to include any information (such as testimonials or general promotional materials) in a disclosure document on the ground that it is not specifically prohibited by state law.

[728] The prohibition on external links, like the requirement that a disclosure be a single document, effectively prevents franchisors from furnishing disclosures through a series of linked, but separate, documents. This ensures that electronic

[735] Franchise NPR, 64 FR at 57345.

[736] *See* Interpretive Guides, 44 FR at 49969. While the Commission has allowed some flexibility in how franchisors and subfranchisors should prepare disclosure documents, it also made clear that both ''the franchisor and the subfranchisor are responsible for each other

[745] Many states require franchisors to keep records on franchise sales transactions. *E.g.,* Cal. Corp. Code at 31150; Haw. Rev. Stat. at 482E–5; 815 Ill. Comp. Stat. at 705/36; Md. Code Ann, Bus. Reg. at 14–224; Minn. Stat. at 80C.10; N.D. Cent. Code at 51–19–16; Or. Rev. Stat. at 650.010; R.I. Gen. Laws at 19–28.1–13; Wash. Rev. Code at 19.100.150.

[746] Rule enforcement actions brought under Section 19 of the FTC Act have a three-year statute of limitations. 15 U.S.C. 57b. Reliance on franchisees for copies of disclosure documents in law enforcement work is impracticable. Franchisees may not retain copies or may not have complete copies. Moreover, large franchise systems may use multiple versions of their disclosures over time and in different states. Obtaining all relevant copies from franchisees may be unworkable. Therefore, for law enforcement purposes, it is essential that franchisors retain copies of their disclosures for some length of time, consistent with state practices.

[747] Bundy, NPR 18, at 13; Stadfeld, NPR 23, at 5.

[748] *See* BI, NPR 28, at 7–8 (This ''provides useful clarification regarding the minimum time period the Commission expects franchisors to maintain such records.'').

[749] Several Commission trade regulation rules also require a three-year recordkeeping requirement. *See*, *e.g.*, Wool Labeling Rule, 16 CFR 300.31(c); Fur Labeling Rule, 16 CFR 301.41(b); Textile Labeling Rule, 16 CFR 303.39(c); Alternative Fuel Labeling Rule, 16 CFR 309.23; R-Value Rule, 16 CFR 460.9.

[750] *E.g.*, Cal. Corp. Code at 31150; Haw. Rev. Stat. at 482E–5; 815 Ill. Comp. Stat. at 705/36; Md. Code Ann, Bus. Reg. at 14–224; Minn. Stat. at 80C.10; N.D. Cent. Code at 51–19–16; Or. Rev. Stat. at 650.010; R.I. Gen. Laws at 19–28.1–13; Wash. Rev. Code at 19.100.150.

[751] No comments were submitted on this proposed Rule section.

[752] *See* 16 CFR 436.1(a)(22).

[753] *See* 16 CFR 436.1(a)(22).

[754] *See* 16 CFR §§

[765] PMR&W, NPR 4, at 6.

[766] NFC, NPR 12, at 16.

[767] *See* section 436.9(f). This provision also address the commenters' concerns about permitting franchisors to furnish updates orally.

[768] *But see* IL AG, at 10 (suggesting that the Rule state that franchisors may have other disclosure obligations under Section 5 of the FTC Act); Bundy, at 3 (suggesting a continuous updating requirement for ''materially adverse events.''). The quarterly update provision specifies when a franchisor must prepare revised disclosures to ensure that they are timely. It does not address whether a franchisor may have other obligations to notify prospective franchisees of material changes under state common

[780] Typical of these comments was H&H, which urged the Commission to raise the threshold to $1,000 in order to recognize the fact that costs in general have increased substantially since the Rule was initially promulgated. H&H, NPR 9, at 4. *See also* Gurnick, NPR 21A, at 8; GPM, NPR Rebuttal 40, at 9.

[781] Baer, NPR 11, at 15-16. In the alternative, Mr. Baer suggested that the threshold should be set at 1% of the amount of average retail sales achieved by outlets using the franchise system in the United States in the most recent year for which data is available. Mr. Baer asserted that if ''a system has average retail sales of $1 million, $10,000 is not a number which should trigger concerns. There is no need for the Commission to regulate *de minimis* investments with this type of burdensome and costly disclosure obligation.

center, or mart. According to Chevron, all of these services or products are sold as part of a unified deal when the prospective franchisee purchases the franchised gasoline outlet. Therefore, the Commission should also exempt the sale of such tangential services or goods sold along with a gasoline station under a unified agreement.[793]

In response to these comments, the Commission intends that it be clear that the PMPA exemption should be read broadly to cover other branded services and products (such as a car wash or mart) sold to the prospective franchisee under the same franchise agreement as the gasoline station. The Commission believes that, as a practical matter, it may be impossible to divide a single franchise agreement for gasoline and other services into its component parts for disclosure purposes, and such an approach is inconsistent with the PMPA. Nevertheless, separate or subsequent sales of a franchise to a gasoline station owner, such as a 7-Eleven or Subway outlet, fall outside of the exemption. An individual who operates a gasoline station is just as much in need of pre-sale disclosure for the purchase of a non-related franchise, such as an ice cream store, as any other prospective franchisee.

3. Sections 436.8(a)(5) and (a)(6): Sophisticated investor exemptions

Sections 436.8(a)(5) and (a)(6) add three new exemptions to the final amended Rule, collectively referred to as the ''sophisticated investor exemptions.'' As noted, the sophisticated investor exemptions as adopted are substantially similar to their counterparts as proposed in the Franchise NPR.[794]

Franchisors enthusiastically supported the creation of sophisticated investor exemptions.[795] They maintained that franchising today often involves heavily-negotiated, multi-million dollar deals between franchisors and highly sophisticated individuals and corporate franchisees with highly competent counsel. In the course of such deals, prospective franchisees often demand and receive material information from the franchisor that equals or exceeds the disclosures required by the Rule. These commenters asserted that such business arrangements are not the kinds of franchise sales that the Commission originally intended to cover.

On the other hand, several franchisees and their advocates opposed the exemptions, or expressed reservations about them.[796] Some feared that while prospective franchisees may appear to be sophisticated—either because of their net worth or general prior business experience—they actually may have limited knowledge of the risks inherent in operating the specific franchise being offered. In short, these commenters advised the Commission to protect the wealthy, but inexperienced.[797]

Section 436.8(a)(5)(i)—the ''large franchise investment'' exemption—exempts franchise sales where the initial investment is at least $1 million, exclusive of unimproved land and franchisor financing. Section 436.8(a)(5)(ii)—the ''large franchisee'' exemption—exempts franchise sale to ongoing entities—such as airports, hospitals, and universities—with at least $5 million net worth and five years of prior business experience. Section 436.8(a)(6)—the ''insiders'' exemption—exempts franchise sales to the owners, directors, and managers of an entity before it becomes a franchisor.[798] Each of these exemptions is discussed in the section below.

a. Section 436.8(a)(5)(i): Large investment exemption

Section 436.8(a)(5)(i) exempts from the Rule franchise sales where the prospective franchisee makes an initial investment totaling at least $1 million, excluding the cost of unimproved land.[799] To ensure that the large investment exemption is not overly broad and does not create a loophole, section 436.8(a)(5)(i) sets forth additional safeguards beyond the $1 million threshold to preserve protection for the average investor.[800] FirstTm07es to i.0.1.111 prospective fthrsignve a $1

[793] *See* Pillsbury Winthrop (on behalf of Chevron U.S.A. Inc.).

[794] Franchise NPR, 64 FR at 57345.

[795] *E.g.*, Gust Rosenfeld, at 7; J&G, at 7; Marriott, at 2-4; Starwood, at 2-3; 7-Eleven, NPR 10, at 2; NFC, NPR 12, at 17; IFA, NPR 22, at 7; AFC, NPR 30, at 2-3; Marriott, NPR 35, at 6. *See also* Kaufmann, ANPR, 18 Sept. 97 Tr., at 165; Wieczorek, *id.*, at 187-88; Tifford, *id.*, at 194 (noting that the Rule imposes unnecessary costs on sophisticated franchisees and adds unwarranted delay in the high-paced negotiation process, where parties often are anxious to cement their deals quickly to beat out the competition).

[796] *See, e.g.*, Bundy, NPR 18, at 14; Stadfeld, NPR 23, at 7-8; Karp, NPR 24, at 6-8. *But see* Caruso, ANPR 118 (''[F]ranchisees in the larger successful systems are themselves fairly sophisticated and in less need of protection by the FTC or any other government agency.'').

[797] *See* Selden, at 1; Gee, at 2; Karp, at 6-7; Pu, at 2; Zarco & Pardo, ANPR 134, at 4-5; Kezios, ANPR, 6 Nov. 97 Tr., at 47-48; Bundy, *id.*, at 48-49; Stadfeld, NPR 23, at 8; Karp, NPR 24, at 6-8; NFA, NPR 27, at 3. *See also* NADA (urging the Commission to consider exemptions on a case-by-case basis only).

[798] Two commenters noted that the inclusion of the three sophisticated investor exemptions in the final amended Rule could be misleading because a franchisor may still have obligations to make disclosures under state law. Bundy, at 3; IL AG, at 10. Howard Bundy, for example, urged the Commission to include a warning in the final amended Rule itself that exemption from the Franchise Rule does not necessarily mean exemption from state disclosure law. While this observation is true, the Commission believes the appropriate place to delineate the relationship between the final amended Rule and state law is in anticipated Compliance Guides and other business and consumer education materials.

[799] At least two states provide some form of exemption for transactions involving large initial investments. Illinois permits a franchisor to apply for an exemption from both registration and disclosure where the investment for a single franchise unit exceeds $1 million. Maryland exempts franchises that require an initial investment of $750,000 or more from registration, but not from disclosure.

[800] These safeguards were included in the proposed version of this provision. Franchise NPR, 64 FR at 57321 and 57345.

[801] *E.g.*, PMRW, NPR 4, at 3; Wendy's, NPR 5, at 2; McDonalds, NPR 7, at 2; H&H, NPR 9, at 4; Baer, NPR 11, at 16; NFC, NPR 12, at 20. Marriott, for example, stated that not only are sophisticated franchisees able to protect their own interests, but the self-interest of others involved in the project, such as bankers, is sufficient to protect those interests as well. Marriott, NPR 35, at 6. *See, e.g.*, Baer, NPR 11, at 16; Gurnick, NPR 21, at 3; J&G, NPR 32, at 3.

[802] Stadfeld, NPR 23, at 8; Karp, NPR 24, at 6.

[803] Karp, at 7; Karp, NPR 24, at 6-7. *See also* Stadfeld, NPR 23, at 7-8 (''Being wealthy should not be a basis for being screwed.'').

> income the prospective franchisee has from which one can estimate his or her financial sophistication and tolerance of risk.[804]

In lieu of the ''investment'' model offered by the Commission, Mr. Karp urged the Commission to consider SEC Regulation D,[805] which ''properly focuses on the qualifications of the investor, not the size of the investment.'' In his view, the large franchise exemption does the opposite. ''The fact that a franchisee may be ready to invest a highly leveraged $1.5 million franchise investment does not prove that such a person is so sophisticated that a disclosure document would be of no benefit.''[806]

Mr. Karp also discounted the potential benefit of the large investment exemption to franchisors. According to Mr. Karp, the exemption would be of little benefit to the franchisor unless 100% of its franchise sales involved transactions over the threshold level. If so, he insisted, there is no additional compliance burden imposed by requiring disclosures be given to all prospective franchisees because the franchisor has to prepare the disclosures in any event.[807]

After reviewing the comments, we are persuaded that a large investment exemption is warranted. Since the Rule's inception, the Commission has considered a prospective franchisee's level of investment as one measure of sophistication. For example, in granting the Automobile Importers of America's petition for exemption from the Rule under Section 18(g), the Commission observed:

> Prospective motor vehicle dealers make extraordinarily large investments. As a practical matter, investments of this size and scope involve relatively knowledgeable investors or the use of independent business advisors, and an extended period of negotiation. The record is consistent with the conclusion that the transactions negotiated by such knowledgeable investors over time and with the aid of business advisors produce the pre-sale information disclosure necessary to ensure that investment decisions are the product of an informed assessment of the potential risks and benefits of the proposed investment.[808]

Accordingly, it is clear that investment level is one indicium of sophistication.

More important, we are convinced that franchisors should have a bright-line standard that will clearly indicate when and under what circumstances the sophisticated investor exemption will apply. An exemption based upon the oprove

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[804] Karp, NPR 24, at 7. *See also* Selden, at 2 (''The idea that disclosure becomes unnecessary when the investment exceeds an arbitrary threshold, because scale is a proxy for sophistication or bargaining power, is an oxymoron.''); Gee, at 3 (''The FTC should focus on the capabilities of the investor as opposed to the size of the investment.''). Mr. Selden also asserted that franchisors are not always forthcoming with information, suggesting that had the Commission solicited the views of franchisees of large hotel systems, for example, we would have a different impression. *Id.* We note, however, that not a single hotel franchisee or large restaurant franchisee submitted any comment in response to the large investment exemption discussed in the ANPR, NPR, and Staff Report. Accordingly, we are unconvinced that Mr. Selden's concerns raise a serious issue.

[805] *See* 17 CFR 230.501(5), (6), and (8). *See also* Wendy's, NPR 5, at 2.

[806] Karp, NPR 24, at 8.

[807] Karp, NPR 24, at 6. *See also* Bundy, ANPR, 6 Nov. 97 Tr., at 21-22; Jeffers, *id.*, at 23-24; Stadfeld, NPR 23, at 8.

[808] 45 FR 51763-64 (Aug. 5, 1980).

[809] Section 18(g) of the FTC Act. 15 U.S.C. 57a(g). One commenter observed that while franchisors can file individual petitions for exemptions from the Rule under Section18(g) of the FTC Act, the process is costly and the delay involved often renders this approach an unviable option. Duvall & Mandel, ANPR 114, at 16. Section 18(g) of the FTC Act provides a mechanism for parties to petition for relief from Commission trade regulation rules where potential abuse is unlikely. Section 18(g) exemption petitions are placed on the public record for comment. The entire process of reviewing and granting such a petition may take several months to more than one year, depending on any comments received.

[810] For a detailed discussion of staff's analysis, see Staff Report, at 238.

[811] In light of the management demands on operating multiple units, it is reasonable to believe that purchasers of multiple units may be persons with significant prior business experience.

[812] We also assume that in many instances this universe of sophisticated investors will include existing franchisees with significant ''hands-on'' experience with the franchisor. In its Franchise NPR comment, NFC describes at length the changing nature of franchising in the United States. Specifically, NFC notes that:

''While franchising's roots may be traced to the grant of an individual franchise to one entrepreneur (or a small group of entrepreneurs) possessing no prior knowledge of or experience in the subject industry . . . it is nevertheless the case that over the decade many of America's oldest and largest franchisors do not follow that paradigm. Instead, they find it far more efficient and profitable for all concerned to largely restrict the grant of United States franchises to: (i) sophisticated corporations with the resources and background necessary to optimally operate subject franchises and (ii) existing franchisees whose experience, profitability, and mastery of the franchisor's system strongly suggest future success.''

NFC, NPR 12, at 17. Accordingly, at least some franchisees purchasing multiple units are existing franchisees with prior ''hands-on'' experience with the franchisor.

[813] *E.g.*, Baer, NPR 11, at 16; Gurnick, NPR 21, at 3; Marriott, NPR 35, at 6.

[814] NASAA, NPR 17, at 12. Seth Stadfeld added that it is not difficult to invest $1.5 million when there is a down payment plus financing of a substantial portion of the investment. ''Indeed, because they are taking on larger obligations, there is all the more reason and urgency why they should get the material, factual and contractual information that is otherwise available under the Rule.'' Stadfeld, NPR 23, at 8. *See also* NFA, NPR 27, at 3.

[815] ''In our considerable experience, individuals purchasing franchises involving a $1 million investment have a clear understanding of the terms and conditions of the business arrangements and have obtained professional financial and/or legal advice before entering into the franchise agreement.'' McDonald's, NPR 7, at 2. *See also* 7-Eleven, NPR [illegible], at 2. ess arranp86 Tmment, NFC describ franchises im8t0per-0.029 TD-0.002

offer basis the cost of land, which could vary widely depending on local market conditions. A single, clear threshold is vastly superior, in our view. Accordingly, for these reasons, we believe that $1 million, excluding unimproved land, strikes the appropriate balance.

Finally, we note that the Staff Report, adopting language offered by the IFA in response to the Franchise NPR, proposed to exclude ''real estate.'' In response to the Staff Report, three commenters urged the Commission to clarify the meaning of the term ''real estate'' either in the Rule or in Compliance Guides. The IFA, for example, noted that the term ''real estate'' may encompass ''raw land, buildings, leasehold improvements, fixtures, and the like.''[821] The IFA asserted that the value of the exemption would be diminished if all such items were excluded from consideration in determining whether an initial investment totals $1 million. It suggested that the term ''real estate'' be defined to exclude only the franchisee's investment in unimproved land.[822] Similarly, Starwood urged that only ''land'' should be excluded, but ''all real estate improvements and fixtures should be counted in the sum invested.''[823] Piper Rudnick offered yet a different version: ''any real property acquired to establish and operate the franchised business.''[824]

After considering the comments, the Commission has concluded that the phrase ''unimproved land'' is more appropriate than ''real estate.'' As IFA noted, the exclusion of fixtures, equipment, and other improvements to property from the $1 million threshold would leave the exemption so narrow, that it would be useless in all but the most expensive franchise offerings, defeating the very purpose of the exemption. Excluding ''real estate''—which is significantly broader than the more limited term ''unimproved land''—would also impact disproportionately real estate-intensive companies—such as hotels and restaurants. The justification for a large investment exemption is that individuals investing $1 million or more are sufficiently sophisticated that they do not need the Rule's protections. This rationale applies equally whether the prospective franchisee invests $1 million to purchase a building or the prospective franchisee buys equipment or other assets. Accordingly, excluding unimproved land from the large investment exemption's $1 million threshold strikes the appropriate balance between providing franchisors with a clear threshold, while ensuring regulatory relief for large investments.

Exclusion of franchisor financing. Section 436.8(5)(i) does not count monies that are obtained through franchisor (or affiliate) financing toward the large initial investment exemption's $1 million threshold. The exclusion of franchisor financing adds a measure of protection to the prospective franchisee because traditional lenders are very likely to require a due diligence investigation of the offering, whereas the franchisor or its affiliate likely would not.

A few commenters opposed the exclusion of franchisor-financing when calculating a prospective franchisee's initial investment. For example, Marriott asserted that it does not believe that there are inherent risks that would justify excluding financing from the franchisor. Indeed, it feared that this exclusion might have the unintended effect of harming franchisees by discouraging franchisors from offering financing to prospects in order to qualify for the exemption.[825]

After careful assessment of the comments, the Commission has concluded that financing obtained from the franchisor or an affiliate should not be counted toward the large investment exemption threshold. Otherwise, a franchisor could be tempted to increase the cost of the initial investment to qualify for the large investment exemption, while simultaneously offering to finance the deal itself, all without proper pre-sale disclosures. In that regard, the Commission agrees with Eric Karp, who observed that the assumption that a prospective franchisee will have a sufficient level of equity tends to disappear ''where a franchisee obtains financing from the franchisor or its affiliates or from a selling franchisee; in such instances, far less equity may be required.''[826]

Further, it is reasonable to assume that a lender, in order to minimize its own financial risk, will ensure that a prospective franchisee will conduct a due diligence investigation of the franchise offering. Indeed, by involving a lender, the prospective franchisee effectively ensures that there is an independent, sophisticated entity inserted into the sales process. This additional safeguard would be lost if sources of financing for purposes of the exemption included the franchisor and its affiliates.

iii. Acknowledgment

To take advantage of the large investment exemption, section 436.8(5)(i) requires the franchisor to obtain the prospective franchisee's signed acknowledgment that the investment satisfies the $1 million threshold. This will reduce the opportunity for fraud by enabling the prospect to verify that the investment meets or exceeds the exemption threshold. Therefore, it will reduce the probability that the franchisor will misrepresent the initial cost of the franchise to qualify for the exemption, as well as provide a paper trail in the event an enforcement action becomes necessary.

Several commenters failed to understand the purpose of the acknowledgment or believed that it would serve no useful purpose. For example, BI stated: ''We do not understand the purpose or the importance of the acknowledgment by the prospective franchisee of the application of the exemption. The acknowledgment does not protect the prospective franchisee, except, perhaps to put the prospect on notice that it may be entitled to receive a disclosure document.''[827]

Seth Stadfeld asserted that the acknowledgment requirement could be abused. ''[F]ranchisors could further a fraud by playing up to and flattering the prospective franchisee into thinking that he is so sophisticated that he doesn't need the disclosures that the little people need.''[828] On the other hand, Howard Bundy advised that the acknowledgment should be expanded. He would revise the Rule to read: ''The franchisee's estimated investment, excluding any affiliate financing, totals at least $1.5 million and the prospective franchisee signs an acknowledgment stating the basis for the exemption from the Rule and providing the CFR citation to the Rule and verifying the grounds for the exemption . . .''[829]

The Commission is convinced that the acknowledgment requirement serves a useful purpose. As previously noted, the acknowledgment will ensure that a

[821] IFA, at 3.

[822] IFA, NPR 22, at 7.

[823] Starwood, at 2. *See also* Marriott, at 2 (an ''investment'' should include buildings).

[824] Piper Rudnick, at 6-7.

[825] Marriott, NPR 35, at 6. *See also* J&G, NPR 32, at 4. At the same time, Eric Karp disputed the view expressed in the Franchise NPR that lenders may act as an effective check, requiring a prospect to have sufficient equity capital before granting a loan. He contended that there is ''no support in the record as to what amount of equity a bank might require on a franchise investment of $1.5 Million.'' Karp, NPR 24, at 7.

[826] Karp, NPR 24, at 7.

[827] BI, NPR 28, at 13.

[828] Stadfeld, NPR 23, at 8.

[829] Bundy, NPR 18, at 14.

[838] NFC, NPR 12, at 21.

[839] No state has a comparable disclosure exemption. Several states—including California, Indiana, Maryland, New York, North Dakota, Rhode Island, South Dakota, and Washington—have an exemption from registration for ''experienced franchisors.'' To qualify for the exemption, a franchisor must typically have a net worth of at least $5 million and have had 25 franchise locations in operation during the previous five years.

[840] Franchise NPR, 64 FR at 57321. *See* Kaufmann, ANPR, 18 Sept. 97 Tr., at 190. *But see* Kezios, 18 Sept. 97 Tr., at 191-92 (opposing exemption for large institutions, suggesting that they need franchise advice and counsel as well).

[841] For example, in 1997, FTC staff was asked for an advisory opinion on whether a travel services company would be covered by the Rule if it sold outlets to hospitals. The staff advised that the hospital could not qualify as a fractional franchisee because it did not have the requisite two years of experience in providing travel-related services. Advisory 97-7, Bus. Franchise Guide (CCH) ¶ 6487 (1997). Hospitals and other large institutions such as airports and universities, however, are hardly unsophisticated prospective franchisees.

[842] Gust Rosenfeld, at 7; J&G, at 7; Marriott, at 2; Piper Rudnick, at 6-7; Starwood, at 3.

[843] Selden, at 1 (large franchisee exemption thresholds are too low); Gee, at 2; Pu, at 2 (Commission should focus on capabilities of franchisee, not size of investment). Two franchisee associations—the AAFD and the AFA—did not comment on this issue.

[844] *E.g.*, IL AG, NPR 3, at 2; PMR&W, NPR 4, at 3; Wendy's, NPR 5, at 3; Triarc, NPR 6, at 1; H&H, NPR 9, at 5; Baer, NPR 11, at 16; NFC, NPR 12, at 22; BI, NPR 28, at 14; Tricon, NPR 34, at 7; Marriott, NPR 35, at 7.

[845] Nothing prevents an ''entity'' under this provision from being an individual, but most individuals who have been in business for at least five years and have generated an individual net worth of at least $5 million are likely to have created a corporation or other formal organization through which to conduct business.

[846] Net worth of an entity can readily be determined from the entity's balance sheet or other financial information, typically submitted as part the application process.

[847] At the same time, several franchisee representatives criticized the large franchisee exemption as inappropriate. For example, Andrew Selden asserted that the large franchisee exemption will ''sweep in thousands of small business entrepreneurs who own three or four units or independent businesses, or perhaps unrelated family wealth. Personal net worth has no correlation whatsoever with the need for information to make an informed business investment decision in respect to an unfamiliar franchise.'' Selden, at 1. As noted above, however, the sophisticated investor exemptions are premised not on the notion that sophisticated investors do not need pre-sale disclosure, but that they are able to obtain such information, or greater information, without federal government intervention. This is particularly true of large franchisees, such as

small enough net worth to not be indicative of the level of sophistication that would indicate no need for mandatory disclosures.''[850] The Commission believes that the $5 million net worth requirement strikes the right balance, granting relief to sophisticated entities, while protecting those entities for whom the purchase of a franchise would be a significant financial risk.

iv. Prior experience

In addition to requiring $5 million net worth, section 436.8(a)(5)(ii) requires large franchisees to have five years of prior business experience in any line of business, as proposed in the Franchise NPR. A few commenters opined that the prior experience prerequisite is unnecessary, and urged the Commission to focus only on the large franchisee's net worth. The NFC, for example, asserted that: ''Even if a large corporation does not have prior experience in franchising specifically, it is reasonable to assume that it can protect its own interests when negotiating for the purchase of a franchise.''[851]

On the other hand, Triarc urged the Commission to focus on prior experience in lieu of net worth. It noted that it is possible that a franchisee with 10 years of experience and 50 units may wish to finance its operation with debt rather than equity. Under the circumstances, this presumably sophisticated franchisee would fail the net worth test:

> What if a large corporate franchisee with $20.0 million of net worth declares a $16.0 million dividend to its shareholders or otherwise does a recapitalization which takes its net worth below the threshold? Over the years, some gigantic companies that are financially healthy have had huge negative net worths and negative earnings. . . . We would suggest that net worth is often an indicator of how a company chooses to finance itself rather than of sophistication.[852]

After considering these arguments, the Commission concludes that both the $5 million net worth and five years experience prerequisites are necessary to ensure that the Rule continues to protect businesses with limited experience, limited assets, and, by inference, limited prior success. For example, a small sandwich shop franchisee is not necessarily sophisticated enough to purchase a hotel merely because the franchisee has operated one or more sandwich shops for five years. Similarly, several wealthy individuals who form a partnership without any prior *business experience* are not necessarily sophisticated merely because of their net worth. Both prerequisites are necessary to ensure that the large franchisee exemption does not create a loophole, putting small and unsophisticated entities at an unacceptable financial risk.

v. Affiliates and parents

Finally, section 436.8(a)(5)(ii) refines the proposed exemption published in the Franchise NPR, which used the term ''corporation'' and made no mention of parents or affiliates. As revised, a franchisor may consider the prior experience and net worth of the franchisee's affiliates and parents when determining whether the franchisee qualifies as a ''large franchisee.''

A few commenters noted that the prior experience and net worth prerequisites would essentially disqualify new corporations. They asserted that there are legitimate tax and liability reasons why an experienced franchisee may wish to establish a separate corporation for a particular franchise transaction. For example, according to Marriott, it is not unusual in the lodging and restaurant industries to form ''special purpose entities (SPEs) . . . to insulate either a parent company or the individual investors from liability.''[853] If so, then such a new corporation would not meet the exemption's net worth and prior experience prerequisites.[854] These commenters urged the Commission to permit the franchisor to consider the consolidated net worth and experience of franchisee affiliates and parents.[855] The Commission is persuaded that the net worth and prior experience prerequisites may not make sense when applied to franchisee spin-off subsidiaries or affiliates that are formed primarily for tax or limited-liability purposes. Accordingly, section 436.8(5)(ii) makes clear that a franchisor may aggregate commonly-owned franchisee assets in determining the availability of the large entity exemption:[856]

> The franchisee (or its parent and any affiliates) is an entity that has been in business for at least five years and has a net worth of at least $5 million.[857]

c. Section 436.8(a)(6): Officers, owners, and managers exemption

Section 436.8(a)(6) of the final amended Rule adds a new exemption for officers, owners,[858] and managers of a business before it becomes a franchisor.[859] In such circumstances, it reasonably can be assumed that the prospective franchisee already is familiar with every aspect of the business system and the associated risks. Thus, disclosure would serve little purpose. Indeed, in some instances, a company may wish to offer units only to its owners, officers, and managers. If not exempt from the Rule, these companies would have to go through the burden and expense of creating a disclosure document for isolated sales to company insiders. To ensure that individuals qualifying for the exemption have recent and sufficient experience with the business, however, section 436.8(a)(6) is limited to individuals who have been associated with the company within 60 days of the sale and who have been involved for at least two years with the company.

Section 436.(8)(a)(6) refines the proposed Rule's ''insiders'' exemption which would have limited the exemption to owners and officers. During the Rule amendment proceeding, several commenters urged the Commission to broaden the exemption to include ''trustees, general partners and any individual who has or had management responsibility for the offer

[850] Bundy, NPR 18, at 14.

[851] NFC, NPR 12, at 21-22. Similarly, J&G maintained that any ''entity or group of entities with a $5 million or more net worth should, by definition, be deemed to have the requisite sophistication to satisfy the exclusion or exemption.'' J&G, NPR 32, at 4.

[852] Triarc, NPR 6, at 2.

[853] Marriott, NPR 35, at 7.

[854] *See also, e.g.*, NFC, NPR 12, at 22; J&G, NPR 32, at 4; H&H, NPR 9, at 5. Triarc, for example, noted that one Arby's franchisee owns 700 units and is one of the largest privately owned restaurant operators in the world. It asked ''why should we have to give disclosure to that franchisee merely because he sets up a new corporate entity to own his next Arby's store?'' Triarc, NPR 6, at 1-2.

[855] Starwood, at 3; NFC, NPR 12, at 22; J&G, NPR 32, at 4; H&H, NPR 9, at 5.

[856] In the same vein, the definition of ''affiliate'' covers both franchisee and franchisor affiliates, as noted in our discussion of the definitions, above.

[857] This modifies slightly an earlier version of the large franchisee exemption which would have required the purchaser *and* its parent or affiliates to satisfy the net worth and prior experience prerequisites. *See* Marriott, at 3-4; J&G, at 7.

[858] CA Bar would limit this exemption to those with an equity ownership in the company. In its view, those with a non-equity interest, such as a lender, typically do not participate in the business, in contrast to an equity owner, and therefore should be excluded from the exemption. CA Bar, at 8. While CA Bar's observation is correct, the Rule need not be revised to address this issue. A lender or other non-equity interest owner will be excluded from the exemption because he or she will not satisfy the exemption's prior experience prerequisite.

[859] The ''insider'' exemption is modeled after nearly identical language in California's statute. Washington and Rhode Island have similar exemptions. *See* Duvall & Mandel, ANPR 114, at 21 (suggesting a narrower approach).

litigation over Rule coverage issues.[875] Third, retaining an express exclusion in the Rule itself is needed to ensure that the Commission does not change its view and seek to enforce the Rule against cooperatives in the future.[876] Fourth, the value of retaining the exclusion outweighs any benefit from streamlining the Rule.[877]

The Commission appreciates the concern raised by these commenters. Nonetheless, we see no compelling reason to keep the exclusions in the Rule itself. As a preliminary matter, removing the exclusions from the Rule should not be equated with expanding the scope of part 436 to cover entities currently dealt with in these exclusions: the Commission continues to hold that these business relationships do not meet the criteria for such coverage. They simply do not satisfy the definitional elements of the term ''franchise.'' Removal of the exclusions from the Rule is part of the Commission's effort to streamline the Rule.

Nevertheless, the Commission included the exclusions in the original Rule to clarify the limits of the term ''franchise,'' and for that reason the concepts embodied in the exclusions continue to serve a valuable consumer education function.[878] However, as with other sections of this document, we are disinclined to include general consumer education materials in the text of the final amended Rule itself, absent compelling evidence that such messages are warranted to address specific problems identified in the record. While the commenters asserted that confusion exists over the definition of the term ''franchise,'' not a single individual cooperative member voiced any confusion over the scope of the ''franchise'' definition, nor any concern about the distinction between franchises and cooperatives, during the entire Rule amendment proceeding. Under the circumstances, the proper forum to discuss limits to the definition of the term ''franchise'' is in this document and in future Compliance Guides. To that end, the Commission reaffirms the four exclusions and specifically adopts the discussion of the exclusions set forth in the original SBP at 43 FR 59708-10.

G. Section 436.9: Additional Prohibitions

The final amended Rule prohibits nine acts or practices that violate Section 5 of the FTC Act. The original Rule contained four of them, namely, prohibitions against: (1) making statements that contradict the franchisor's disclosures;[879] (2) making financial performance representations without a reasonable basis and without written substantiation for the representation at the time the representation is made;[880] (3) failing to make available written substantiation for any financial performance representations;[881] and (4) failing to make promised refunds.[882]

Second, the final amended Rule adds two new prohibitions concerning the furnishing of disclosures. Specifically, section 436.9(e) prohibits franchise sellers from failing to furnish a copy of the basic disclosure documents to prospective franchisees early in the sales process, upon reasonable request. Section 436.9(f) prohibits franchise sellers from failing to furnish a prospect in the sales process who has already received the basic disclosure document with a copy of any updated disclosure document or quarterly update to an existing disclosure document, upon reasonable request, before the prospective franchisee signs a franchise agreement.[883]

Third, the final amended Rule adds two anti-fraud prohibitions designed to preserve the integrity of the disclosure document and franchise agreement. Section 436.9(g) prohibits franchise sellers from materially altering the terms and conditions of any franchise agreement presented to a prospective franchisee for signing, unless the seller informs the prospective franchisee of the changes seven days before execution of the agreement. Section 436.9(h) prohibits franchise sellers from disclaiming or requiring a franchisee to waive reliance on any representation made in a disclosure document or its exhibits or attachments.

Finally, section 436.9, based upon our law enforcement history and the obviously deceptive nature of the practice, adds a new anti-shill prohibition designed to prevent the use of paid testimonials or shill references. Specifically, section 436.9(b) prohibits franchise sellers from misrepresenting that any person has purchased a similar franchise or operated a similar franchise

[875] *E.g.*, NCBA, at 4; NCFC, at 2.

[876] *E.g.*, AMF; CHS; NCBA, at 5.

[877] *E.g.*, Spandorf, at 12; CHS; Reizman Burger, at 3-4.

[878] We also note that there are many other business relationships that share some similarities with franchises, such as distributorships, multilevel marketing programs, and some work-at-home schemes. Yet, these arrangements were not expressly excluded from the Rule. Rather, the definition of the term ''franchise'' is sufficient to set out the parameters of the Rule's scope. To the extent that these relationships may be confused with franchises, the Commission has provided needed clarification in the Final Interpretative Guides. The same approach is warranted for cooperatives. Nonetheless, based upon the comments, the Commission specifically reaffirms the four exemptions in this Statement and anticipates that future Compliance Guides will do the same. As in other areas of Rule interpretation, the staff of the Commission can also address future questions concerning the definition of the term ''franchise'' on a case-by-case basis through informal advisory opinions.

[879] *See* 16 CFR 436.1(f). ''Without this provision, the Commission believes that the disclosures required by the rule could be contradicted in oral sales presentations and rendered of little value without violating the rule.'' Original SBP, 43 FR at 59695.

[880] *See* 16 CFR 436.1(b)(2) and (c)(2); UFOC Item 19. Original SBP, 43 FR at 59684-690 (The earnings representation standards are ''intended to prevent or minimize potential misrepresentations or distortions in the representations made by franchisors, while at the same time permitting franchisors to use informative representations as part of their marketing scheme.'').

[881] *See* 16 CFR 436.1(b)(2) and (c)(2); UFOC Item 19. In the original SBP, the Commission rejected the idea that franchisors should always provide a copy of their substantiation of financial performance claims to the prospective franchisee. At the same time, it found that ''the benefit to be derived from permitting those prospective franchisees who so wish to review the franchisor's substantiation far outweighs speculative harms that could arise from such disclosure.'' Original SBP, 43 FR at 59691.

[882] *See* 16 CFR 436.1(h). In the original SBP, the Commission observed that numerous consumers complained about the difficulty they experienced when they attempted to obtain refunds from their franchisors. ''It is clear from the record that all franchisors do not adequately adhere to the refund policies they themselves agree to in their contracts.'' Original SBP, 43 FR at 59696-97. *See also* Staff Review, at 29 (some franchisees continue to experience problems with obtaining refunds).

[883] We decline to adopt a third prohibition recommended in the Staff Report that would have prohibited franchisors from failing to furnish a prospective transferee of an existing franchised outlet with a copy of an existing disclosure document of the franchisor, upon request. As recommended in the Staff Report, this prohibition would not have required a franchisor to prepare a current disclosure document solely for the benefit of a transferee. Rather, a franchisor would have been permitted to give a prospective franchisee a copy of its most recent disclosure document. For example, a franchisor who stopped selling franchises and no longer possessed a current disclosure document could have complied with this prohibition by giving a prospective transferee a copy of its most recent disclosure document, even if that document were at the time out-of-date. *See* Staff Report, at 264. In response to the Staff Report, five commenters opined that this proposed prohibition would have resulted in franchisors being forced to disclose information that could have been misleading to the prospective transferee, subjecting the franchisor to potential liability. CA Bar, at 10; Kaufmann, at 6; Seid, at 7; Spandorf, at 10-11; Wiggin and Dana, at 5. We agree. An ''existing'' disclosure document would have no relevance to a transfer unless the document were current. Moreover, a current disclosure document may not accurately portray the business arrangement entailed in the transfer, because it would explain the terms and conditions of the franchisor's *current* franchise agreement, while a transferee assumes the terms and conditions of an *ongoing* franchise agreement. Moreover, to the extent that a potential transferee wishes to see a copy of the franchisor's disclosure document, he or she can obtain a copy from a commercial service, from a franchise registration state, and more frequently online (such as through California's Cal-Easi website). *But see* Bundy, at 10.

[884] *E.g.*, *FTC v. Netfran Dev. Corp.*, No. 05-CV-22223 (S.D. Fla. 2005); *FTC v. Morrone's Water Ice, Inc.*, No. 02-3720 (E.D. Pa. 2002).

[885] For example, Peter Lagarias stated: ''In my experience, the providing of earnings claims in contravention of . . . [Item 19] often occurs both orally and in writing. The most common written method of earnings claims is by newspaper or magazine articles about the franchise system which contain the earnings claims. These news articles are reproduced and provided to prospective franchisees in contravention of the Rule.'' Lagarias, RR 13, at 2. *See also* Brown, ANPR 4, at 4 (''There have therefore been endless variations of supposedly 'indirect' franchisor representations of profitability, [ranging] from the proverbial notation on a napkin or envelope, to prearranged referrals to 'typical'' franchisees, to use of 'company store' figures with plain implications of comparability, and to the required preparation of a 'business plan' by the prospective franchisee and its 'review' and 'oral adjustment' by franchisor or personnel.''); Bundy, ANPR 119, at 1 (''I have never met a franchisee who had been in operation more than a few weeks who did not receive earnings claims before investing in a franchise. It simply does not happen. They either have received them from the franchisor or its agent directly (often in writing or on floppy disk) or from third parties to whom they have been directed.''); IL AG, RR 25, at 2 (''The most common situation and opportunity for abuse is the franchisor sales representative who makes oral representations as to earnings potential when talking with prospects.''); WA Securities, RR 37, at 3 (''Our fraud investigations reveal that a substantial number of franchisors or their sales representatives are making written or oral earnings claims to prospective franchisees even when the disclosure document states that no earnings claims are made.''); AAFD, RR 39, at 6 (''Probably less than 2% of franchisors make formal earnings disclosures, [while] the vast majority of franchisees claim they have received oral (and often informal written) earnings claims and projections.'').

[886] Of course, franchisors are always free to disseminate additional truthful information to a prospective franchisee. *See* 16 CFR 436.1(a)(21) (franchisors are not precluded from giving other nondeceptive information orally, visually, or in separate literature so long as such information is not contradictory to the information in the disclosure document).

[887] The anti-shill prohibition is also broad enough to cover the use of ''institutional shills,'' companies that purport to act like a Better Business Bureau that provide consumers with ''independent'' reports on its members. *See FTC v. United States Bus. Bureau*, Bus. Franchise Guide (CCH) ¶ 10865 (S.D. Fla. 1995).

[888] Scam franchisors frequently use shill references in order to bolster their financial performance and success claims. *E.g.*, *FTC v. Car Checkers of Am., Inc.*, No. 93-623 (mlp) (D.N.J. 1993); *FTC v. Am. Legal Distrib., Inc.*, No. 1:88-CV-519-MHS (N.D. Ga. 1988). Harm resulting from the use of shills is also demonstrated by numerous Commission business opportunity law enforcement actions. *E.g.*, *FTC v. Am. Entertainment Distrib., Inc.*, No. 04-22431 CIV-Huck (S.D. Fla. 2004); *FTC v. Hart Mktg. Enter.*, No. 98-222-CIV-T-23 E (M.D. Fla. 1998); *FTC v. Unitel Sys., Inc.*, No. 3-
97CV1enfti,3ai8-MHS:5k 0 Tw4 Tf0.5532 0 Tm 0 TD-0sTw(, No-23(6j/F Enter.001j7 0 0 7 240NCL56 0 TDse Bette6 0 8 Tn

prospective franchisees acting reasonably under the circumstances.[892] Indeed, our law enforcement experience demonstrates that prospects rely on financial performance claims in making their investment decision.[893] Thus, this prohibition is necessary to prevent deception.

Section 436.9(c) of the amended Final Rule revises the original Rule, however, by permitting the franchisor to make financial representations in Item 19 of the disclosure document. This achieves greater uniformity with the UFOC Guidelines, by eliminating the original Rule's requirement that a franchisor making financial performance claims furnish prospects with a separate earnings disclosure document.

4. Section 436.9(d): Availability of financial performance substantiation

Section 436.9(d) of the final amended Rule also retains the original Rule's prohibition against failing to make available to prospective franchisees and to the Commission, upon reasonable request, written substantiation for any financial performance representation made in Item 19.[894] This prohibition is tied to the previous prohibition against the making of unreasonable and unsubstantiated financial performance representations. The prohibition against failing to make available written substantiation ensures that prospective franchisees and the Commission can review and verify the data underlying any performance representation, while relieving franchisors of the burden of having to present what could be voluminous data in the disclosure document itself. Knowing that their financial performance claims are subject to Commission review—coupled with the Commission's authority to bring Rule enforcement actions for false or unsubstantiated claims—helps discourage the making of unsubstantiated claims, thus ultimately preventing fraud.

[892] *E.g.*, original SBP, 43 FR at 59684-85 (''The use of deceptive and inaccurate profit and loss statements by franchisors has resulted in a legion of 'horror stories.''). *See also* Staff Review, at 25 (earnings claims most frequently reported franchise problem).

[893] *E.g.*, *FTC v. Netfran Dev. Corp.*, No. 05-CV-22223 (S.D. Fla. 2005); *United States v. Robert Lasseter*, No. 3:03-1177 (M.D. Tenn. 2003); *FTC v. Morrone's Water Ice, Inc.*, No. 02-3720 (E.D. Pa. 2002); *FTC v. Car Wash Guys Int*'l., Inc., No. 00-8197 ABC (RNBx) (C.D. Cal.); *FTC v. Tower Cleaning Sys., Inc.*, No. 96 58 44 (E.D. Pa. 1996); *United States v. Tutor Time Child Care Sys., Inc.*, No. 96-2603 (N.D. Cal. 1996); *FTC v. Mortgage Serv. Assocs., Inc.*, No. 395-CV-1362 (AVC) (D. Conn. 1995); *FTC v. Sage Seminars, Inc.*, C-95-2854-SBA (N.D. Cal. 1995).

[894] 16 CFR 436.1(b)(2); 436.1(c)(2).

5. Section 436.9(e): Earlier disclosure upon request

Section 436.9(e) of the final amended Rule prohibits a franchise seller from failing to furnish a copy of the franchisor's disclosure document to a prospective franchisee earlier than required, upon request.[895] Accordingly, any prospective franchisee in the sales process can obtain a copy of the franchisor's disclosure document before the standard 14-day time for making disclosures set out in section 436.2 (14 calendar-days before the signing of a franchise agreement or payment of any fee in connection with the franchise sale). Because prospects may incur a variety of costs in determining whether to consider a particular franchise offering, a franchisor's withholding of its disclosure document can result in economic injury. For example, as discussed above in connection with the timing of making disclosures, early disclosure may prevent injury by enabling prospects to review the franchisor's disclosure document before agreeing to pay money to advance the sale, such as incurring travel expenses to visit company headquarters.

Further, the Commission is convinced that this prohibition is also necessary in light of our decision to eliminate the original Rule's mandatory face-to-face disclosure trigger. As discussed in connection with section 436.2 above, the Commission is persuaded that the face-to-face meeting trigger is unnecessary given the explosion of alternative media since the original Rule was promulgated in the 1970s. Nonetheless, the Commission recognizes that several commenters voiced concern that, absent early disclosure, a franchise seller could influence a prospective franchisee's investment decision well before the prospect could verify the franchisor's claims through the disclosure document, or before the prospect expends funds reviewing the offering.[896] To address these concerns, we are persuaded that it is proper to require franchise sellers to furnish disclosures earlier than the standard 14 calendar-days disclosure trigger, upon the franchisee's reasonable request.[897] The Commission believes this prohibition strikes the right balance between relieving franchisors of the burden to furnish disclosures at the first face-to-face meeting in all instances, and the prospective franchisee's desire to review disclosures early in the sales process before investing significant time, effort, and money in considering the franchise offering.[898]

[895] The prohibition on failing to give out disclosures earlier in the sales process pertains to ''prospective franchisees'' only. A franchisor has no obligation to furnish disclosures to competitors, the media, academicians, or researchers. It applies to prospective franchisees already in the sales process. Accordingly, a franchisor need not furnish a copy of its disclosures to individuals seeking general information on the franchisor or who do not qualify to purchase a franchise. We would expect a franchisor to furnish disclosures, upon request, to any prospective franchisees who have submitted a franchise application and who have been notified that they qualify to purchase a franchise. *See* IFA, at 3. *See also* Winslow, at 91.

[896] Turner, NPR 13, at 1; Karp, NPR 24, at 5-6; Bundy, NPR 18, at 5-6. *See also* original SBP, 43 FR at 59639 (''[O]nce a prospect has been 'hooked,' it is difficult, if not impossible, to 'extricate himself.''').

6. Section 436.9(f): Furnishing updated disclosures

Section 436.9(f) prohibits a franchisor from failing to furnish a prospective franchisee who has received a basic disclosure document with updated disclosures, upon the prospect's reasonable request. Specifically, it prohibits the franchisor from failing to furnish ''the franchisor's most recent disclosure document and any quarterly updates to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.''

[897] IFA urged the Commission to define the term ''reasonable request.'' IFA, at 3. We note that the similar term ''reasonable demand'' has long been part of the original Rule in connection with the provision of written substantiation for financial performance representations. 16 CFR 436.1(b)(2) and 1(c)(2) (''such material is made available to any prospective franchisee and to the Commission or its staff upon reasonable demand.''). Similarly, the UFOC Guidelines provide that a franchisor making financial performance claims must include a statement in its Item 19 disclosure that ''substantiation of the data used in preparing the earnings claim will be made available to the prospective franchisee on reasonable request.'' UFOC, Item 19d. There is no indication in the record that the use of the terms ''reasonable request'' or ''reasonable demand'' has been confusing or otherwise unclear. We believe determinations about ''reasonableness'' can be made only on a case-by-case basis. At a minimum, we will consider whether a request is ''reasonable'' based upon the timing and manner in which the request has been made. For example, it may be unreasonable for a prospective franchisee to request a copy of the disclosure document on the morning of the day a franchisor's representative flies to the prospect's city for a meeting. Similarly, it may not be reasonable for a prospective franchisee to make the request by leaving a message with the doorman at the franchisor's headquarters, or at the hotel where a franchisor's representative is staying.

[898] It is noteworthy that state franchise laws, at the very least, require franchisors to file current disclosure documents before franchisors may offer franchises for sale. Franchisors typically have disclosure documents available at the time they make franchise offerings. Accordingly, this new prohibition imposes no requirement that did not already exist under the original Rule's first face-to-face meeting disclosure requirement and under state franchise filing laws. *But see* Duvall, at 2 (this prohibition negates any benefit gained from eliminating the ''first personal meeting requirement'').

specifically disclaims such misrepresentations); *Nobles v. Citizens Mortgage Corp.*, 479 So.2d 822 (Fla. Dist. Ct. App. 1985) (under Florida law, a merger or integration clause will not bar evidence of fraud in the inducement).

[918] For example, in *Alphagraphics Franchising, Inc., v. Whaler Graphics, Inc.*, 840 F. Supp. 708 (D. Ariz. 1993), the court held that there was fraud in the inducement regarding an arbitration forum selection clause, despite the presence of an integration clause in the franchise contract. ''It is well-settled that a party cannot free himself from fraud by incorporating [an integration clause] in a contract.'' *Id.*, at 711 (citations omitted).

[919] *See* J&G, NPR 32, at 5.

[920] Section 436.6(b).

[921] Haff, at 3; Singler, at 3. Mr. Haff, for example, asserted that it is unconscionable for the FTC to permit a franchisor to disclaim its own materials through a franchise agreement integration clause. Haff, at 3.

[922] For example, a franchisor would be liable for a Rule violation if its promotional literature made financial performance claims, while its Item 19 said that no such claims are authorized, or its promotional literature stated that exclusive territories are available, while its disclosure document offered no such benefit.

[923] Two franchisor representatives specifically urged the Commission to clarify the Rule to ensure that the parties are free to negotiate contract terms. *See* Baer, ANPR 25, at 4-5; Duvall & Mandel, ANPR 114, at 22. They feared that if the franchisor negotiates with a prospective franchisee for different terms than what appears in the disclosure document, (*e.g.*, a different initial franchise fee or royalty payment), the franchisor will effectively violate the Rule because the franchisor will not have furnished the prospective franchisee with a disclosure document spelling out the specific agreed-upon terms and conditions in advance of the 920

[926] *See FTC v. Hillary's Servs., Inc.*, No. 94-CV-2312 (E.D. Pa. 1994); *FTC v. Richard L. Levinger*, No. 94-0925-PHXRCB (D. Ariz. 1994); *FTC v. McKleans, Inc.*, Bus. Franchise Guide (CCH) ¶ 9853 (D. Conn. 1989) (franchisors violated the Franchise Rule by, among other things, failing to provide promised refunds). *See also FTC v. William A. Skaife*, Bus. Franchise Guide (CCH) [1989-1990 Transfer Binder] ¶ 9555 (C.D. Cal. 1990); *FTC v. Nat'l Bus. Consultants, Inc.*, Bus. Franchise Guide (CCH) ¶ 9385 (E.D. La. 1989); *FTC v. Am. Legal Distrib., Inc.*, No. 1:88-CV-519-MHS (N.D. Ga. 1988); *United States v. Tuff-Tire Am., Inc.*, Bus. Franchise Guide (CCH) [1985-1986 Transfer Binder] ¶ 8353 (M.D. Fla. 1985); *United States v. Fed. Energy Sys., Inc.*, Bus. Franchise Guide (CCH) [1983-85 Transfer Binder] ¶ 8180 (C.D. Cal. 1984) (franchisors misrepresented refund policy in violation of Section 5); *FTC v. Nat'l Audit Defense Network, Inc.*, No. CV-S-02-0131 LRH-PAL (D. Nev. 2002); *FTC v. Travel Bahamas Tours, Inc.*, No. 97-6181-CIV-Ferguson (S.D. Fla. 1997) (companies misrepresented refund policy in violation of Section 5 of the FTC Act). *Cf. Philips Elecs. N. Am. Corp.*, FTC No. 022-3095 (2002); *Tim R. Wofford*, FTC No. 012 3191 (2002) (the failure to honor rebate offers as promised violates Section 5 of the FTC Act).

[927] *See* original SBP, 43 FR at 59696 (''Numerous consumers complained about the difficulty they experienced when they attempted to obtain refunds from their franchisors.'').

[928] One commenter, Dady & Garner, suggested that franchisees should always receive a refund (excluding actual costs) if they never actually open or operate an outlet. Dady & Garner, ANPR 127, at 4. We believe the substantive terms and conditions of refunds are a matter of contract between the parties [illegible]

Among other things, the Executive Order provides that federal agencies should carefully assess the necessity of limiting the policymaking discretion of the states and such actions should be taken ''only where there is constitutional and statutory authority

Commission, it nonetheless sets forth principles that the Commission might consider in determining the preemptive effect of its regulations.

[951] Franchise NPR, 64 FR at 57324.

[952] *See* 16 CFR 436.3.

[953] *E.g.*, Pay-Per-Call Rule, 16 CFR 308.8; Used Car Rule, 16 CFR 455.7

[954] *See* Interpretive Guides, at 49968. *See generally* Business Opportunity NPR, 71 FR at 19054-57.

[955] 15 U.S.C. 57b.

amendment will have an annual effect on the national economy of $100,000,000 or more; (2) estimates that the amendment will cause a substantial change in the cost or price of certain categories of goods or services; or (3) otherwise determines that the amendment will have a significant effect upon covered entities or upon consumers.

In general, the commenters supported the proposed franchise amendments because they reduce inconsistencies with state franchise disclosure laws, reduce compliance burdens on franchisors that are not likely to engage in abusive practices that the Rule was intended to prevent, and update the original Rule to address new technologies. Only one commenter addressed the economic impact of part 436, voicing concern generally that the original and amended Franchise Rule impose unnecessary costs.[956] No commenter, however, indicated that the amendments would have an annual impact of more than $100,000,000, cause substantial change in the cost of goods or services, or otherwise have a significant effect upon covered entities or consumers.[957]

At the same time, some commenters questioned whether particular rule amendments pertaining to franchising might be unnecessary, or offered alternatives. Section III of this document analyzes these comments in detail. After careful consideration of the comments, and the record as a whole, the Commission has determined that there are no facts in the record, or other reasons to believe, that the part 436 amendments will have significant effects on the national economy, on the cost of goods or services, or on covered parties or consumers. In any event, to the extent, if any, these final rule amendments will have such effects, the Commission has previously explained above the need for, and the objectives of, the final amendments; the regulatory alternatives that the Commission has considered; the projected benefits and adverse economic or other effects, if any, of the amendments; the reasons that the final amendments will attain their intended objectives in a manner consistent with applicable law; the reasons for the particular amendments that the agency has adopted; and the significant issues raised by public comments, including the Commission's assessment of and response to those comments on those issuesD(adverse economic or](Tule atory)TjFlexionlsellA commenr/ir inte
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[956] *See generally* Winslow. However, this commenter did not quantify the additional cost burdens arising as a result of the Rule *amendments*—as opposed to those imposed by the original Rule or by state law—nor provide any data or statistics supporting his view, that would permit us to assess the economic impact of the Rule amendments.

[957] As previously noted, part 437 of the final amended rule (the business opportunity section) is substantively identical to the business opportunity coverage of the original Rule. Part 437 imposes no additional disclosures, recordkeeping requirements, or prohibitions on business opportunity sellers. Accordingly, the part 437 amendments impose no economic costs or compliance burdens on business opportunities covered by the original Franchise Rule.

[958] 5 U.S.C. 601- 612.

[959] 5 U.S.C. 605.

[960] The SBA size thresholds set forth what constitutes a small entity in a particular line of business, regardless of whether the entity is a franchisor, licensee, contractor, parent corporation, affiliate, agent, or other entity. For the same reason, it is difficult to estimate the number of small entities that will be subject to the business opportunity requirements set forth at part 437.

[961] *See generally* 13 CFR Part 121. According to the SBA standards, the $6 million receipts threshold applies to retailers as diverse as automotive parts and tire stores; floor coverings and window treatment stores; camera and photography stores; hardware and garden suppliers; many food stores; health care product stores; many clothing stores; sporting good stores; florists; and pet supply stores. The $6 million threshold also is applicable to hotels; restaurants; automotive repair centers; car washes; and laundry services. While the $6 million threshold is typical of a wide cross-section of small businesses, some of which may be franchises, it sheds no light on the number of franchisors that are small businesses.

[962] Industry data are also difficult to come by. In the 1990's, the International Franchise Association produced a series of reports called *The Profile of Franchising* that sought to quantify and describe franchise systems in the United States. While these

[969] One Staff Report commenter voiced concern

assertion that the demand for disclosure documents will increase as a result of the amended Rule. Finally, many franchisors establish and maintain websites for ordinary business purposes, including advertising their goods or services and to facilitate communication with the public. Accordingly, any costs franchisors would incur specifically as a result of electronic disclosure under part 436 appear to be low.

As set forth in the 2005 Notices, staff estimates that the non-labor burden incurred by franchisors under part 436 will differ based on the length of the disclosure document and the number of disclosure documents produced. Staff estimates that 2,000 franchisors (80% of total franchisors covered by the Rule) will print 100 disclosure documents at $35 each. Thus, staff estimates that 80% of covered franchisors will each incur $3,500 in printing and mailing costs ($35 for printing and mailing x 100 disclosure documents). Staff estimates that the remaining 20% of franchisors (500) will send 50% of the 100 documents electronically, with a cost of $5 per electronic disclosure. Thus, staff estimates that 20% of covered franchisors will each incur $2,000 in distribution costs (($250 for electronic disclosure [$5 for electronic disclosure x 50 disclosure documents] + $1,750 for printing and mailing [$35 for printing and mailing x 50 disclosure documents])).

Thus, the cumulative annual hours burden for part 436 of the amended Rule is approximately 19,500 hours ((32 hours of annual disclosure burden x 250 new franchisors) + (4 hours of average annual disclosure burden x 2,250 established franchisors) + (1 hour of annual recordkeeping burden x 2,500 total business format franchisors)). The cumulative annual labor costs for part 436 of the amended Rule is approximately $4,282,500 (($8,000 attorney costs x 250 new franchisors) + ($1,000 attorney costs x 2,250 established franchisors) + ($13 clerical costs x 2,500 total business format franchisors)). Finally, the cumulative annual non-labor costs for part 436 of the amended Rule is approximately $8,000,000 (($3,500 printing and mailing costs x 2,000 franchisors) + (($250 electronic distribution costs + $1,750 printing and mailing costs) x 500 franchisors)).

B. Part 437

As noted throughout this document, business opportunities covered by the original Franchise Rule will remain covered, without any substantive change, under part 437 of the amended Rule. Part 437 of the amended Rule imposes no additional disclosures, recordkeeping, or prohibitions.[975]

Estimated annual hours burden for part 437: 16,750 hours.

The burden estimates for compliance with part 437 will vary depending on the business opportunity sellers' prior experience with the Franchise Rule. As set forth in the 2005 Notices, staff estimates that 250 or so new business opportunity sellers will enter the market each year, requiring approximately 30 hours each to develop a Rule-compliant disclosure document. Thus, staff estimates that the cumulative annual disclosure burden for new business opportunity sellers will be approximately 7,500 hours (250 new business opportunity sellers x 30 hours). Staff further estimates that the remaining 2250 established business opportunity sellers will require no more than approximately 3 hours each to update the disclosure document. Accordingly, staff estimates that the cumulative annual disclosure burden for established business opportunity sellers will be approximately 6,750 hours (2250 established business opportunity sellers x 3 hours).

Business opportunity sellers may need to maintain additional documentation for the sale of business opportunities in some states, which could take up to an additional hour of recordkeeping per year. Accordingly, staff estimates that business opportunity sellers will cumulatively incur approximately 2,500 hours of record keeping burden each year (2,500 business opportunity sellers x 1 hour).

Thus, the total burden for business opportunity sellers is approximately 16,750 hours ((7,500 hours of disclosure burden for new business opportunity sellers + 6,750 hours of disclosure burden for established business opportunity sellers + 2,500 of recordkeeping burden for all business opportunity sellers)).

Estimated annual labor cost burden for part 437: $3,595,000.

Labor costs are determined by applying applicable wage rates to associated burden hours. Staff presumes an attorney will prepare or update the disclosure document at $250 per hour. Accordingly, staff estimates that business opportunity sellers incur approximately $3,562,500 in labor costs due to compliance with the Rule's disclosure requirements ((250 new business opportunity sellers x $250 per hour x 30 hours per business opportunity) + (2,250 established business opportunity sellers x $250 per hour x 3 hours per business opportunity)).

Staff anticipates that recordkeeping would be performed by clerical staff at approximately $13 per hour. At 2,500 hours per year for all affected business opportunities, this would amount to a total cost of $32,500 (2,500 hours for recordkeeping x $13 per hour). Thus, the combined labor costs for recordkeeping and disclosure for business opportunity sellers is approximately $3,595,000 ($3,562,500 for disclosures + $32,500 for recordkeeping).

Estimated non-labor cost for part 437: $3,887,500.

Business opportunity sellers must also incur costs to print and distribute the disclosure document. These costs vary based upon the length of the disclosures and the number of copies produced to meet the expected demand. Staff estimates that 2,500 business opportunity sellers print and mail 100 documents per year at a cost of $15 per document, for a total cost of $3,750,000 (2,500 business opportunity sellers x 100 documents per year x $15 per document).

Business opportunity sellers must also complete and disseminate an FTC-required cover sheet that identifies the business opportunity seller, the date the document is issued, a table of contents, and a notice that tracks the language specifically provided in part 437 of the Rule. Although some of the language in the cover sheet is supplied by the government for the purpose of disclosure to the public, and is thus excluded from the definition of ‘‘collection of d0r for the purposebthe4 TjTuimately

[975] In April 2006, the Commission published the Business Opportunity NPR, 71 FR 19054 (Apr. 12, 2006). Among other things, the proposed Business Opportunity Rule would amend part 437 substantially, reducing the number of disclosures pertaining to business opportunities. At the same time, the proposed Business Opportunity Rule would expand part 437 to include a broader array of business opportunities than covered by the original Franchise Rule. In response to the business opportunity NPR, the Commission received over 17,000 comments, many opposing the inclusion of multilevel marketing companies under the proposed rule. Several comments specifically questioned the paperwork burdens that might be imposed by the part 437 amendments. *E.g.*, DSA, Business Opportunity NPR. Commission staff is currently analyzing the comments. For now, however, only those businesses opportunities covered by the original Franchise Rule—such as vending machine and rack display opportunities—remain covered under part 437.

complete and disseminate 100 cover sheets per year at a cost of approximately $0.55 per cover sheet, or a total cost of approximately $137,500 (2,500 business opportunity sellers x 100 cover sheets per year x $0.55 per cover sheet).

Accordingly, the cumulative non-labor cost incurred by business opportunity sellers each year due to compliance with part 437 will be approximately $3,887,500 ($3,750,000 for printing and mailing documents + $137,500 for completing and mailing cover sheets).

Thus, the cumulative annual hours burden for part 437 of the amended Rule is approximately 16,750 hours ((30 hours of average annual disclosure burden x 250 new business opportunity sellers) + (3 hours of annual disclosure burden x 2,250 established business opportunity sellers) + (1 hour of annual recordkeeping burden x 2,500 total business opportunity sellers)). The

business from the retailer's location where the seller purchases no goods, services, or commodities directly or indirectly from the retailer, a person the retailer requires the seller to do business e

can help you understand how to use this disclosure document, is available from the Federal Trade Commission. You can contact the FTC at 1-877-FTC-HELP or by writing to the FTC at 600 Pennsylvania Avenue, NW., Washington, D.C. 20580. You can also visit the FTC's home page at www.ftc.gov for additional information. Call your state agency or visit your public library for other sources of information on franchising.

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

(6) [The issuance date].

(f) A franchisor may include the following statement between the statements set out at paragraphs (e)(2) and (3) of

[1]

cooperatives. If franchisor-owned outlets have controlling voting power, disclose the maximum and minimum fees that may be imposed.

(g) *Item 7: Estimated Initial Investment.* Disclose, in the following tabular form, the franchisee's estimated initial investment. State the title ''**YOUR ESTIMATED INITIAL INVESTMENT**'' in capital letters using bold type. Franchisors may include additional expenditure tables to show expenditure variations caused by differences such as in site location and premises size.

ITEM 7 TABLE:
YOUR ESTIMATED INITIAL INVESTMENT

Column 1 Type of expenditure	Column 2 Amount	Column 3 Method of payment	Column 4 When due	Column 4 To whom payment is to be made
Total.				

(1) In column 1:

(i) List each type of expense, beginning with pre-opening expenses. Include the following expenses, if applicable. Use footnotes to include remarks, definitions, or caveats that elaborate on the information in the Table.

(A) The initial franchise fee.

(B) Training expenses.

(C) Real property, whether purchased or leased.

(D) Equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements, and decorating costs, whether purchased or leased.

(E) Inventory to begin operating.

(F) Security deposits, utility deposits, business licenses, and other prepaid expenses.

(ii) List separately and by name any other specific required payments (for example, additional training, travel, or advertising expenses) that the franchisee must make to begin operations.

(iii) Include a category titled ''Additional funds— [initial period]'' for any other required expenses the franchisee will incur before operations begin and during the initial period of operations. State the initial period. A reasonable initial period is at least three months or a reasonable period for the industry. Describe in general terms the factors, basis, and experience that the franchisor considered or relied upon in formulating the amount required for additional funds.

(2) In column 2, state the amount of the payment. If the amount is unknown, use a low-high range based on the franchisor's current experience. If real property costs cannot be estimated in a low-high range, describe the approximate size of the property and building and the probable location of the building (for example, strip shopping center, mall, downtown, rural, or highway).

(3) In column 3, state the method of payment.

(4) In column 4, state the due date.

(5) In column 5, state to whom payment will be made.

(6) Total the initial investment, incorporating ranges of fees, if used.

(7) In a footnote, state:

(i) Whether each payment is non-refundable, or describe the circumstances when each payment is refundable.

(ii) If the franchisor or an affiliate finances part of the initial investment, the amount that it will finance, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments. Franchisors may refer to § 436.5(j) of this part for additional details.

(h) *Item 8: Restrictions on Sources of Products and Services.* Disclose the franchisee's obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications. Include obligations to purchase imposed by the franchisor's written agreement or by the franchisor's practice.[4] For each applicable obligation, state:

(1) The good or service required to be purchased or leased.

(2) Whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of that good or service.

(3) Any supplier in which an officer of the franchisor owns an interest.

(4) How the franchisor grants and revokes approval of alternative suppliers, including:

(i) Whether the franchisor's criteria for approving suppliers are available to franchisees.

(ii) Whether the franchisor permits franchisees to contract with alternative suppliers who meet the franchisor's criteria.

(iii) Any fees and procedures to secure approval to purchase from alternative suppliers.

(iv) The time period in which the franchisee will be notified of approval or disapproval.

(v) How approvals are revoked.

(5) Whether the franchisor issues specifications and standards to franchisees, subfranchisees, or approved suppliers. If so, describe how the franchisor issues and modifies specifications.

(6) Whether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees. If so, describe the precise basis by which the franchisor or its affiliates will or may derive that consideration by stating:

(i) The franchisor
circumstances when each payment is

[4] Franchisors may include the reason for the requirement. Franchisors need not disclose in this Item the purchase or lease of goods or services provided as part of the franchise without a separate charge (such as initial training, if the cost is included in the franchise fee). Describe such fees in Item 5 of this section. Do not disclose fees already described in § 436.5(f) of this part.

[5] Take figures from the franchisor's most recent annual audited financial statement required in § 436.5(u) of this part. If audited statements are not yet required, or if the entity deriving the income is an affiliate, disclose the sources of information used in computing revenues.

(8) If a designated supplier will make payments to the franchisor from franchisee purchases, disclose the basis for the payment (for example, specify a percentage or a flat amount). For purposes of this disclosure, a ''payment'' includes the sale of similar goods or services to the franchisor at a lower price than to franchisees.

(9) The existence of purchasing or distribution cooperatives.

(10) Whether the franchisor negotiates purchase arrangements with suppliers, including price terms, for the benefit of franchisees.

(11) Whether the franchisor provides material benefits (for example, renewal or granting additional franchises) to a franchisee based on a franchisee's purchase of particular products or services or use of particular suppliers.

(i) *Item 9*: *Franchisee's Obligations*. Disclose, in the following tabular form, a list of the franchisee's principal obligations. State the title ''**FRANCHISEE'S OBLIGATIONS**'' in capital letters using bold type. Cross-reference each listed obligation with any applicable section of the franchise or other agreement and with the relevant disclosure document provision. If a particular obligation is not applicable, state ''Not Applicable.'' Include additional obligations, as warranted.

ITEM 9 TABLE:

FRANCHISEE'S OBLIGATIONS

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

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

(C) Whether the franchisor has the power to form, change, or dissolve the advertising council.

(iv) Whether the franchisee must participate in a local or regional advertising cooperative. If so, state:

(A) How the area or membership of the cooperative is defined.

(B) How much the franchisee must contribute to the fund and whether other franchisees must contribute a different amount or at a different rate.

(C) Whether the franchisor-owned outlets must contribute to the fund and, if so, whether those contributions are on the same basis as those for franchisees.

(D) Who is responsible for administering the cooperative (for example, franchisor, franchisees, or advertising agency).

(E) Whether cooperatives must operate from written governing documents and whether the documents are available for the franchisee to review.

(F) Whether cooperatives must prepare annual or periodic financial statements and whether the statements are available for review by the franchisee.

(G) Whether the franchisor has the power to require cooperatives to be formed, changed, dissolved, or merged.

(v) Whether the franchisee must participate in any other advertising fund. If so, state:

(A) Who contributes to the fund.

(B) How much the franchisee must contribute to the fund and whether other franchisees must contribute a different amount or at a different rate.

(C) Whether the franchisor-owned outlets must contribute to the fund and, if so, whether it is on the same basis as franchisees.

(D) Who administers the fund.

(E) Whether the fund is audited and when it is audited.

(F) Whether financial statements of the fund are available for review by the franchisee.

(G) How the funds were used in the most recently concluded fiscal year, including the percentages spent on production, media placement, administrative expenses, and a description of any other use.

(vi) If not all advertising funds are spent in the fiscal year in which they accrue, how the franchisor uses the remaining amount, including whether franchisees receive a periodic accounting of how advertising fees are spent.

(vii) The percentage of advertising funds, if any, that the franchisor uses principally to solicit new franchise sales.

(5) Disclose whether the franchisor requires the franchisee to buy or use electronic cash registers or computer systems. If so, describe the systems generally in non-technical language, including the types of data to be generated or stored in these systems, and state the following:

(i) The cost of purchasing or leasing the systems.

(ii) Any obligation of the franchisor, any affiliate, or third party to provide ongoing maintenance, repairs, upgrades, or updates.

(iii) Any obligations of the franchisee to upgrade or update any system during the term of the franchise, and, if so, any contractual limitations on the frequency and cost of the obligation.

(iv) The annual cost of any optional or required maintenance, updating, upgrading, or support contracts.

(v) Whether the franchisor will have independent access to the information that will be generated or stored in any electronic cash register or computer system. If so, describe the information that the franchisor may access and whether there are any contractual limitations on the franchisor's right to access the information.

(6) Disclose the table of contents of the franchisor's operating manual provided to franchisees as of the franchisor's last fiscal year-end or a more recent date. State the number of pages devoted to each subject and the total number of pages in the manual as of this date. This disclosure may be omitted if the franchisor offers the prospective franchisee the opportunity to view the manual before buying the franchise.

(7) Disclose the franchisor's training program as of the franchisor's last fiscal year-end or a more recent date.

(i) Describe the training program in

8

franchisor unilaterally offers to provide certain benefits or protections to franchisees as a matter of policy, use a footnote to describe the policy and state whether the policy is subject to change.

(3) In the summary column for Item 17(c), state what the term ''renewal'' means for your franchise system, including, if applicable, a statement that franchisees may be asked to sign a contract with materially different terms and conditions than their original contract.

ITEM 17 TABLE:

disclosure document. Financial performance information that differs from that included in Item 19 may be given only if: (1) a franchisor provides the actual records of an existing outlet you are considering buying; or (2) a franchisor supplements the information provided in this Item 19, for example, by providing information about possible performance at a particular location or under particular circumstances.

(2) If a franchisor does not provide any financial performance representation in Item 19, also state:

We do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or

ITEM 20 TABLE NO. 1—Continued

Systemwide Outlet Summary
For years [ ] to [ ]

Column 1 Outlet Type	Column 2 Year	Column 3 Outlets at the Start of the Year	Column 4 Outlets at the End of the Year	Column 5 Net Change

ITEM 20 TABLE NO. 3

Status of Franchised Outlets

For years [ ] to [ ]

Column 1 State	Column 2 Year	Column 3 Outlets at Start of Year	Column 4 Outlets Opened	Column 5 Terminations	Column 6 Non-Renewals	Column 7 Reacquired by Franchisor	Column 8 Ceased Operations-Other Reasons	Column 9 Outlets at End of the Year
	2004							
	2005							
	2006							
	2004							
	2005							

ITEM 20 TABLE NO. 4—Continued

Status of Company-Owned Outlets

For years [ ] to [ ]

Column 1 State	Column 2 Year	Column 3 Outlets at Start of Year	Column 4 Outlets Opened	Column 5 Outlets Reacquired From Franchisee	Column 6 Outlets Closed	Column 7 Outlets Sold to Franchisee	Column 8 Outlets at End of the Year
	2005						
	2006						

(A) In column 1, list each state with one or more company-owned outlets.

(B) In column 2, state the last three fiscal years.

(C) In column 3, state the total number of company-owned outlets in each state at the start of the fiscal year.

(D) In column 4, state the total number of company-owned outlets opened in each state during each fiscal year.

(E) In column 5, state the total number of franchised outlets reacquired from franchisees in each state during each fiscal year.

(F) In column 6, state the total number of company-owned outlets closed in each state during each fiscal year. Include both actual closures and instances when an outlet ceases to operate under the franchisor's trademark.

(G) In column 7, state the total number of company-owned outlets sold to franchisees in each state during each fiscal year.

(H) In column 8, state the total number of company-owned outlets operating in each state at the end of each fiscal year.

(3) Disclose, in the following tabular form, projected new franchised and company-owned outlets. A sample Item 20(5) Table is attached as Appendix F to this part.

ITEM 20 TABLE NO. 5

Projected Openings As Of [Last Day of Last Fiscal Year]

Column 1 State	Column 2 Franchise Agreements Signed But Outlet Not Opened	Column 3 Projected New Franchised Outlet In The Next Fiscal Year	Column 4 Projected New Company-Owned Outlet In the Next Fiscal Year
Total			

(i) In column 1, list each state where one or more franchised or company-owned outlets are located or are projected to be located.

(ii) In column 2, state the total number of franchise agreements that had been signed for new outlets to be located in each state as of the end of the previous fiscal year where the outlet had not yet opened.

(iii) In column 3, state the total number of new franchised outlets in each state projected to be opened during the next fiscal year.

(iv) In column 4, state the total number of new company-owned outlets in each state that are projected to be opened during the next fiscal year.

(4) Disclose the names of all current franchisees and the address and telephone number of each of their outlets. Alternatively, disclose this information for all franchised outlets in the state, but if these franchised outlets total fewer than 100, disclose this information for franchised outlets from contiguous states and then the next closest states until at least 100 franchised outlets are listed.

(5) Disclose the name, city and state, and current business telephone number, or if unknown, the last known home telephone number of every franchisee who had an outlet terminated, canceled, not renewed, or otherwise voluntarily or involuntarily ceased to do business under the franchise agreement during the most recently completed fiscal year or who has not communicated with the franchisor within 10 weeks of the disclosure document issuance date.[10] State in immediate conjunction with this information: ''If you buy this franchise, your contact information may be disclosed to other buyers when you leave the franchise system.''

(6) If a franchisor is selling a previously-owned franchised outlet now under its control, disclose the following additional information for that outlet for the last five fiscal years. This information may be attached as an addendum to a disclosure document, or, if disclosure has already been made, then in a supplement to the previously furnished disclosure document.

(i) The name, city and state, current business telephone number, or if unknown, last known home telephone number of each previous owner of the outlet;

(ii) The time period when each previous owner controlled the outlet;

(iii) The reason for each previous change in ownership ((unde3ate,)Tj-1 -1.1m the mos111

[10] Franchisors may substitute alternative contact information at the request of the former franchisee, such as a home address, post office address, or a personal or business email address.

speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you.'' Franchisors may also disclose the number and percentage of current and former franchisees who during each of the last three fiscal years signed agreements that include confidentiality clauses and may disclose the circumstances under which such clauses were signed.

(8) Disclose, to the extent known, the name, address, telephone number, email address, and Web address (to the extent known) of each trademark-specific franchisee organization associated with the franchise system being offered, if such organization:

(i) Has been created, sponsored, or endorsed by the franchisor. If so, state the relationship between the organization and the franchisor (for example, the organization was created by the franchisor, sponsored by the franchisor, or endorsed by the franchisor).

(ii) Is incorporated or otherwise organized under state law and asks the franchisor to be included in the franchisor's disclosure document during the next fiscal year. Such organizations must renew their request on an annual basis by submitting a request no later than 60 days after the close of the franchisor's fiscal year. The franchisor has no obligation to verify the organization's continued existence at the end of each fiscal year. Franchisors may also include the following statement: ''The following independent franchisee organizations have asked to be included in this disclosure document.''

(u) *Item 21*:

(2) Can provide an independent and reliable report about the franchise or the experiences of any current or former franchisees.

(c) Disseminate any financial performance representations to prospective franchisees unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in Item 19 (§ 436.5(s)) of the franchisor's disclosure document. In conjunction with any such financial performance representation, the franchise seller shall also:

(1) Disclose the information required by §§ 436.5(s)(3)(ii)(B) and (E) of this part if the representation relates to the past performance of the franchisor's outlets.

(2) Include a clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.

(d) Fail to make available to prospective franchisees, and to the Commission upon reasonable request, written substantiation for any financial performance representations made in Item 19 (§ 436.5(s)).

(e) Fail to furnish a copy of the franchisor's disclosure document to a prospective franchisee earlier in the sales process than required under § 436.2 of this part, upon reasonable request.

(f) Fail to furnish a copy of the franchisor's most recent disclosure document and any quarterly updates to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.

(g) Present for signing a franchise agreement in which the terms and conditions differ materially from those presented as an attachment to the disclosure document, unless the franchise seller informed the prospective franchisee of the differences at least seven days before execution of the franchise agreement.

(h) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations.

(i) Fail to return any funds or deposits in accordance with any conditions disclosed in the franchisor's disclosure document, franchise agreement, or any related document.

Subpart G—Other Provisions

§ 436.10 Other laws and rules.

(a) The Commission does not approve or express any opinion on the legality of any matter a franchisor may be required to disclose by part 436. Further, franchisors may have additional obligations to impart material information to prospective franchisees outside of the disclosure document under Section 5 of the Federal Trade Commission Act. The Commission intends to enforce all applicable statutes and rules.

(b) The FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with part 436. A law is not inconsistent with part 436 if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures.

§ 436.11 Severability.

If any provision of this part is stayed or held invalid, the remainder will stay in force.

Appendix A to Part 436—Sample Item 10 Table

SUMMARY OF FINANCING OFFERED

Item Financed	Source of Financing	Down Payment	Amount Financed	Term (Yrs)	Interest Rate	Monthly Payment	Prepay Penalty	Security Required	Liability Upon Defauls do666.. oRiability w0 0 10

APPENDIX B TO PART 436

APPENDIX D TO PART 436—SAMPLE ITEM 20(3) TABLE—Continued

Status of Franchise Outlets
For years 2004 to 2006

Column 1 State	Column 2 Year	Column 3 Outlets at Start of Year	Column 4 Outlets Opened	Column 5 Terminations	Column 6 Non-Renewals	Column 7 Reacquired by Franchisor	Column 8 Ceased Operations-Other Reasons	Column 9 Outlets at End of the Year
	2006	41	8	1	0	1	2	45

APPENDIX E TO PART 436—SAMPLE ITEM 20(4) TABLE

Status of Company-Owned Outlets
For years 2004 to 2006

Column 1 State	Column 2 Year	Column 3 Outlets at Start of Year	Column 4 Outlets Opened	Column 5 Outlets Reacquired From Franchisees	Column 6 Outlets Closed	Column 7 Outlets Sold to Franchisees	Column 8 Outlets at End of the Year
NY	2004	1	0	1	0	0	2
	2005	2	2	0	1	0	3
	2006	3	0	0	3	0	0
OR	2004	4	0	1	0	0	5
	2005	5	0	0	2	0	3
	2006	3	0	0	0	1	2
Totals	2004	5	0	2	0	0	7
	2005	7	2	0	3	0	6
	2006	6	0	0	3	1	2

APPENDIX F TO PART 436—SAMPLE ITEM 20(5) TABLE

Projected New Franchised Outlets
As of December 31, 2006

Column 1 State	Column 2 Franchise Agreements Signed But Outlet Not Opened	Column 3 Projected New Franchised Outlets in the Next Fiscal Year	Column 4 Projected New Company-Owned Outlets in the Current Fiscal Year
CO	2	3	1
NM	0	4	2
Total	2	7	3

■ Add a new part 437 as follows:

PART 437—DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING BUSINESS OPPORTUNITIES

Sec.
437.1 The Rule.
437.2 Definitions.
437.3 Severability.

Authority:

the prospective business opportunity purchaser will be operating.

(2) The business experience during the past 5 years, stated individually, of each of the business opportunity seller's current directors and executive officers (including, and hereinafter to include, the chief executive and chief operating officer, financial, business opportunity marketing, training and service officers). With regard to each person listed, those persons' principal occupations and employers must be included.

(3) The business experience of the business opportunity seller and the business opportunity seller's parent firm (if any), including the length of time each: (i) Has conducted a business of the type to be operated by the business opportunity purchaser; (ii) has offered or sold a business opportunity for such business; (iii) has conducted a business or offered or sold a business opportunity for a business (A) operating under a name using any mark set forth under paragraph (a)(1)(iii) of this section, or (B) involving the sale, offering, or distribution of goods, commodities, or services which are identified by any mark set forth under paragraph (a)(1)(iii) of this section; and (iv) has offered for sale or sold business opportunities in other lines of business, together with a description of such other lines of business.

(4) A statement disclosing who, if any, of the persons listed in paragraphs (a)(2) and (3) of this section:

(i) Has, at any time during the previous seven fiscal years, been convicted of a felony or pleaded nolo contendere to a felony charge if the felony involved fraud (including violation of any business opportunity law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade;

(ii) Has, at any time during the previous seven fiscal years, been held liable in a civil action resulting in a final judgment or has settled out of court any civil action or is a party to any civil action (A) involving allegations of fraud (including violation of any business opportunity law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade, or (B) which was brought by a present or former business opportunity purchaser or business opportunity purchasers and which involves or involved the business opportunity relationship; *Provided, however*, That only material individual civil actions need be so listed pursuant to this paragraph (4)(ii) of this section, including any group of civil actions which, irrespective of the materiality of any single such action, in the aggregate is material;

(iii) Is subject to any currently effective State or Federal agency or court injunctive or restrictive order, or is a party to a proceeding currently pending in which such order is sought, relating to or affecting business opportunity activities or the business opportunity seller-purchaser relationship, or involving fraud (including violation of any business opportunity law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade.

Such statement shall set forth the identity and location of the court or agency; the date of conviction, judgment, or decision; the penalty imposed; the damages assessed; the terms of settlement or the terms of the order; and the date, nature, and issuer of each such order or ruling. A business opportunity seller may include a summary opinion of counsel as to any pending litigation, but only if counsel's consent to the use of such opinion is included in the disclosure statement.

(5) A statement disclosing who, if any, of the persons listed in paragraphs (a)(2) and (3) of this section at any time during the previous 7 fiscal years has:

(i) Filed in bankruptcy;

(ii) Been adjudged bankrupt;

(iii) Been reorganized due to insolvency; or

(iv) Been a principal, director, executive officer, or partner of any other person that has so filed or was so adjudged or reorganized, during or within 1 year after the period that such person held such position in such other person. If so, the name and location of the person having so filed, or having been so adjudged or reorganized, the date thereof, and any other material facts relating thereto, shall be set forth.

(6) A factual description of the business opportunity offered to be sold by the business opportunity seller.

(7) A statement of the total funds which must be paid by the business opportunity purchaser to the business opportunity seller or to a person affiliated with the business opportunity seller, or which the business opportunity seller or such affiliated person imposes or collects in whole or in part on behalf of a third party, in order to obtain or commence the business opportunity operation, such as initial business opportunity fees, deposits, down payments, prepaid rent, and equipment and inventory purchases. If all or part of these fees or deposits are returnable under certain conditions, these conditions shall be set forth; and if not returnable, such fact shall be disclosed.

(8) A statement describing any recurring funds required to be paid, in connection with carrying on the business opportunity business, by the business opportunity purchaser to the business opportunity seller or to a person affiliated with the business opportunity seller, or which the business opportunity seller or such affiliated person imposes or collects in whole or in part on behalf of a third party, including, but not limited to, royalty, lease, advertising, training, and sign rental fees, and equipment or inventory purchases.

(9) A statement setting forth the name of each person (including the business opportunity seller) the business opportunity purchaser is directly or indirectly required or advised to do business with by the business opportunity seller, where such persons are affiliated with the business opportunity seller.

(10) A statement describing any real estate, services, supplies, products, inventories, signs, fixtures, or equipment relating to the establishment or the operation of the business opportunity business which the business opportunity purchaser is directly or indirectly required by the business opportunity seller to purchase, lease or rent; and if such purchases, leases or rentals must be made from specific persons (including the business opportunity seller), a list of the names and addresses of each such person. Such list may be made in a separate document delivered to the prospective business opportunity purchaser with the prospectus if the existence of such separate document is disclosed in the prospectus.

(11) A description of the basis for calculating, and, if such information is readily available, the actual amount of, any revenue or other consideration to be received by the business opportunity seller or persons affiliated with the business opportunity seller from suppliers to the prospective business opportunity purchaser in consideration for goods or services which the business opportunity seller requires or advises the business opportunity purchaser to obtain from such suppliers.

(12)(i) A statement of all the material terms and conditions of any financing arrangement offered directly or indirectly by the business opportunity seller, or any person affiliated with the business opportunity seller, to the prospective business opportunity purchaser; and

(ii) A description of the terms by which any payment is to be received by the business opportunity seller from (A) any person offering financing to a prospective business opportunity purchaser; and (B) any person arranging for financing for a prospective business opportunity purchaser.

(13) A statement describing the material facts of whether, by the terms of the business opportunity agreement or other device or practice, the business opportunity purchaser is:

(i) Limited in the goods or services he or she may offer for sale;

(ii) Limited in the customers to whom he or she may sell such goods or services;

(iii) Limited in the geographic area in which he or she may offer for sale or sell goods or services; or

(iv) Granted territorial protection by the business opportunity seller, by which, with respect to a territory or area, (A) the business opportunity seller will not establish another, or more than any fixed number of, business opportunities or company-owned outlets, either operating under, or selling, offering, or distributing goods, commodities or services, identified by any mark set forth under paragraph (a)(1)(iii) of this section; or (B) the business opportunity seller or its parent will not establish other business opportunities or company-owned outlets selling or leasing the same or similar products or services under a different trade name, trademark, service mark, advertising or other commercial symbol.

(14) A statement of the extent to which the business opportunity seller requires the business opportunity purchaser (or, if the business opportunity purchaser is a corporation, any person affiliated with the business opportunity purchaser) to participate personally in the direct operation of the business opportunity.

(15) A statement disclosing, with respect to the business opportunity agreement and any related agreements:

(i) The term (*i.e.*, duration of arrangement), if any, of such agreement, and whether such term is or may be affected by any agreement (including leases or subleases) other than the one from which such term arises;

(ii) The conditions under which the business opportunity purchaser may renew or extend;

(iii) The conditions under which the business opportunity seller may refuse to renew or extend;

(iv) The conditions under which the business opportunity purchaser may terminate;

(v) The conditions under which the business opportunity seller may terminate;

(vi) the obligations (including lease or sublease obligations) of the business opportunity purchaser after termination of the business opportunity by the business opportunity seller, and the obligations of the business opportunity purchaser (including lease or sublease obligations) after termination of the business opportunity by the business opportunity purchaser and after the expiration of the business opportunity;

(vii) The business opportunity purchaser's interest upon termination of the business opportunity, or upon refusal to renew or extend the business opportunity, whether by the business opportunity seller or by the business opportunity purchaser;

(viii) The conditions under which the business opportunity seller may repurchase, whether by right of first refusal or at the option of the business opportunity seller (and if the business opportunity seller has the option to repurchase the business opportunity, whether there will be an independent appraisal of the business opportunity, whether the repurchase price will be determined by a predetermined formula and whether there will be a recognition of goodwill or other intangibles associated therewith in the repurchase price to be given the business opportunity purchaser);

(ix) The conditions under which the business opportunity purchaser may sell or assign all or any interest in the ownership of the business opportunity, or of the assets of the business opportunity business;

(x) The conditions under which the business opportunity seller may sell or assign, in whole or in part, its interest under such agreements;

(xi) The conditions under which the business opportunity purchaser may modify;

(xii) The conditions under which the business opportunity seller may modify;

(xiii) The rights of the business opportunity purchaser's heirs or personal representative upon the death or incapacity of the business opportunity purchaser; and

(xiv) The provisions of any covenant not to compete.

(16) A statement disclosing, with respect to the business opportunity seller and as to the particular named business being offered:

(i) The total number of business opportunity purchasers operating at the end of the preceding fiscal year;

(ii) The total number of company-owned outlets operating at the end of the preceding fiscal year;

(iii) The names, addresses, and telephone numbers of (A) The 10 business opportunity outlets of the named business opportunity business nearest the prospective business opportunity purchaser's intended location; or (B) all business opportunity purchasers of the business opportunity seller; or (C) all business opportunity purchasers of the business opportunity seller in the State in which the prospective business opportunity purchaser lives or where the proposed business opportunity is to be located, *Provided, however*, That there are more than 10 such business opportunity purchasers. If the number of business opportunity purchasers to be disclosed pursuant to paragraph (a)(16)(iii)(B) or (C) of this section exceeds 50, such listing may be made in a separate document delivered to the prospective business opportunity purchaser with the prospectus if the existence of such prospectus; ;(p(sj-TDc1 -unity puress oppoCineclosi
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for such reacquisitions, refusals to renew or terminations, and the number falling within each such category, including but not limited to the following: failure to comply with quality control standards, failure to make sufficient sales, and other breaches of contract.

(17)(i) If site selection or approval thereof by the business opportunity seller is involved in the business opportunity relationship, a statement disclosing the range of time that has elapsed between signing of business opportunity agreements or other agreements relating to the business opportunity and site selection, for agreements entered into during the preceding fiscal year; and

(ii) If operating business opportunity outlets are to be provided by the business opportunity seller, a statement disclosing the range of time that has elapsed between the signing of business opportunity agreements or other agreements relating to the business opportunity and the commencement of the business opportunity purchaser's business, for agreements entered into during the preceding fiscal year.

With respect to the disclosures required by paragraphs (a)(17) (i) and (ii) of this section, a business opportunity seller may at its option also provide a distribution chart using meaningful classifications with respect to such ranges of time.

(18) If the business opportunity seller offers an initial training program or informs the prospective business opportunity purchaser that it intends to provide such person with initial training, a statement disclosing:

(i) The type and nature of such training;

(ii) The minimum amount, if any, of training that will be provided to a business opportunity purchaser; and

(iii) The cost, if any, to be borne by the business opportunity purchaser for the training to be provided, or for obtaining such training.

(19) If the name of a public figure is used in connection with a recommendation to purchase a business opportunity, or as a part of the name of the business opportunity operation, or if the public figure is stated to be involved with the management of the business opportunity seller, a statement disclosing:

(i) The nature and extent of the public figure's involvement and obligations to the business opportunity seller, including but not limited to the promotional assistance the public figure will provide to the business opportunity seller and to the business opportunity purchaser;

(ii) The total investment of the public figure in the business opportunity operation; and

(iii) The amount of any fee or fees the business opportunity purchaser will be obligated to pay for such involvement or assistance provided by the public figure.

(20)(i) A balance sheet (statement of financial position) for the business opportunity seller for the most recent fiscal year, and an income statement (statement of results of operations) and statement of changes in financial position for the franchisor for the most recent three fiscal years. Such statements are required to have been examined in accordance with generally accepted auditing standards by an independent certified or licensed public accountant.

Provided, however, That where a business opportunity seller is a subsidiary of another corporation which is permitted under generally accepted accounting principles to prepare financial statements on a consolidated or combined statement basis, the above information may be submitted for the parent if (A) the corresponding unaudited financial statements of the business opportunity seller are also provided, and (B) the parent absolutely and irrevocably has agreed to guarantee all obligations of the subsidiary;

(ii) Unaudited statements shall be used only to the extent that audited statements have not been made, and provided that such statements are accompanied by a clear and conspicuous disclosure that they are unaudited. Statements shall be prepared on an audited basis as soon as practicable, but, at a minimum, financial statements for the first full fiscal year following the date on which the business opportunity seller must first comply with this part shall contain a balance sheet opinion prepared by an independent certified or licensed public accountant, and financial statements for the following fiscal year shall be fully audited.

(21) All of the foregoing information in paragraphs (a) (1) through (20) of this section shall be contained in a single disclosure statement or prospectus, which shall not contain any materials or information other than that required by this part or by State law not preempted by this part. This does not preclude business opportunity sellers or brokers from giving other nondeceptive information orally, visually, or in separate literature so long as such information is not contradictory to the information in the disclosure statement required by paragraph (a) of this section. This disclosure statement shall carry a cover sheet distinctively and conspicuously showing the name of the business opportunity seller, the date of issuance of the disclosure statement, and the following notice imprinted thereon in upper and lower case bold-face type of not less than 12 point size:

Information for Prospective Business Opportunity Purchasers Required by Federal Trade Commission

* * * * *

To protect you, we've required your business opportunity seller to give you this information. We haven't checked it, and don't know if it's correct. It should help you make up your mind. Study it carefully. While it includes some information about your contract, don't rely on it alone to understand your contract. Read all of your contract carefully. Buying a business opportunity is a complicated investment. Take your time to decide. If possible, show your contract and this information to an advisor, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, you should let us know about it. It may be against the law.

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

Federal Trade Commission,
Washington, D.C.

Provided, That the obligations to furnish such disclosure statement shall be deemed to have been met for both the business opportunity seller and the business opportunity broker if either such party furnishes the prospective business opportunity purchaser with such disclosure statement.

(22) All information contained in the disclosure statement shall be current as of the close of the business opportunity seller's most recent fiscal year. After the close of each fiscal year, the business opportunity seller shall be given a period not exceeding 90 days to prepare a revised disclosure statement and, following such 90 days, may distribute only the revised prospectus and no other. The business opportunity seller shall, within a reasonable time after the close of each quarter of the fiscal year, prepare revisions to be attached to the disclosure statement to reflect any material change in the business opportunity seller or relating to the business opportunity business of the business opportunity seller, about which the business opportunity seller or broker, or any agent, representative, or employee thereof, knows or should know. Each prospective business opportunity purchaser shall have in his or her possession at the ''time for making of disclosures,'' the disclosure statement and quarterly revision for the period most recent to the ''time for making of disclosures7559 0 TD0 Tk0oDur c0.00es, fss5pRr5gTj/F4 the

that time. Information which is required to be audited pursuant to paragraph (a)(20) of this section is not required to be audited for quarterly revisions. *Provided, however*, That the unaudited information is accompanied by a statement in immediate conjunction therewith that clearly and conspicuously discloses that such information has not been audited.

(23) A table of contents shall be included within the disclosure statement.

(24) The disclosure statement shall include a comment which either positively or negatively responds to each disclosure item required to be in the disclosure statement, by use of a statement which fully incorporates the information required by the item. Each disclosure item therein must be preceded by the appropriate heading, as set forth in Note 3 of this part.

(b) To make any oral, written, or visual representation to a prospective business opportunity purchaser which states a specific level of potential sales, income, gross or net profit for that prospective business opportunity purchaser, or which states other facts which suggest such a specific level, unless:

(1) At the time such representation is made, such representation is relevant to the geographic market in which the business opportunity is to be located;

(2) At the time such representation is made, a reasonable basis exists for such representation and the business opportunity seller has in its possession material which constitutes a reasonable basis for such representation, and such material is made available to any prospective business opportunity purchaser and to the Commission or its staff upon reasonable demand.

Provided, further, That in immediate conjunction with such representation, the business opportunity seller shall disclose in a clear and conspicuous manner that such material is available to the prospective business opportunity purchaser; and *Provided, however*, That no provision within paragraph (b) of this section shall be construed as requiring the disclosure to any prospective business opportunity purchaser of the identity of any specific business opportunity purchaser or of information reasonably likely to lead to the disclosure of such person's identity; and *Provided, further*, That no additional representation as to a prospective business opportunity purchaser's potential sales, income, or profits may be made later than the ''time for making of disclosures'';

(3) Such representation is set forth in detail along with the material bases and assumptions therefor in a single legible written document whose text accurately, clearly and concisely discloses such information, and none other than that provided for by this part or by State law not preempted by this part. Each prospective business opportunity purchaser to whom the representation is made shall be furnished with such document no later than the ''time for making of disclosure''; *Provided, however*, That if the representation is made at or prior to a ''personal meeting'' and such meeting occurs before the ''time for making of disclosures'', the document shall be furnished to the prospective business opportunity purchaser to whom the representation is made at that ''personal meeting'';

(4) The following statement is clearly and conspicuously disclosed in the document described by paragraph (b)(3) of this section in immediate conjunction with such representation and in not less than twelve point upper and lower-case boldface type:

CAUTION

These figures are only estimates of what we think you may earn. There is no assurance you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

(5) The following information is clearly and conspicuously disclosed in the document described by paragraph (b)(3) of this section in immediate conjunction with such representation:

(i) The number and percentage of outlets of the named business opportunity business which are located in the geographic markets that form the basis for any such representation and which are known to the business opportunity seller or broker to have earned or made at least the same sales, income, or profits during a period of corresponding length in the immediate past as those potential sales, income, or profits represented; and

(ii) The beginning and ending dates for the corresponding time period referred to by paragraph (b)(5)(i) of this section, *Provided, however*, That any business opportunity seller without prior business opportunity experience as to the named business opportunity business so indicate such lack of experience in the document described in paragraph (b)(3) of this section.

Except, That representations of the sales, income or profits of existing business opportunity outlets need not comply with paragraph (b) of this section.

(c) To make any oral, written, or visual representation to a prospective business opportunity purchaser which states a specific level of sales, income, gross or net profits of existing outlets (whether business opportunity purchaser-owned or company-owned) of the named business opportunity business, or which states other facts which suggest such a specific level, unless:

(1) At the time such representation is made, such representation is relevant to the geographic market in which the business opportunity is to be located;

(2) At the time such representation is made, a reasonable basis exists for such representation and the business opportunity seller has in its possession material which constitutes a reasonable basis for such representation, and such material is made available to any prospective business opportunity purchaser and to the Commission or its staff upon reasonable demand, *Provided, however*, That in immediate conjunction with such representation, the business opportunity purchaser discloses in a clear and conspicuous manner that such material is available to the prospective franchisee; and *Provided, further*, That no provision within paragraph (c) of this section shall be construed as requiring the disclosure to any prospective business opportunity purchaser of the identity of any specific business opportunity purchaser or of information reasonably likely to lead to the disclosure of such person's identity; and *Provided, further*, That no additional representation as to the sales, income, or gross or net profits of existing outlets (whether business opportunity purchaser-owned or company-owned) of the named business opportunity business may be made later than the ''time for making of disclosures'';

(3) Such representation is set forth in detail along with the material bases and assumptions therefor in a single legible written document which accurately, clearly and concisely discloses such information, and none other than that provided for by this part or by State law not preempted by this part. Each prospective business opportunity purchaser to whom the representation is made shall be furnished with such document no later than the ''time for making of disclosures,'' *Provided, however*, That if the representation is made at or prior to a ''personal meeting'' and such meeting occurs before the ''time for making of disclosures,'' the document shall be furnished to the prospective business opportunity purchaser to whom the representation is made at that ''personal meeting'';

(4) The underlying data on which the representation is based have been

prepared in accordance with generally accepted accounting principles;

(5) The following statement is clearly and conspicuously disclosed in the document described by paragraph (c)(3) of this section in immediate conjunction with such representation, and in not less th ly

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business opportunity experience as to the named business opportunity business;

(vi) If applicable, a statement clearly and conspicuously disclosing that the business opportunity seller has not been in business long enough to have actual business data;

(vii) A cover sheet, distinctively and conspicuously showing the name of the business opportunity seller, the date of issuance of the document, and the following notice printed thereon in not less than 12 point upper and lower case boldface type:

Information for Prospective Business Opportunity Purchasers About Business Opportunity [Sales] [Income] [Profit] Required by the Federal Trade Commission

To protect you, we've required the business opportunity seller to give you this information. We haven't checked it and don't know if it's correct. Study these facts and figures carefully. If possible, show them to someone who can advise you, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, let us know about it. It may be against the law. There may also be laws about business opportunities in your State. Ask your State agencies about them.

Federal Trade Commission,
Washington, D.C.

(viii) A table of contents;

(6) Each prospective business opportunity purchaser shall be notified at the ''time for making of disclosures'' of any material changes that have occurred in the information contained in this document.

(f) To make any claim or representation which is contradictory to the information required to be disclosed by this part.

(g) To fail to furnish the prospective business opportunity purchaser with a copy of the business opportunity seller's business opportunity agreement and related agreements with the document, and a copy of the completed business opportunity and related agreements intended to be executed by the parties at least 5 business days prior to the date the agreements are to be executed.

Provided, however, That the obligations defined in paragraphs (b) through (g) of this section shall be deemed to have been met for both the business opportunity seller and the broker if either such person furnishes the prospective business opportunity purchaser with the written disclosures required thereby.

(h) To fail to return any funds or deposits in accordance with any conditions disclosed pursuant to paragraph (a)(7) of this section.

§ 437.2 Definitions.

As used in this part, the following definitions shall apply:

(a) The term *business opportunity* means any continuing commercial relationship created by any arrangement or arrangements whereby:

(1) A person (hereinafter ''business opportunity purchaser'') offers, sells, or distributes to any person other than a ''business opportunity seller'' (as hereinafter defined), goods, commodities, or services which are:

(i)(A) Supplied by another person (hereinafter ''business opportunity seller''); or ""Tw ((as Commissi)ood] TDn5Tj Nrm111 TD (dif)Tj -6.cflmisim.u

14. Person participation required of the business opportunity purchaser in the operation of the business opportunity.
15. Termination, cancellation, and renewal of the business opportunity.
16. Statistical information concerning the number of business opportunity purchasers (and company-owned outlets).
17. Site selection.
18. Training programs.
19. Public figure involvement in the business opportunity.
20. Financial information concerning the business opportunity seller.

By direction of the Commission.

Donald S. Clark,

Secretary.

Note: Attachment A is published for information purposes only and will not be codified in Title 16 of the Code of Federal Regulations.

ATTACHMENT A.

TABLE OF COMMENTERS

Rule Review Commenters

Leonard Swartz, Arthur Anderson & Co. (''Swartz'')

John Tifford, Brownstein Zeidman & Lore

Ronnie Volkening (''Volkening''), The Southland Corp. (''Southland'')

Dennis E. Wieczorek, Rudnick & Wolfe (''Wieczorek'')

ANPR 162. Kamlesh Patel, Baskin & Robbins Franchisee (''K. Patel'')
ANPR 163. Nicholas & Marilyn Apostal, Baskin & Robbins Franchisee (''Apostal'')
ANPR 164. Patrick Sitin, Baskin & Robbins Franchisee (''Sitin'')
ANPR 165. Paul & Lisa SeLander, Baskin & Robbins Franchisee (''SeLander'')
ANPR 166. S. Bhilnym, Baskin & Robbins Franchisee (''Bhilnym'')
ANPR 167. Mike & Kathy Denino, Baskin & Robbins Franchisee (''Denino'')

ANPR Workshop Participants

Michael Bennett, Longaberger Company (''Bennett'')
Kennedy Brooks (''Brooks'')
John Brown, Amway Corporation (''J. Brown'')
Howard Bundy, Bundy & Morrill (''Bundy'')
Delia Burke, Jenkins & Gilchrist (''Burke'')
Andrew Caffey, Esq. (''Caffey'')
Dale Catone, Office of the Maryland Attorney General (''Cantone'')
Emilio Casillas, Washington State Securities Division (''Casillas'')
Richard Catalano, Esq. (''Catalano'')
Sherry Christopher, Esq. (''Christopher'')
Michael W. Chiodo, Domino's Franchisee (''Chiodo'')
Martin Cordell, Washington State Securities Division (''Cordell'')
Joseph Cristiano, Carvel Franchisee (''Cristiano'')
John D'Alessandro, Quaker State Lube Distributor (''D'Alessandro'')
Mark Deutsch, former franchisee (''Deutsch'')
Steve Doe, Franchisee (''Doe'')
Gary Duvall, Graham & Dunn (''Duvall'')
Eric Ellman, Direct Selling Association (''Ellman'')
Debbie Fetzer, Snap-On Franchisee (''Fetzer'')
David Finigan, Illinois Securities Department (''Finigan'')
Mark B. Forseth, Jenkens & Gilchrist (''Forseth'')
Richard W. Galloway, Domino's Pizza Franchisee (''Galloway'')
Elizabeth Garceau, Pro Design (''E. Garceau'')
Michael Garceau, Pro Design (''M. Garceau'')
Roger Gerdes, Microsoft Corp. (''Gerdes'')
Rick Geu, The Pampered Chef (''Geu'')
Judy Gitterman, Jenkens & Gilchrist (''Gitterman'')
Susan Grant, National Consumers League (''Grant'')
Bruce Hoar, Hanes Franchisee (''B. Hoar'')
Thomas Hoar, Hanes Franchisee (''T. Hoar'')
Nelson Hockert-Lotz, Domino's Pizza Franchisee (''Hockert-Lotz'')
Tee Houston-Aldridge, World Inspection Network (''Houston-Aldridge'')
Robert James, Florida Dept. of Agriculture & Consumer Services (''James'')
Carl Jeffers, Intel Marketing Systems (''Jeffers'')
Erik Karp, Witmer, Karp, Warner & Thuotte (''Karp'')
David Kaufmann, Kaufmann, Feiner, Yamin, Gildin & Robbins (''Kaufmann'')
Harold Kestenbaum, Hollenbrug, Bleven, Solomon, Ross (''Kestenbaum'')
Susan Kezios, American Franchisee Association (''Kezios'')
Mark Kirsch, Rudnick Wolfe, Epstien & Zeidman (''Kirsch'')
Charles Lay, Brite Site Franchisee (''Lay'')
Mike Ludlum, Entreprenuer Media (''Ludlum'')
Marge Lundquist, Franchisee (''Lundquist'')
Gerald Marks, Marks & Krantz (''Marks'')
Philip McKee, National Consumers League (''McKee'')
Dianne Mousley, Mike Schmidt's Phil. Hoagies Franchisee (''Mousley'')
Joseph Punturo, Office of the New York Attorney General (''Punturo'')
Mehran Rafizadeh, GNC Franchisee (''Rafizadeh'')
David R. Raymond, Esq. (''Raymond'')
Iris Sandow, Blimpie Franchisee (''Sandow'')
Philip Sanson, Illinois Securities Department (''Sanson'')
Matthew Shay, International Franchise Association (''IFA'')
David Silverman, Sportworld Int'l (''Silverman'')
Neil Simon, Hogan & Hartson (''Simon'')
Caron Slimak (''Slimak''), Jacadi USA Franchisee
J. H. Snow, Jenkens & Gilcrist (''Snow'')
Adam Sokol, Illinois Attorney General's Office (''Sokol'')
Kat Tidd, Esq. (''Tidd'')
John Tifford, Rudnick Wolfe, Epstien & Zeidman, (''Tifford'')
Robert Tingler, Franchise Bureau Chief. Illinois Attorney General's Office (''Tingler'')
Bertrand Unger, PR One (''Unger'')
Dr. Spencer Vidulich, Pearle Vision Franchisee (''Vidulich'')
Dick Way, PR One (''Way'')
Dennis Wieczorek, Rudnick & Wolfe (''Wieczorek'')
Erik Wulff, Hogan & Hartson (''Wulff'')
Barry Zaslav, Coverall North America (''Zaslav'')

Franchise Rule Notice of Proposed Rulemaking Commenters

NPR 1. Patrick E. Meyers, The Quizno's Corporation (''Quizno's'')
NPR 2. Steven A. Rosen, Frannet (''Frannet'')
NPR 3. Robert Tingler, Franchise Bureau Chief, Illinois Attorney General (''IL AG'')
NPR 4. Dennis E. Wieczorek, Piper Marbury Rudnick & Wolfe (''PMR&W'')
NPR 5. Jack Schuessler, Wendy's Intl, Inc. (''Wendy's'')
NPR 6. Curtis S. Gimson, Triarc Restaurant Group (''Triarc'')
NPR 7. Eugene Stachowiak, McDonald's (''McDonalds'')
NPR 8. David E. Holmes (''Holmes'')
NPR 9. Erik B. Wulff, John F. Dienelt, Hogan & Hartson (''H&H'')
NPR 10. Ronnie R. Volkening, 7-Eleven, Inc. (''7-Eleven'')
NPR 11. John R.F. Baer, Robert T. Joseph, Alan H. Silberman, Sonnenschein Nath & Rosenthal (''Baer'')
NPR 12. Morton A. Aronson, Neil A. Simon, David J. Kaufmann, National Franchise Council (''NFC'')
NPR 13. Alaska Turner (''Turner'')
NPR 14. Susan P. Kezios, American Franchisee Association (''AFA'')
NPR 15. Warren L. Lewis, Lewis & Kolton (''Lewis'')
NPR 16. John W. Regnery, Snap-On Inc. (''Snap-On'')
NPR 17. Dale E. Cantone, Stephen W. Maxey, Joseph J. Punturo, NASAA Franchise and Business Opportunity Project Group (''NASAA'')
NPR 18. Howard E. Bundy, Bundy & Morrill, Inc. (''Bundy'')
NPR 19. Laurie Taylor (''Taylor'')
NPR 20. Jonathan Hubbell, Prudential Real Estate Affiliates (''PREA'')
NPR 21. David Gurnick, Arter & Hadden (''Gurnick'')
NPR 22. Don J. DeBolt, Matthew R. Shay, International Franchise Association (''IFA'')
NPR 23. L. Seth Stadfeld, Weston, Patrick, Willard & Redding (''Stadfeld'')
NPR 24. Eric H. Karp, Witmer, Karp, Warner & Thuotte (''Karp'')
NPR 25. Janet L. McDavid, American Bar Association, Section of Antitrust Law (''ABA AT'')
NPR 26. Randall Loeb, NaturaLawn of America (''NaturaLawn'')
NPR 27. Tony Rolland, National Franchisee Association (''NFA'')
NPR 28. Andrew P. Loewinger, Buchannan Ingersoll (''BI'')
NPR 29. Jeffrey E. Kolton, Frandata (''Frandata'')
NPR 30. AFC Enterprises (''AFC'')