

FRANCHISE RULE

16 C.F.R. Part 436



COMPLIANCE GUIDE

May 2008

INTRODUCTION

This Compliance Guide is intended to help franchisors comply with the Federal Trade Commission's amended Franchise Rule. The original Franchise Rule went into effect on October 21, 1979. The Federal Trade Commission ("FTC" or "the Commission") approved amendments to the Franchise Rule on January 22, 2007.

Since July 1, 2007, franchisors could comply with the FTC's disclosure requirements by using any one of the following formats: (1) the original Franchise Rule; (2) the Uniform Franchise Offering Circular ("UFOC"); or (3) the amended Franchise Rule. Once a franchisor selects a disclosure format, it must use that format and no other. As of July 1, 2008, however, all franchisors must use *only* the amended Franchise Rule.

This Guide does not modify the amended Rule. It explains the requirements of the amended Rule. ***Moreover, it does not exhaustively cover every requirement*** contained in the amended Rule, but focuses on amended Rule provisions that depart from the familiar UFOC Guidelines. This Guide also includes sample disclosures that illustrate the new provisions and will be useful in preparing compliant disclosures.

There is no substitute for the text of the amended Rule. It is the authoritative statement of what franchisors need to do to comply. Thus, the amended Rule's text – along with its explanatory Statement of Basis and Purpose – is the starting point and ultimate authority in preparing compliant disclosures. This Guide is an additional resource, representing the FTC staff's view of what the law requires. This Guide will be updated periodically as new interpretive issues arise.

Other important resources for compliance guidance are the "Amended Franchise Rule FAQ's" on the FTC's web site at <http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtm>, and staff opinions that have been issued in response to specific requests regarding particular fact situations. The staff opinions can be found at <http://www.ftc.gov/bcp/franchise/netadopin.shtm>.

The advice in this Guide is not binding on the Commission. In addition, the original Rule's Statement of Basis and Purpose and previous informal staff advisory opinions remain valid sources of interpretation, except to the extent of any conflict with the amended Rule's requirements.

Like the original Franchise Rule and the UFOC Guidelines, the amended Rule requires franchisors to give prospective franchisees material information, including background information on the franchisor, the costs of entering into the business, the legal obligations of the franchisor and the franchisee, statistics on franchised and company-owned outlets, and audited financial information. In addition, if franchisors elect to make any financial performance representations, the amended Franchise Rule requires certain disclosures and substantiation for those representations. For the most part, these disclosures are based upon the UFOC Guidelines, with which many franchisors and practitioners are already familiar.

As outlined below, the amended Rule differs from the UFOC Guidelines (and the original Rule) in several respects. First, the amended Rule updates the UFOC Guidelines to address new technologies, like the Internet. Second, the amended Rule requires more disclosure about the nature of franchisor-franchisee relationships. The amended Rule includes several disclosure requirements not included in the UFOC Guidelines. Also, the Amended Rule exempts certain entities that the original Rule did not exempt, and prohibits certain practices not addressed in the original Rule.

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FRANCHISE RULE COVERAGE

Whether the Franchise Rule applies to a particular business relationship depends upon whether the relationship meets the Rule's definition of a "franchise" and whether an exemption or exclusion applies.

WHAT TYPES OF RELATIONSHIPS ARE COVERED?

The amended Rule covers the offer and sale of franchises. As under the original Rule, a commercial business arrangement is a "franchise" if it satisfies three definitional elements. Specifically, the franchisor must: (1) promise to provide a trademark or other commercial symbol; (2) promise to exercise significant control or provide significant assistance in the operation of the business; and (3) require a minimum payment of at least \$500 during the first six months of operations.

Like the original Rule, the amended Rule covers business format and product franchises. The name given to the business arrangement is irrelevant in determining whether it is covered by the amended Rule. A business arrangement described as a "franchise" will not be covered unless it meets the three definitional elements in the amended Rule. In the same vein, a self-described "distributorship" will be covered by the amended Rule only if the three definitional elements are satisfied.

Further, the amended Rule covers relationships that are represented either orally or in writing as having the characteristics specified in the amended Rule's definition of "franchise," regardless of whether the representations are, in fact, true or can be fulfilled. Accordingly, if a seller of a business arrangement represents that it licenses its trademark, promises to provide significant assistance in the buyer's business operations, and charges a minimum payment of at least \$500, the arrangement will be covered by the Rule even if, for example, the seller, in fact, has no trademark or has no means to provide any assistance to buyers.

The “Trademark” Element

A franchise entails the right to operate a business that is “identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark.” The term “trademark” is intended to be read broadly to cover not only trademarks, but any service mark, trade name, or other advertising or commercial symbol. This is generally referred to as the “trademark” or “mark” element.

The franchisor need not own the mark itself, but at the very least must have the right to license the use of the mark to others. Indeed, the right to use the franchisor’s mark in the operation of the business – either by selling goods or performing services identified with the mark or by using the mark, in whole or in part, in the business’ name – is an integral part of franchising. In fact, a supplier can avoid Rule coverage of a particular distribution arrangement by expressly prohibiting the distributor from using its mark.

The “Significant Control or Assistance” Element

The amended Rule covers business arrangements where the franchisor “will exert or has the authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation.”

When Is Control or Assistance Significant?

The more franchisees reasonably rely upon the franchisor’s control or assistance, the more likely the control or assistance will be considered “significant.” Franchisees’ reliance is likely to be great when they are relatively inexperienced in the business being offered for sale or when they undertake a large financial risk. Similarly, franchisees are likely to reasonably rely on the franchisor’s control or assistance if the control or assistance is unique to that specific franchisor, as opposed to a typical practice employed by all businesses in the same industry.

Further, to be deemed “significant,” the control or assistance must relate to the franchisee’s overall method of operation – not a small part of the franchisee’s business. Control or assistance involving the sale of a specific product that has, at most, a marginal effect on a

franchisee's method of operating the overall business will not be considered in determining whether control or assistance is "significant." Significant types of control include:

- site approval for unestablished businesses;
- site design or appearance requirements;
- hours of operation;
- production techniques;
- accounting practices;
- personnel policies;
- promotional campaigns requiring franchisee participation or financial contribution;
- restrictions on customers; and
- locale or area of operation.

Significant types of assistance include:

- formal sales, repair, or business training programs;
- establishing accounting systems;
- furnishing management, marketing, or personnel advice;
- selecting site locations;
- furnishing systemwide networks and website; and
- furnishing a detailed operating manual.

To a lesser extent, the following factors will be considered when determining whether "significant control or assistance" is present in a relationship:

- a requirement that a franchisee service or repair a product (except warranty work);
- inventory controls;
- required displays of goods; and
- on-the-job assistance with sales or repairs.

What Activities Do Not Constitute Significant Control or Assistance?

Promotional activities, in the absence of additional forms of assistance, will not be deemed “significant.” This includes furnishing a distributor with point-of sale advertising displays, sales kits, product samples, and other promotional materials intended to help the distributor in making sales. It also includes providing advertising in such media as radio and television, whether provided solely by the franchisor or on a cooperative basis with franchisees.

In addition, the following items do not constitute significant control or assistance, as a matter of Commission policy¹:

- trademark controls designed solely to protect the trademark owner’s legal ownership rights in the mark under state or federal trademark laws (such as display of the mark or right of inspection);
- health or safety restrictions required by federal or state law or regulations;
- agreements between a bank credit interchange organization and retailers or member banks for the provision of credit cards or credit services; and
- assisting distributors in obtaining financing to be able to transact business.

The “Required Payment” Element

The last of the three definitional elements of a franchise covered by the amended Rule is that purchasers of the business arrangement must be required to pay to the franchisor (or to an affiliate), as a condition of obtaining a franchise or starting operations, a sum of at least \$500 at

¹ See Original Interpretive Guides, 44 Fed. Reg. 49,966, at 49,967 (Aug. 24, 1979).

any time prior to or within the first six months of the commencement of operations of the franchised business.

What Types of Payments Constitute “Required Payments”?

“Payment” is intended to be read broadly, capturing all sources of revenue that a franchisee must pay to a franchisor or its affiliate for the right to associate with the franchisor, market its goods or services, and begin operation of the business. Often, required payments go beyond a simple franchisee fee, entailing other payments that the franchisee must pay to the franchisor or an affiliate by contract – including the franchise agreement or any companion contract. Required payments may include:

- initial franchise fee;
- rent;
- advertising assistance;
- equipment and supplies (including such purchases from third parties if the franchisor or its affiliate receives payment as a result of the purchase);
- training;
- security deposits;
- escrow deposits;
- non-refundable bookkeeping charges;
- promotional literature;
- equipment rental; and
- continuing royalties on sales.

Payments which, by practical necessity, a franchisee must make to the franchisor or affiliate also count toward the required payment. A common example of a payment made by

practical necessity is a charge for equipment that can only be obtained from the franchisor or its affiliate and no other source.

What Types of Payments Do Not Constitute “Required Payments”?

The “payment” element of the franchise definition does not include “payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.”² “Reasonable amounts” means amounts not in excess of those that a reasonable businessperson normally would purchase for a starting inventory or supply, or to maintain an ongoing inventory or supply. This “inventory exemption” also includes goods intended to be furnished to the public through lease. Thus, franchisees – such as those in the auto or furniture rental business – can take advantage of this inventory exemption. The inventory exemption, however, does not include goods that a franchisee must purchase for its own use in the operation of the business, such as equipment or ordinary business supplies.

WHAT TYPES OF RELATIONSHIPS ARE NOT COVERED?

As discussed in the Statement of Basis and Purpose, the amended Rule no longer covers the sale of business opportunity ventures. It also does not cover the sale of franchises to be located outside of the United States and its territories.

Business Opportunities

Disclosure requirements and prohibitions pertaining to business opportunities are now set forth in a separate Rule – 16 C.F.R. Part 437. At present, Part 437 is substantively identical to the disclosure requirements and prohibitions set forth in the original Franchise Rule. The Commission, however, is contemplating amending Part 437, and there is an ongoing rulemaking on that issue.

² For background information on the reasons for the inventory exemption, see Original Interpretive Guides, 44 Fed. Reg. at 49,967.

Sales of Franchises to Be Located Outside of the United States and its Territories

As a matter of policy, the amended Rule reaches only the offer or sale of franchises to be located in the United States and its territories. Accordingly, the amended Rule does not apply, for example, to the sale of a franchise to an American citizen living in Paris (or in Chicago), or to a French citizen in Paris, when the outlet will be located in Europe.³

WHAT TYPES OF RELATIONSHIPS ARE EXEMPT?

Some business arrangements satisfying the three definitional elements of the term “franchise” nonetheless may be exempt from the amended Franchise Rule. First, the amended Rule retains each of the exemptions found in the original Rule: the minimum required payment, fractional franchise, leased departments, and oral agreements exemptions. Second, the amended Rule adds new exemptions for sales governed by the Petroleum Marketing Practices Act, and for certain sales involving sophisticated investors.

Minimum Payment Exemption

Exempt from the Franchise Rule are franchise sales where “the total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operations of the franchisee’s business is less than \$500.”⁴ A franchisee commences operation when it first makes goods or services available for sale. A commitment entered into during the first six months that requires a payment later than six months after commencing operation (such as a promissory note or that portion of lease payments made after six months) is not counted toward the \$500 minimum.

³ Limitation of the geographic scope of the amended Franchise Rule is not intended to limit the FTC’s jurisdiction, as it is 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.

⁴ The Commission may adjust the \$500 threshold – and all other monetary thresholds found in the Rule’s exemptions – every four years for inflation.

Fractional Franchise Exemption

The amended Rule exempts the sale of fractional franchises. A fractional franchise relationship is created when the following two elements are present at the start of the relationship:

- The franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and
- The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

Whose Experience May Be Considered?

The amended Rule expands the original Rule's list of individuals whose prior experience will satisfy the first element to include current directors or officers of a parent or affiliate. The experience of directors or officers of a parent or an affiliate may be considered, so long as those individuals' prior experience has been in the same line of business.

What Does "Same Line of Business" Mean?

"Same line of business" means selling competitive goods, or being in a business that would ordinarily be expected to sell the type of goods to be distributed under the franchise. Accordingly, an independent ice cream store owner might qualify as a fractional franchisee if he or she were to enter into a franchise relationship with an ice cream cake supplier. However, the ice cream store owner would probably not qualify as a fractional franchisee if he or she were to enter into a franchise relationship to expand the product line to include items not typically found in ice cream stores, like greeting cards.

How Is Sales Volume Calculated?

When considering the second required element – whether increased sales volume from the fractional franchise relationship exceeds 20% of total sales – the parties may measure incremental sales resulting from the fractional franchise against total sales at all stores owned by

the franchisee (franchised or non-franchised). For example, an individual owning several hardware stores may introduce a new product at one store only. The store owner should measure the increase in sales attributed to the new product against the aggregate total sales volume for all products sold through his or her businesses.

Leased Department Exemption

Like the original Rule, the amended Rule exempts leased department arrangements. A “leased department” is an arrangement in which an independent retailer sells its own goods and services from premises leased from a larger retailer in the larger retailer’s store. These arrangements usually occur in the merchandising of footwear, optometry, tobacco, cosmetics, and jewelry. For example, a jeweler may rent space from a department store to sell jewelry and watches. Technically, this relationship may be a franchise because the jeweler becomes associated with the department store’s trademark, and the department store may impose what arguably could be considered significant control over the operation, like operating hours. This exemption is available only if the independent retailer is not required directly or indirectly to purchase its goods or services from either the larger retailer or from suppliers required or approved by the larger retailer.

Oral Agreements

The amended Rule exempts purely oral relationships that lack any written evidence of a material term of the franchise relationship or agreement, as a matter of policy, to avoid problems of proof in its enforcement. However, the exemption does not apply when there is any writing, even if unsigned, with respect to a material term, such as a purchase invoice for goods or equipment.

Petroleum Marketers and Resellers Exemption

The amended Rule expressly exempts petroleum marketers and resellers covered by the Petroleum Marketing Practices Act (“PMPA”). The most common types of franchises falling under this exemption are gasoline station franchises.

The PMPA exemption is intended to be read broadly. It covers not only gasoline stations, but other services and products – such as a repair center, car wash, or convenience store – sold to a prospective franchisee under the same, unified, franchise agreement as the gasoline station itself. However, the offer or sale of a convenience store or other franchise to an existing gasoline station franchisee under a separate franchise agreement is not exempt, and is, in fact, no different from the ordinary sale of a franchise to an existing franchisee.

Large Franchise Investment Exemption

The amended Rule exempts franchise offers and sales where the initial investment is at least \$1 million, excluding the cost of unimproved land and any franchisor (or affiliate) financing.⁵ In addition, the prospective franchisee must sign an acknowledgment that the franchise sale is exempt from the Franchise Rule because the prospective franchisee will be making an initial investment of at least \$1 million.

What Is an “Initial Investment”?

A franchisee’s “initial investment” is limited to the type of expenses that would ordinarily appear in an Item 7 disclosure – expenses paid through the opening of the outlet and any additional expenses paid through the three-month initial period thereafter. It does not reach all possible payments to the franchisor made over the life of the franchise agreement. Accordingly, future obligations to pay rent, royalties, or advertising fund contributions to be made over the life of the franchise agreement do not count toward the “initial investment.” The “initial investment” also does not reach costs associated with unimproved land,⁶ nor any funds obtained through franchisor (or affiliate) financing.

⁵ As noted previously, the Commission may adjust the large investment threshold every four years for inflation.

⁶ In determining whether the threshold is met, the cost of buildings, fixtures, equipment, and other improvements to the land may be included, but not the unimproved land itself.

Further, the exemption focuses on the level of the “initial investment,” not on the number of outlets or the type of outlets being sold. Accordingly, the exemption will apply where the total projected initial investment is reached, whether for a single unit or multiple units. At the same time, it is possible that the large investment exemption may apply to some, but not all, of a franchisor’s franchise sales. For example, a fast-food restaurant franchisor may sell stand-alone, full facility restaurant franchises for an initial cost of \$1 million, while at the same time selling kiosks for a much reduced price, such as \$100,000. Under the circumstances, only the sale of the stand-alone restaurants would qualify for the exemption.

Do Conversion Franchises and Transfers Qualify for the Exemption?

Conversion franchises and transfers of franchised outlets may qualify for the large investment exemption. In a conversion franchise, a business owner has already invested in his or her existing business and now seeks to associate with a particular franchisor’s mark by entering into a franchise agreement with that franchisor. When considering a conversion franchisee’s “initial investment” in a franchise, the conversion franchisee’s previous investment in the outlet (as opposed to the current value of the outlet) may be considered. This is true even though the conversion franchisee’s initial investment was not paid to the franchisor making the current offer.

In a transfer, a prospective franchisee buys an existing franchise directly from an existing franchisee, but then may enter into a new franchise agreement with the franchisor. The fact that a transferee will assume an existing contract or may renegotiate an existing contract with the franchisor ordinarily has no bearing on his or her level of sophistication as an investor. As long as he or she satisfies the monetary threshold, the large investment exemption is available. As in the case of the conversion franchisee, the prior investment to a party other than the franchisor – here, the transferring franchisee – does not preclude application of the large investment exemption.

Who must Make the Initial Investment?

Where an investor group seeks to purchase a franchise, at least one individual must invest at the \$1 million level for the exemption to apply. The large investment exemption is premised on the assumption that a franchisee’s ability to pay a large sum equates with sophistication. That assumption fails when no one investor standing alone is investing at the requisite threshold level. For purposes of this provision, a husband and wife can be considered a single individual since their assets are typically commingled.

What Is the “Acknowledgment” Requirement?

To take advantage of the large investment exemption, franchisors must obtain from the prospective franchisee a signed acknowledgment that the investment satisfies the \$1 million threshold. The acknowledgment must contain the following prescribed statement:

The franchise sale is for more than \$1 million – excluding the cost of unimproved land and any financing received from the franchisor or an affiliate – and thus is exempt from the Federal Trade Commission’s Franchise Rule disclosure requirements, pursuant to 16 C.F.R. § 436.8(a)(5)(i).

While the amended Rule does not specify the exact format of the acknowledgment the acknowledgment must be clear and conspicuous and in plain English, consistent with the Rule’s general directions, and the franchisor has the burden to prove that the acknowledgment was furnished to, and signed by, the prospective franchisee.

Large Franchisee Exemption

The amended Franchise Rule exempts franchise offers and sales to large entities – such as airports, hospitals, and universities – that have been in business for at least five years and have a net worth of at least \$5 million.⁷

⁷ As with the minimum required payment and large investment thresholds noted above, the Commission may adjust the threshold for the large franchisee exemption – currently set at \$5

What Type of Business Experience Is Required?

To qualify for the exemption, the large entity must have five years of prior business experience. That experience, however, need not be in franchising, or even in the franchised business in particular. For example, a hospital seeking to purchase a flower shop franchise could qualify for the exemption, even though the hospital may not have any prior experience with franchising or with the flower industry.

How Is Net Worth Determined?

To qualify for the large franchisee exemption, the prospective franchisee-entity must have a net worth of \$5 million. The 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.

May the Experience and Net Worth of Parent and Affiliate Companies Be Considered?

When determining the prior experience and net worth of a franchisee-entity, franchisors may consider the prior experience and net worth of the prospective franchisee's affiliates and parents. For example, a franchisor – such as a hotel – may wish to establish a separate corporation for a particular transaction. It is possible, however, that the new spin-off corporation will meet neither the net worth nor prior experience prerequisites. The amended Rule makes clear that the prior experience and net worth of the parent may be considered in such circumstances. Accordingly, franchisors may aggregate commonly-owned franchisee assets in determining the availability of the large entity exemption.

The “Insiders” Exemption

The amended Rule adds a new exemption for franchise sales to the officers, directors, general partners, managers (collectively “officers”), and owners of a franchisor. The prerequisites to qualify for this exemption differ depending upon whether the individual

million – every four years for inflation.

franchise purchaser is an officer, director, general partner, or manager, on the one hand, or an owner, on the other.

To take advantage of the exemption, an officer must seek to purchase at least a 50% ownership interest in the franchise being offered for sale. In addition, the officer must have at least two years of experience with the franchisor as an officer, director, general partner, or manager. Further, the prior experience must be recent: the officer must currently be associated with the franchisor or have been associated with the franchisor within 60 days of the proposed franchise sale. For example:

- An officer new to the company with only 14 months of experience would not qualify for the exemption. The officer must have two years of experience with the company to qualify.
- An officer with five years of experience with the company who leaves the company on January 1, 2007, would not qualify for the exemption if she were to seek to purchase a franchise on July 1, 2007. The officer's prior experience must be within 60 days of the franchise sale.

To take advantage of the exemption, an owner must also seek to purchase at least a 50% ownership interest in the franchise being offered for sale. In addition, the owner must have had at least a 25% interest in the franchisor for at least two years, and that ownership interest must be recent – at least 60 days before the sale of the franchise. For example:

- An owner of only a 10% interest in a company would not qualify for the insiders exemption if she were seeking to purchase a franchise. She must own at least 25% of the company to qualify.
- An owner of a 50% interest in the company would not qualify for the exemption if he owned his interest for only eight months. To qualify, an owner, even if a sole stockholder, must own his interest for at least two years.
- A sole stockholder of the company would not qualify for the exemption if she sells her shares in the company and then seeks to purchase a franchise eight months after the sale. The ownership interest must be recent – within 60 days of the sale.

Exclusions from the Amended Rule

The following relationships are excluded from the amended Rule. Although each of these relationships may have some superficial similarities with a franchise relationship, none of them meet the definitional elements of the term “franchise,” and should not be confused with a franchise relationship.

- **Employer-Employee Relationship Exclusion**

Bona fide employer-employee relationships are excluded from coverage under the amended Rule. The Commission will apply the traditional test of “right to control” in determining whether an employment relationship exists. Specifically, in determining whether a bona fide employer-employee relationship exists, the Commission will consider: (1) whether the employer pays a salary or definite sum of money as consideration for the work; (2) whether the employee can be discharged or his employment terminated without liability on the part of the employer; and (3) whether the “employee” must invest money in the business before being “hired.”⁸

- **General Partner Relationship Exclusion**

Bona fide relationships among general partners are excluded from coverage under the amended Rule. All partners in the partnership must be general partners to qualify for the exclusion. The Commission will look carefully at “partnership” arrangements that seek to exploit this exclusion by, for example, structuring a relationship to shield a “limited partner” (a *de facto* franchisor) from liability to the disadvantage of the “general” partner (a *de facto* franchisee).

⁸ Original Interpretive Guides, 44 Fed. Reg. at 49,968.

- **Cooperative Associations Exclusion**

Two types of “cooperative associations” qualify for this exclusion: (1) agricultural cooperatives authorized by the Capper-Volstead Act, 7 U.S.C. § 291; and (2) retailer-owned cooperative chains. Retailer-owned cooperatives are those operated by and for independent retailers on a cooperative basis. The members must be independent retailers, and the organization must furnish services or goods primarily to its members.

- **Certification or Testing Services Exclusion**

The amended Rule continues to exclude relationships that are created solely by arrangements with bona fide certification or testing services, such as are offered by Underwriters Laboratories and similar organizations. Franchising involves distribution of goods or services through selected outlets. In contrast, certification or testing services authorize use of their trademark by all parties meeting their standards and willing to pay their fee.

- **Single Trademark License Exclusion**

The amended Rule continues to exclude trademark licensing arrangements in which a single licensee is granted the right to use the trademark. This exclusion also includes a “one-on-one” licensing arrangement, *i.e.*, the license of a trademark to a single licensee who manufactures the trademarked goods according to the licensor’s specifications. This arrangement is common, for example, in the clothing industry where trademark owners license the manufacture of textiles. The exclusion also includes “collateral product” licensing, *i.e.*, the practice of licensing a trademark that is well-known in one context (*e.g.*, a soft drink logo) for use in another (*e.g.*, on clothing or decorative items embossed with the soft drink logo). This exclusion also includes licensing agreements entered into in the course of settlement negotiations in trademark infringement litigation, when the licensor grants the “infringing” party a license to use the trademark for a specified period.

DISCLOSURE COMPLIANCE OBLIGATIONS

The Rule specifies who must prepare the disclosures, who must furnish them to prospective franchisees, how franchisees receive the disclosures, and how long franchisees must have to review the disclosures and any revisions to the standard franchise agreement.

WHO IS RESPONSIBLE FOR PREPARING DISCLOSURE DOCUMENTS?

Franchisors are responsible for preparing disclosure documents. The term “franchisor” means “any person [including any individual, group, association, limited or general partnership, corporation or any other entity] who grants a franchise and participates in the franchise relationship.” Both requirements are necessary. Accordingly, franchise sellers – such as brokers – who engage only in pre-sale activities but who have no post-sale relationship obligations are not “franchisors” under the amended Rule.

Subfranchisors are also responsible for preparing disclosure documents. The term “franchisor” expressly includes subfranchisors. The term “subfranchisor” means “a person [including any individual, group, association, limited or general partnership, corporation or any other entity] who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.” This term does not include a third-party broker with no post-sale performance obligations, even if called a “subfranchisor.”

Both the franchisor and any subfranchisor are responsible for each other’s compliance with the amended Rule and are jointly and severally liable for each other’s violations. The franchisor and subfranchisor bear a joint responsibility under the Rule to ensure that required disclosures are made and are accurate. Some of the required disclosures may need to be supplied by the subfranchisor only or by the franchisor only. In other instances, both the franchisor and subfranchisor must supply the information so that the required disclosure is accurate.

Generally, Items 1-4 (information about the franchise system, prior business experience, litigation, and bankruptcy) call for both the franchisor and subfranchisor to supply information. In addition, a subfranchisor must provide Item 20 information (franchisee and company-owned outlet data). The franchisor must also provide Item 20 information if its statistics differ materially from the subfranchisor's statistics. Finally, both the franchisor and any subfranchisor must include their own financial statements in Item 21.

WHO IS RESPONSIBLE FOR FURNISHING DISCLOSURE DOCUMENTS?

Franchisors (including any subfranchisors) are responsible for furnishing disclosure documents to each prospective franchisee. A "prospective franchisee" is "any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship." Accordingly, franchisors do not have to furnish copies of their disclosure documents to members of the general public – such as journalists, academicians, or those surfing online who hit upon a franchisor's website. A person must have some bona fide interest in becoming a franchisee, not mere curiosity. At the same time, franchisors may comply with the obligation to furnish disclosure documents to "prospective franchisees" through an agent or representative of a prospective franchisee, such as an attorney. In the case of a corporate prospect, disclosures can be furnished to a company officer.

What Happens When an Existing Franchisee Sells His or Her Outlet?

A transferee – a person who purchases an existing franchise directly from the franchisee who owns it, without any significant contact with the franchisor – is not a prospective franchisee. Even if the franchisor has, and exercises, the right to approve or disapprove a subsequent sale (transfer) of a franchised unit, the transferee will not be entitled to receive disclosures unless the franchisor plays some more significant role in the sale. For example, if the franchisor provides financial performance information to the prospective transferee, the franchisor would be required to provide the transferee with its disclosure document.

What Happens When an Existing Franchisee Purchases Additional Outlets?

A franchisor is not required to provide a disclosure document to a franchisee exercising a right under the franchise agreement to establish any new outlets (as opposed to selling outlets to others), nor to a franchisee who chooses to keep its existing outlet post-term either by extending its present franchise agreement or by entering into a new agreement, unless the new relationship is under terms and conditions materially different from the present agreement.

WAYS OF FURNISHING DISCLOSURE DOCUMENTS

The amended Rule expressly permits franchisors to furnish disclosure documents by any method they wish, including electronically. While a disclosure document must still be “in writing,” that term is defined broadly as “any document or information in printed form or in any form capable of being preserved in tangible form and read.” It includes: type-set, word-processed, and handwritten documents, as well as documents transmitted as electronic information on a computer disk, a CD-ROM, an email, or in web pages posted on the Internet.

Are There Any Specific Requirements for Electronic Disclosures?

While the amended Rule permits electronic disclosure, it also makes clear that such disclosures must not include electronic features such as pop-up windows, audio, video, and links to external documents. Features that enable a prospective franchisee to review a disclosure document efficiently are permitted, however, such as scroll bars, search features, and internal links (such as links between the Table of Contents and the specific disclosure items).

Further, the amended Rule recognizes that franchisors may wish, but are not required, to furnish disclosures in alternative media. To that end, the cover page requirements permit franchisors to include a new provision that informs prospective franchisees how they may obtain a disclosure document in an alternative form – whether via an email, a CD-ROM, an Internet posting, or some other means.

Is Electronic Disclosure Permitted for All Franchisors as of July 1, 2007?

Since July 1, 2007, franchisors have been permitted to use one of three formats: the original Franchise Rule, the UFOC Guidelines, or the amended Rule. As of June 30, 2008, however, **only** the amended Rule format will be permitted. Technically, this requirement would permit a franchisor to furnish disclosures electronically only if the franchisor opted to use the amended Rule – the only one of the three available sets of disclosure requirements that expressly permits electronic disclosure. Nevertheless, the FTC staff would not recommend enforcement action against any franchisor that did not opt to comply with the amended Rule prior to June 30, 2008, but furnished electronic disclosures, if the franchisor was otherwise in total compliance with either the UFOC Guidelines or the original Franchise Rule. While ensuring that franchise purchasers receive adequate protection, this approach conforms to the spirit of the Electronic Signatures in Global and National Commerce Act (“E-SIGN”), 15 U.S.C. § 7001. Accordingly, for FTC compliance, all franchisors can begin using electronic disclosures on July 1, 2007. Whether electronic disclosure satisfies state requirements is an issue that can be resolved only by consulting with individual state authorities. Of course, any franchisor electing to furnish disclosures electronically must follow the specific instructions pertaining to electronic documents set forth in the amended Rule (*e.g.*, no pop-up screens, audio, or video).

AT WHAT POINT IN THE SALES PROCESS MUST A FRANCHISOR FURNISH THE DISCLOSURE DOCUMENT?

The amended Rule provides that franchisors must furnish prospective franchisees with a disclosure document at least 14 calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale. The 14 days begin the day after delivery of the disclosure document. The signing of any agreement or receipt of payment can take place on the fifteenth day after delivery. This ensures that prospective franchisees have at least a full 14 days in which to review the disclosures.

Upon reasonable request, franchisors also must furnish a disclosure document to a prospective franchisee earlier in the sales process than 14 calendar days before the franchisee signs or pays. The failure to comply with a reasonable request for an earlier delivery is an independent violation of the Rule. This does not mean that a franchisor must tender a disclosure document to any person who asks for a copy. Rather, it applies where the parties have taken steps to begin the sales process. For example, a prospective franchisee who has received a positive response from a franchisor after submitting an application to purchase a franchise may ask for a copy of the franchisor's disclosure document at that time or thereafter. A franchisor may not charge any fee in connection with a prospective franchisee's right to receive a disclosure document in advance of the disclosure deadline.

Payment to or Binding Agreement with the Franchisor or Affiliate

The amended Rule provides that disclosures must be furnished 14 days in advance of the franchisee making a payment to, or signing a binding agreement with, "the franchisor or an affiliate in connection with the proposed franchise sale." This language makes clear that payments to, or agreements with, third parties do not trigger the franchisor's disclosure obligation because a franchisor cannot control, or does not necessarily know, when a prospective franchisee may proceed to pay or make a commitment to third parties. Accordingly, payments or agreements that a prospective franchisee voluntarily makes on his or her own in connection with reviewing a franchise offer, such as providing a retainer to an attorney or payments for a market feasibility study, do not trigger a franchisor's disclosure obligation.

Actions That Constitute the Furnishing of Disclosure Documents

Franchisors now have many options as to how they furnish disclosure documents. Under the amended Rule, a franchisor will have furnished a disclosure document in a timely manner if the franchisor has:

- hand-delivered, faxed, emailed, or otherwise delivered to the prospective franchisee a copy of the document by the required date;

- provided directions for accessing the document on the Internet to the prospective franchisee by the required date; or
- sent a paper or tangible electronic copy (for example, a computer disk or CD-ROM) to the address specified by the prospective franchisee by first-class United States mail at least three calendar days before the required date.

OPPORTUNITY FOR PROSPECTIVE FRANCHISEES TO REVIEW THE FRANCHISE AGREEMENT

Except in limited circumstances, the amended Franchise Rule eliminates the original Rule's requirement that prospective franchisees always have at least five business days in which to review the completed franchise agreement. Under the amended Rule, it is only if the franchisor has unilaterally and materially altered the terms and conditions of the basic franchise agreement (or any related agreement) attached to the disclosure document previously furnished to a prospective franchisee that the franchisor is required to afford the prospective franchisee additional time – now seven calendar days – to review it before the revised agreement is signed. This does not include instances where changes to the agreement arise out of negotiations initiated by the prospective franchisee.

Unilateral Material Modifications by the Franchisor

The mandatory seven calendar day review period does not apply where the only differences between the standard agreements and the completed agreements are non-substantive “fill-in-the-blank” provisions, such as the date, name, and address of the franchisee. The addition of substantive terms such as a specific radius or geographic area comprising a protected territory, the actual number of stores to be opened pursuant to an area development agreement, the specific interest rate payable by the franchisee, or other contractual terms that were not previously disclosed in the basic disclosure document or its attachments will trigger the seven calendar day review period.

Unilateral Material Modifications by the Franchisee

The amended Rule expressly exempts from the seven calendar day review period changes to a previously disclosed franchise or other agreement where such changes were initiated at the prospective franchisee's request. When a prospective franchisee is the party introducing contract modifications, the seven calendar day review period is not required. Even if some of the changes benefit the franchisor, changes made under these circumstances will be considered initiated by the prospective franchisee. Whether or not a particular change benefits one party or the other is irrelevant. What is determinative is whether the prospective franchisee has knowledge of the change before signing the agreement. As long as the prospective franchisee has initiated the process of revising documents that previously have been presented for signing, any discussions about changes, and any agreed upon changes thereafter, are clearly made with the prospective franchisee's knowledge.

THE DISCLOSURE DOCUMENT

The overview that follows highlights key changes and provides sample disclosures for each item in the disclosure document required by the amended Rule. For a discussion of the general instructions for preparing a disclosure document, see pages 121 - 125 below.

THE COVER PAGE

The disclosure document begins with a cover page that provides prospective franchisees with information about the franchise being offered for sale. The amended Rule updates the original cover page to include references to the franchisor's email address and website. It also provides prospective franchisees with additional sources of information, including a reference to the FTC's Consumer's Guide to Buying a Franchise ("Guide").⁹ While the amended Rule prohibits the inclusion of links to external materials in a disclosure document, franchisors may, if they wish, link to the Guide on the page on the FTC's web site where that specific document is found.

When preparing the cover page, franchisors must follow the specific order and form set out in the Rule. The title of the cover page is "**FRANCHISE DISCLOSURE DOCUMENT**," and it must appear in both capital letters and boldface type. The cover page must next state the franchisor's name, type of business organization, principal business address, telephone number, and, if applicable, the franchisor's email address and the address of the primary Internet home page of the system being offered for sale. Franchisors need not list every home page address owned by, or associated with, the franchise system. The cover page must also include a sample of the primary business trademark that franchisees will use in the business and provide a brief description of the franchised business. Certain prescribed statements must also be included in the cover page.

⁹ The current edition of the Guide is now titled "Buying a Franchise, A Consumer Guide."

Reference to Item 5 and Item 7 Fees and Investment

The cover page contains a modified version of the reference to Item 5 and Item 7 fees and investment required by the UFOC Guidelines. The UFOC Guidelines require that the cover page state the total amounts listed in the Item 5 and Item 7 disclosures. Under the amended Rule, the cover page reference makes clear that Item 5 initial fees disclosures are a subset of the Item 7 total investment disclosure. The amended Rule makes this clear by specifying a standard format that franchisors must follow in referencing Item 5 and Item 7 on the cover page. That specified format is as follows:

The total investment necessary to begin operation of a [franchise system name] franchise is [the total amount of Item 7]. This includes [the total amount in Item 5] that must be paid to the franchisor or affiliate.

Available Disclosure Formats

Franchisors may use a wide variety of means for furnishing disclosure documents, including email, CD ROM, or the Internet (such as a password protected portion of a website). If a franchisor makes disclosure documents available in more than one medium, it may wish to advise prospects that they can obtain a copy in a medium that is more convenient to them. To that end, franchisors may include the following optional statement in the cover page:

You may wish to receive your disclosure document in another format that is more convenient to you. To discuss the availability of disclosures in different formats, contact [name or office] at [address] and [telephone number].

For purposes of this disclosure, an “address” may be an email address, business address, or both.

Issuance Date

A franchisor must include the issuance date for the disclosure document on its cover page. The “issuance” date is very flexible, meaning any date upon which the franchisor finalizes that version of the disclosure document for future use. States that require franchisors to register their disclosure documents, however, may use the term “effective date,” meaning the date upon which the state formally approves registration of the disclosure document. Where a franchisor seeks registration in one or more states, the franchisor may use, in lieu of an issuance date, an “effective” date consistent with state approval of the document. A franchisor obtaining an effective date from a registration state may also use the term “effective date,” even in non-registration states.

Inclusion of State Information on the Cover Page

State law may require, or state franchise examiners may request, that franchisors include risk factors or other information in the cover page. The amended Rule specifically allows flexibility on this point. Franchisors are always permitted to comply with state-specific requirements by adding such required information, whether on the cover page, in a separate state-specific cover page, or in an addendum.

Sample Cover Page:

FRANCHISE DISCLOSURE DOCUMENT

Belmont Mufflers, Inc.
A Minnesota Corporation
111 First Street
Jackson, Minnesota 55000
(111) 222-3333
franchiseofficer@belmont_mufflers4u.com
www.belmont_mufflers4u.com



Belmont Mufflers, Inc., repairs and installs motor vehicle exhaust systems. The total investment necessary to begin operation of a Belmont Mufflers franchise is \$100,000. This includes \$42,000 that must be paid to the franchisor or affiliate.

This disclosure document summarizes certain provisions of your franchise agreement and other information in plain English. Read this disclosure document and all agreements carefully. You must receive this disclosure document at least 14 calendar days before you sign a binding agreement with, or make any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

Note, however, that no government agency has verified the information contained in this document.

[Optional: You may wish to receive your disclosure document in another format that is more convenient to you. To discuss the availability of disclosures in different forms, contact Belmont Mufflers' franchise group at 111 First Street, Jackson, MN, 55000 and (111) 222-3333.]

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

Buying a franchise is a complex investment. The information in this disclosure document can help you make up your mind. More information on franchising, such as "[A Consumer's Guide to Buying a Franchise](#)," which can help you understand how to use this disclosure document, is available from the Federal Trade Commission. You can contact the FTC at 1-877-FTC-HELP or by writing to the FTC at 600 Pennsylvania Avenue, NW, Washington, DC 20580. You can also visit the FTC's home page at www.ftc.gov for additional information. Call your state agency or visit your public library for other sources of information on franchising.

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

Issued: April 15, 2008

THE TABLE OF CONTENTS

Each disclosure document must contain a table of contents, following the order and form set forth in the amended Rule. When preparing the table of contents, franchisors must state the page where each disclosure item begins and refer to any exhibits by letter. Note that the titles to specific disclosure items are somewhat different from those used in the UFOC Guidelines:

Sample Table of Contents:

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ITEM 1: THE FRANCHISOR AND ANY PARENTS, PREDECESSORS, AND AFFILIATES

Item 1 of the amended Rule requires franchisors to disclose background information on the franchisor and any parents, predecessors, and affiliates. Unlike the UFOC Guidelines instructions for Item 1, the amended Rule does not expressly require a franchisor to refer to itself as “we,” or to use initials, or a one or two-word shorthand form. Nor does the amended Rule require the franchisor to refer to the franchisee as “you.” However, this approach is consistent with the amended Rule’s general requirement that disclosure must be in plain English. Accordingly, franchisors may use such abbreviated references throughout the disclosure document.

Franchisor Disclosures

Like the UFOC Guidelines, Item 1 of the amended Rule calls for identification of the franchisor. The term “franchisor” means any person who both grants a franchise and participates in the franchise relationship post-sale. This includes any subfranchisor that acts as a franchisor, engaging in pre-sale activities and having post-sale performance obligations. Item 1 also requires disclosure of the type of business organization used by the franchisor – whether a corporation, partnership, or any other business organization, such as a limited liability company.

Agent for Service of Process Disclosure

Item 1 also calls for identification of the franchisor’s agent for service of process. Item 1 of the UFOC Guidelines required franchisors to disclose only the address of the franchisor’s agent, but did not specifically require the franchisor to identify the agent. Item 1 of the amended Rule clarifies this point, specifically requiring franchisors both to identify the agent and to state the agent’s principal business address.

Parent Disclosures

Item 1 of the amended Rule differs from the UFOC Guidelines by requiring franchisors to identify any parent companies. Under the amended Rule, a “parent” means “an entity that controls another entity directly, or indirectly through one or more subsidiaries.” The term includes *all* parents in the chain of ownership, not just the immediate parent-owner of the franchisor, and not just the “ultimate” or “highest” parent in a chain of ownership. Note that Item 1 only requires that franchisors identify parents and provide their principal business addresses. Item 1 does not call for the kind of detailed information about parents that it requires

for affiliates and predecessors – their business background, their length of time selling franchises, or their involvement in other lines of business.

Predecessor Disclosures

The amended Rule requires the disclosure of any predecessor during the prior ten-year period immediately preceding the close of the franchisor’s most recent fiscal year.¹⁰ The amended Rule defines a predecessor as a person from whom the franchisor acquired, directly or indirectly, the major portion of the franchisor’s assets.

A change in ownership of a franchisor alone does not necessarily mean that the franchisor under the former ownership will be considered the “predecessor” of the franchisor under the new ownership. The former ownership must be disclosed as a predecessor only if the new ownership has acquired the majority of the franchisor’s assets from the former ownership, calculated as of the date of the acquisition of those assets. For example, if on July 1, 2006, Glenmont Mufflers purchased 60% of its assets from Belmont Mufflers, and 40% from various suppliers, then Glenmont Mufflers must list Belmont Mufflers as a predecessor.

Further, implicit in the definition of “predecessor” is the requirement that the franchisor purchased operating assets from the predecessor entity *and* that the predecessor itself operated or franchised the same or a similar business. In short, the mere purchase by a franchisor of another entity’s assets by itself does not make the selling entity a predecessor. For example, if Belmont buys the assets of a real estate office – such as a building, fixtures, desks, files, and computers – neither the real estate office nor its owners would be a predecessor.

Principal Business Address Disclosure

Item 1 calls for the disclosure of the principal business address of the franchisor, parent, predecessor, and affiliates. The definition of the term “principal business address” is similar to the definition of that term in the UFOC Guidelines. It refers to the physical address of the home office in the United States. The term excludes post office boxes, private mail drops, such as UPS Store private boxes, and email addresses.

¹⁰ The same time frame should also be used for predecessor disclosures in Item 3 (litigation) and Item 4 (bankruptcy).

Applicable Government Regulations Disclosure

Item 1 calls for the disclosure of any laws that apply to the franchised business specifically. Laws that pertain to all businesses generally – such as child labor laws, local signage restrictions, no-fault liability insurance requirements, business licensing laws, and tax regulations – need not be disclosed, even if those laws have a substantial or disproportionate impact on the business being offered for sale.

Only laws that pertain solely and directly to the industry in which the franchised business is a part must be disclosed in Item 1. Examples include the following:

- A real estate brokerage franchisor would disclose that franchisees are covered by broker licensing laws.
- An optical products franchisor would disclose that franchisees are covered by applicable optometrist/optician staffing regulations and licensing requirements.
- A lawn care franchisor would disclose that certain laws regulating pesticide application to residential lawns will require that franchisees post notices on treated lawns.
- A legal document preparation service would disclose that the preparation of bankruptcy petitions by non-lawyers is regulated by the U.S. Bankruptcy Code.

In any case where industry-specific laws are disclosed, statutory citation and identification are unnecessary. The disclosure should simply state that a specific type of regulation exists and that prospective franchisees should investigate the matter further.

Sample Item 1: The Franchisor, and Any Parents, Predecessors and Affiliates:

ITEM 1: THE FRANCHISOR, PARENTS, PREDECESSORS, AND AFFILIATES

To simplify the language, this disclosure document uses “we” or “us” to mean Belmont Mufflers, Inc., the franchisor. “You” means the individual, corporation, or other entity that buys a Belmont Muffler franchise.

Franchisor, Parent, and Affiliates

We conduct business under the name Belmont Muffler Shops. Our principal business address is 111 First Street, Jackson, Minnesota 55000. We are a Minnesota corporation that was incorporated on September 3, 1983. We do not conduct business under any other name.

Our corporate parent is CTF International, Inc. Its principal business address is 100 Main Street, Chicago, Illinois 77000.

Our affiliate is Belmont Muffler Manufacturers, Inc. Its principal business address is 222 Second Street, Jackson, Minnesota 55000. Belmont Muffler Manufacturers produces and supplies mufflers and related parts to Belmont and other muffler shops.

Agent for Service of Process

Our agent for service of process is Mr. John Smith. His principal business address is 185 Westfield Avenue, St. Paul, Minnesota 55111.

Prior Experience

We started operating muffler businesses in 1983. We started to sell Belmont Muffler Shops franchises in 1993. We currently own and operate 12 Belmont Muffler Shops. Each of these shops is located in urban areas, has approximately 8,000 square feet of floor space, and is located on a busy street. We also sell pipe bending machines, mufflers, and related automotive parts to various muffler shops.

Since 1983, Belmont Muffler Manufacturers, Inc., has been providing mufflers and related parts to muffler shops, including Belmont Muffler Shops franchises. It does not offer or sell franchises in any line of business.

From 1993 to 2003, we also offered franchises for “Repair-All Transmission Shops.” “Repair-All” franchises repaired and replaced motor vehicle transmissions under a marketing plan similar to the franchise offered in this document. Belmont sold 40 of these franchises, primarily in Minnesota, Michigan, Wisconsin, and Illinois. In 2003, Belmont sold this transmission repair company to CTF International, Inc., which no longer offers new “Repair-All” franchises for sale.

The Business We Offer

Your muffler shop franchise will sell and install mufflers, and related automotive parts and service to the general public. You must honor our guarantee to replace mufflers or exhaust pipes that wear out if the vehicle ownership has not changed. Our franchisees often operate their muffler shop franchise with their service stations or tire center. The market for muffler repair is fully developed. Your competitors include department store service departments, service stations, and other national chains of muffler shops.

Applicable Regulations

You must comply with federal, state, and local health and environmental safety regulations concerning the proper handling and disposal of oils, lubricants, cleaning fluids, and other products used in the business. You should investigate the application of these laws further.

ITEM 2: BUSINESS EXPERIENCE

Item 2 of the amended Franchise Rule is substantially similar to Item 2 of the UFOC Guidelines. It requires disclosure of the business experience of certain individuals – including directors and principal officers, among others – for the last five years. A longer period is acceptable if the prior experience is directly relevant to the franchises being offered for sale.

There are, however, important differences between the amended Rule Item 2 and Item 2 of the UFOC Guidelines. First, franchisors need not disclose information about the business experience of any broker that may be involved in sales of its franchises. Second, in addition to disclosing the business background of directors and principal officers, franchisors must disclose the business experience of any individuals – even if they do not have a formal title – who have management responsibility relating to the sale or operation of franchises offered by the disclosure document. It does not matter whether the individuals with management responsibility are employed by the franchisor, an affiliate, or by a parent company. As long as the individual actively manages the sale of franchises or the operation of franchises, that individual's business experience should be noted in the Item 2 disclosure. This does not mean that franchisors must disclose all managers. Rather, sales and operations managers, regardless of whether they have a formal title, should be disclosed if their involvement in either sales or operations is such that a prospective franchisee would rely on their expertise, formulation of policy, or control of the system in making an investment decision.

Sample Item 2: Business Experience

ITEM 2: BUSINESS EXPERIENCE

President and Director: Jane J. Doe

Ms. Doe became President of Belmont Mufflers, Inc., in June 2006. From May 2004 until June 2006, she served as our Vice President. From June 2000 until April 2004, Ms. Doe was Vice President of Atlas, Inc., a Houston, Texas, manufacturer of automobile wheels.

Vice President: Henry Moore

On July 1, 2006, Mr. Moore joined Belmont as Vice President. From January 2000 until July 2006, Mr. Moore served as a manager of Belmont Muffler Manufacturers, Inc.

Franchise Coordinator: Phillip E. Smith

On January 1, 2006, Mr. Smith joined us as a franchise coordinator. From July 2001, until September 2005, Mr. Smith was a manager at Bishop Wash, Inc., a Denver, Colorado, manufacturer and distributor of car wash detergents.

Manager of Franchise Development: Ann Howard

Ms. Howard has managed franchise development at our parent company – CFT International, Inc., since 1995. She oversees the development of all franchise systems owned and operated by CFT International, including Belmont Mufflers, Inc.

ITEM 3: LITIGATION

Item 3 calls for the disclosure of certain lawsuits involving the franchisor and other entities associated with the franchisor – *i.e.*, predecessors, parents, and affiliates – in addition to certain lawsuits involving any person identified in Item 2. These are substantially similar to the disclosure requirements of the original Rule and the UFOC Guidelines. What is new, however, is the requirement that franchisors disclose suits that they initiate against franchisees, as explained below. In preparing an Item 3 disclosure, franchisors must consider two preliminary issues: (1) what types of litigation must be disclosed; and (2) whose litigation must be disclosed.

What Types of Litigation must Be Disclosed?

Under the amended Franchise Rule, certain suits falling into four broad categories must be disclosed in Item 3: pending lawsuits, lawsuits involving the franchise relationship, prior lawsuits, and current government injunctive or restrictive actions. These include arbitrations. Ordinarily, mediations need not be disclosed, unless the mediation results in the settlement of an

ongoing lawsuit that must be disclosed in Item 3. It also includes material foreign litigation, even if the actions are in a foreign court or arbitration forum.

- **Pending Actions**

Two types of pending lawsuits must be disclosed. The first type consists of any administrative, criminal, or material civil action that alleges a violation of a franchise, antitrust, or securities law, or that alleges fraud, unfair or deceptive practices, or comparable allegations. A “material” civil action is one that is likely to influence a prospective franchisee’s investment decision. Accordingly, a franchisor must disclose pending suits such as those filed by the Federal Trade Commission or United States Department of Justice against a franchisor for violations of the Franchise Rule (or other Commission trade regulation rules) or deceptive or unfair trade practices in violation of Section 5 of the FTC Act. It also includes state actions, such as those filed by a state Attorney General.

Second, the franchisor must disclose whether it, any related entity identified in the chart below, or any person identified in Item 2 has been involved in any pending civil lawsuits, “other than ordinary routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations.” These factors must be weighed on a case-by-case basis to determine whether any particular civil action is material and therefore must be disclosed. For example, a civil suit by a supplier against a large franchise system with many franchisees may not be material even if the supplier were to prevail in the suit, if the amount of damages alleged would not have a materially adverse effect on the franchisor’s overall financial condition. On the other hand, a civil suit for toxic dumping or stock manipulation which, if successful, may give

rise to a multi-million dollar civil penalty award may be material because of its likely impact on even a large franchise system's financial condition.

- **Material Actions Involving the Franchise Relationship**

The franchisor must disclose whether it, any related entity identified in the chart below, or any person identified in Item 2 has been a party to any material civil actions involving the franchise relationship in the last fiscal year. Material franchisor-initiated suits – those likely to influence a prospective franchisee's investment decision – must be disclosed. All suits pertaining to the franchise relationship – even a small number of suits – are presumed to be material because they may shed light on problems in the franchise relationship or the likelihood that the franchisor will resort to litigation against a franchisee. One notable exception may involve isolated, non-traditional franchise sales. Where a franchisor sues a franchisee based upon a franchise agreement for a non-traditional outlet – such as an outlet in a hospital or in a military facility – the particulars of that agreement and any suit to enforce it are not necessarily material to the sale of traditional franchises under the franchisor's standard franchise agreement.

Further, only suits filed over the course of the last fiscal year must be disclosed. Franchisors need only prepare this disclosure on an annual basis and disclose only those suits filed (not pending) during the previous fiscal year. Franchisors that begin franchising in the middle of their fiscal year, or that first initiate a lawsuit against a franchisee in the middle of their fiscal year, need only update their documents to disclose franchisor-initiated suits upon the close of their current fiscal year, as part of their annual update.

Only suits involving the “franchise relationship” must be disclosed. Such suits involve contractual obligations between the franchisor and franchisee, arising directly from the operation of the franchised business. The “franchise relationship” limitation specifically excludes actions involving third parties, such as suits by a franchisor against a supplier. It also excludes suits initiated by a franchisor against a franchisee for indemnification of tort liability.

Franchisors disclosing franchisor-initiated litigation may utilize streamlined reporting. While franchisors reporting franchisor-initiated litigation may disclose full case citations and summaries, they may comply with the amended Rule, if they wish, by listing individual suits (by name with citation) under one common heading that serves as a summary. For example, the franchisor may list individual cases under common headings such as “royalty collection suits,” and “system standards.”

- **Prior Actions**

The franchisor must disclose whether it, any related entity identified in the chart below, or any person identified in Item 2 has been involved in certain types of legal actions within 10 years before the issuance date of the disclosure document. Specifically, any convictions or nolo contendere pleas to a felony charge must be disclosed, as well as civil actions in which the franchisor was held liable involving alleged violations of “a franchise, antitrust, or securities law, or involving allegations of fraud, unfair or deceptive practices, or comparable allegations.” For purposes of this disclosure, a party is “held liable” if that party 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.

Accordingly, dismissals, including a dismissal concluding an adversarial proceeding, need not be disclosed.

If a formal settlement agreement must be disclosed, then all material terms of the settlement must be disclosed, whether or not the agreement is confidential. However, franchisors need not disclose the terms of any confidential settlements entered into before the franchisor commenced franchise sales. In addition, any franchisor that has historically used only the original Franchise Rule format set out at 16 C.F.R. Part 436, or which is new to franchising, need not disclose confidential settlements entered into prior to the effective date of the amended Rule.

- **Injunctive Actions**

The franchisor must disclose whether it, any related entity identified in the chart below, or any person identified in Item 2 is subject to a currently effective injunctive or restrictive order or decree resulting from a pending or concluded action brought by a governmental agency – such as the FTC, SEC, or state Attorney General – under a federal, state, or Canadian franchise, securities, antitrust, trade regulation, or trade practice law, or that otherwise relates to the franchise. An injunctive or restrictive order or decree is “currently effective” unless it has (1) been vacated or rescinded by a court or by the issuing agency, or (2) expired by its own terms. If the named parties have fully complied with an order requiring a specific course of action – such as registering its disclosure document – then the order is no longer “currently effective.” However, a party cannot fully comply with an order to act or to refrain from acting (for example, to comply with the amended Franchise Rule) until the order expires by its own terms. Most, if not all, Federal Trade Commission injunctive orders

pursued in federal district court contain no expiration term and, therefore, will almost always be deemed “currently effective.”

Whose Litigation must Be Disclosed?

Item 3 calls for different disclosures depending upon the entity involved in the suit. Whenever a franchisor or predecessor has been involved in one of the four categories of litigation covered in Item 3, that suit must be disclosed.¹¹ If a franchisor’s predecessor is no longer affiliated with the franchisor, the franchisor must make a good faith effort to obtain updates about the predecessor’s prior and current litigation. If unable to do so, the franchisor can note that fact in Item 3.

In contrast, a parent’s litigation must be disclosed only if the parent promises “to back the franchisor financially or otherwise guarantees the franchisor’s performance.” Generally, this means that parent litigation must be disclosed when the parent promises to ensure the franchisor’s post-sale performance either by providing needed funds to the franchisor or by fulfilling the franchisor’s post-sale obligations on behalf of the franchisor. In contrast, affiliate litigation must be disclosed if the affiliate offers franchises under the franchisor’s principal trademark, or if the affiliate promises “to back the franchisor financially or otherwise guarantees the franchisor’s performance.” A franchisor must also disclose currently effective injunctions, decrees, and orders resulting from government legal actions against an affiliate if the affiliate “has offered or sold franchises in any line of business within the last 10 years.”

¹¹ As noted above in connection with Item 1, this disclosure pertains only to predecessors of the franchisor over the last 10 years.

The following chart summarizes the disclosure obligations of franchisor-related entities:

	Pending Lawsuits; Other Material Civil Actions	Franchise Relationship Actions	Prior Actions	Government Injunctions, Decrees, Orders
Franchisor	Must disclose	Must disclose	Must disclose	Must disclose
Predecessor	Must disclose	Must disclose	Must disclose	Must disclose
Affiliate	Must disclose if affiliate promises to back the franchisor financially or otherwise guarantees the franchisor's performance, or sells franchises under the franchisor's principal trademark	Must disclose if affiliate promises to back the franchisor financially or otherwise guarantees the franchisor's performance, or sells franchises under the franchisor's principal trademark	Must disclose if affiliate promises to back the franchisor financially or otherwise guarantees the franchisor's performance, or sells franchises under the franchisor's principal trademark	Must disclose if affiliate guarantees the franchisor's performance, or if the affiliate has offered or sold franchises in any line of business within the last 10 years
Parent	Must disclose if the parent promises to back the franchisor financially or otherwise guarantees the franchisor's performance	Must disclose if the parent promises to back the franchisor financially or otherwise guarantees the franchisor's performance	Must disclose if the parent promises to back the franchisor financially or otherwise guarantees the franchisor's performance	Must disclose if the parent guarantees the franchisor's performance
Directors, trustees, general partners, principal officers, and persons with management responsibility relating to the sale or operation of the franchise offered	Must disclose if named as a party	Must disclose if named as a party	Must disclose if named as a party	Must disclose if named as a party

Sample Item 3: Litigation

ITEM 3: LITIGATION

Pending Actions

Blank v. Belmont Mufflers, Inc., No. 06-111 (M.D. Fla. filed August 1, 2007).

Five franchisees filed suit against us for breach of contract, alleging that we failed to furnish equipment in the time period stated in our franchise agreement. These franchisees seek damages of \$350,000. A trial is scheduled for later in 2007.

Prior Actions

Doe v. Belmont Mufflers, Inc., No. 05-312 (IRT) (S.D.N.Y. filed March 1, 2005).

Our franchisee, Donald Doe, sought to enjoin us from terminating him for nonpayment of royalty fees. On April 3, 2006, Doe withdrew the case when we repurchased his franchise for \$90,000 and agreed not to enforce non-compete clauses against him.

Governmental Actions

Indiana v. Belmont Mufflers, Inc., No. 05-123 (S.D. Ind. filed April 1, 2005).

The Attorney General of Indiana sought to enjoin us, our president Jane Doe, and franchise coordinator Phillip E. Smith, from offering unregistered franchises and using false income representations. The court found that we had offered franchises, that the offers were not registered, and that we had made the alleged false representations. The court enjoined us from repeating those acts.

FTC v. CFT, International Inc., No. 03-222 (D. Minn. filed March 1, 2003).

The Federal Trade Commission filed suit against our parent CFT International, Inc., that guarantees delivery of pipe and equipment to our franchisees. The Commission alleged that CFT violated the Commission's Mail or Telephone Order Merchandise Rule. The Commission obtained an injunction and a civil penalty of \$20,000.

Litigation Against Franchisees in the Last Fiscal Year

During fiscal year 2007, Belmont Mufflers initiated seven lawsuits against franchisees as follows:

Suits to Collect Royalty Payments

Belmont Mufflers vs. Smith, No. 457-123 (E.D. La. 2007)

Belmont Mufflers vs. Jones, No. 07-890 (S.D. Fla. 2007)

Belmont Mufflers vs. Taylor, No. 07-123 (D. Nev. 2007)

Suits to Enforce System Standards

Belmont Mufflers vs. Stevenson, No. 28-098 (C.D. Cal. 2007)

Belmont Mufflers vs. Rogers, No. 2244 (D. R.I. 2007)

Suits to Enforce Covenant-Not-To-Compete

Belmont Mufflers vs. Baker, No. 07-123 (S.D. Fla. 2007)

Belmont Mufflers vs. Harris, No. 072244 (D. Nev. 2007)

Other than these actions, no litigation is required to be disclosed in this disclosure document.

ITEM 4: BANKRUPTCY

The bankruptcy disclosures of the amended Rule are substantively similar to those of the UFOC Guidelines. One difference, however, is the list of persons about whom bankruptcy information must be disclosed. Franchisors must disclose not only the bankruptcy history of the franchisor itself, its affiliates, and predecessors, but also of any of its parents. Moreover, for Item 4 purposes, the disclosure of affiliate and parent information is not limited – as it is for Item 2 and Item 3 – to affiliates or parents that guarantee performance or back the franchisor financially. Bankruptcy history must be disclosed for *all* affiliates and parents: any bankruptcy in which an affiliate or a parent was involved during the 10-year reporting period immediately before the issuance date of the disclosure document must be disclosed.

In addition, franchisors must disclose bankruptcies involving any officer or general partner of the franchisor, and “any other individual who will have management responsibility relating to the sale or operation of franchises offered” by the disclosure document, including those of any company of which they were a principal officer or general partner. As in Items 2 and 3, the question of who, other than officers or a general partner, is subject to the disclosure focuses on actual management responsibility, instead of title.

Sample Item 4: Bankruptcy

ITEM 4: BANKRUPTCY

On March 2, 2004, Belmont filed a petition to reorganize under Chapter 11 of the U.S. Bankruptcy Code in the District of Minnesota, 04-BR-3344. We continued to operate our business and manage our assets as a debtor-in-possession under bankruptcy court supervision. On October 2, 2005, the bankruptcy court confirmed our plan of reorganization, which restructured the rights of creditors by providing for certain payments and discharged their claims.

On March 1, 2007, Belmont Muffler Manufacturers, Inc., our affiliate, filed a petition to reorganize under Chapter 11 of the U.S. Bankruptcy Code in the District of Minnesota, 06-BR-4455.

Belmont's president, Jane Doe, was president of Atlas, Inc., a Houston, Texas, manufacturer of automobile wheels from June 2000 until March 2002. On June 6, 2002, creditors filed an involuntary petition against Atlas for liquidation under Chapter 7 of the U.S. Bankruptcy Code. In re Atlas, Inc., No. 04-BR-555 (S.D. Tex. 2002). On July 14, 2002, the bankruptcy court entered an order for relief against Atlas. A trustee was appointed; she closed Atlas' operations, sold its assets, and distributed the proceeds to creditors in accordance with the priorities of the Bankruptcy Code.

Belmont manager of franchise operations, Philip E. Smith, filed a bankruptcy petition under the liquidation provisions of Chapter 7 of the U.S. Bankruptcy Code on September 7, 1999, after obtaining employment with Belmont on January 1, 1998. In re Smith, No. 06-BR-6789 (D. Minn. 1999). On January 10, 2000, the bankruptcy court entered a discharge.

ITEM 5: INITIAL FEES

Consistent with the UFOC Guidelines, Item 5 of the amended Rule requires the disclosure of any initial fees and any conditions on their refundability. "Initial fees" means "all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee's business opens, whether payable in lump sum or installments."

Uniformity of Fees Disclosure

In some instances, franchisors do not charge the same initial fees to every prospective franchisee. Where fees are not uniform, franchisors have a choice. They can disclose a range of fees paid in the last year. For example, fees may have varied over time because of increases in

costs. In such instances, a range of fees is acceptable. In the alternative, franchisors can disclose the formula used to calculate the initial fees paid in the last fiscal year, along with any factors other than the formula itself that determined the fee amount. For example, franchisors may calculate initial fees based on a dollar amount per number of potential consumers in the prospective franchisees' territory.

If a franchisor only occasionally sells company-owned outlets to franchisees, such isolated sales may not reflect the typical initial fees paid by franchisees. Inclusion of the fees charged in such sales in Item 5 (and on the cover page), even in the calculation of a range of initial fees, could skew the disclosure of initial fees franchisees typically pay the franchisor. Thus, fees from occasional sales of company-owned outlets need not be included in Item 5, and should not be included if doing so would make the fee disclosure misleading.

Refunds

Item 5 requires a disclosure about the refundability of initial fees. Franchisors are not required to refund initial fees paid by prospective franchisees. Nevertheless, if the initial fees are refundable in whole or part, the franchisor must state the terms and conditions under which a refund can be obtained.

Installment Payments

Finally, if any initial fees may be paid on an installment basis, Item 5 requires a disclosure of the installment payment terms. Thus, where the initial fees include payments for goods, equipment, or other items on an installment basis, the franchisor must disclose the payment terms. The amended Rule makes clear that franchisors have the option of disclosing installment payment terms either in Item 5 or in Item 10 (the financing section) of the disclosure document.

Sample Item 5-1: Initial Fees

ITEM 5: INITIAL FEES

All Belmont Muffler Shops franchisees pay a \$42,000 lump sum franchise fee when they sign the franchise agreement. Belmont will refund the entire amount to you if we do not approve your application within 45 days. Belmont will refund \$9,000 of this fee if you do not satisfactorily complete your two-week training. No refunds are available under any other circumstances.

Sample Item 5-2: Initial Fees

ITEM 5: INITIAL FEES

You must pay a franchise license fee of \$1,000 per thousand licensed drivers who reside within your exclusive area when the franchise agreement is signed. The number of licensed drivers is determined by the latest abstract of the state agency which issues drivers' licenses. The minimum fee is \$20,000. When you send your application, you must pay a non-refundable \$500 application fee. You must pay an additional \$5,000 when you receive your equipment. The balance of your fee is payable in 12 equal monthly installments of \$1250 in the case of the minimum fee. The first installment payment is due 1 year after your shop opens. Belmont charges 10% interest, on an annual basis, on the unpaid balance. Interest compounds daily and accrues from the date that you receive your equipment. All buyers pay this uniform fee and receive the same financing terms on the fee. If your application is not accepted, Belmont retains the \$500 for investigative costs, but you are not liable for the remainder of the initial fee. Belmont does not give refunds under any other circumstances.

ITEM 6: OTHER FEES

Like the UFOC Guidelines, Item 6 of the amended Rule requires the disclosure, in a prescribed tabular format, of recurring or occasional fees associated with operating a franchised outlet. These recurring or occasional fees include such charges as royalties, advertising fees, and transfer fees.

Item 6 covers payments made directly to the franchisor or an affiliate, or collected by the franchisor or affiliate for the benefit of a third party. It does not include payments made directly by a franchisee to third parties, such as fees for telephone and Internet service.¹²

¹² Although fees paid directly to third parties need not be disclosed in Item 6, they typically must be disclosed in Item 7 or 8, as discussed below.

Franchisors must state each type of fee, the amount of the fee, and the due date. Any formula used to compute the fee must be disclosed as well. If a fee may increase, franchisors must disclose the maximum amount of the increase or the formula used to determine the increase. For example, a percentage of gross sales is an acceptable formula, provided the franchisor defines what it means by “gross sales.”

Any remarks, definitions, caveats or other information that is necessary to clarify the fees disclosed can be made in the remarks column in the table, or, if the remarks are long, in footnotes to the table. The remarks column (or footnote) must address, if applicable: (1) whether the fee is payable only to the franchisor; (2) whether the fee is imposed and collected by the franchisor; (3) whether the fee is non-refundable or the circumstances when the fee is refundable; (4) whether the fee is uniformly imposed; and (5) the voting power of franchisor-owned outlets on any fee imposed by cooperatives. If the franchisor-owned outlets have controlling voting power, then the franchisor must disclose the maximum and minimum fee that may be imposed.

Unlike Item 5, which requires franchisors to disclose the range or formula used to calculate non-uniform fees paid in the last fiscal year, Item 6 does not require franchisors to disclose whether fees charged in prior periods were different from the current fees. For Item 6 purposes, franchisors need only disclose whether the current fee is uniformly imposed and collected by the franchisor.

Sample Item 6: Other Fees

ITEM 6: OTHER FEES			
(Column 1) Type of fee	(Column 2) Amount	(Column 3) Due Date	(Column 4) Remarks
Royalty (note 1)	4% of total gross sales	Payable monthly on the 10 th day of the next month	Gross sales include all revenue from the franchise location. Gross sales do not include sales tax or use tax.
Advertising (note 1)	2% of total gross sales.	Same as royalty fee	
Cooperative Advertising (note 1)	Maximum - 2% of total gross sales	Established by franchisees	Franchisee may form an advertising cooperative and establish local advertising fees. Company-owned stores have no vote in these cooperatives.
Additional Training (note 1)	\$1,000 per person	Two weeks prior to beginning of training	Belmont trains two persons free. See Item 11.
Additional Assistance (note 1)	\$500 per day	Thirty days after billing.	Belmont provides opening assistance free. See Item 11.
Transfer (note 1)	\$1,000	Before the transfer.	Payable when you sell your franchise. No charge if franchise transferred to a corporation that you control.
Audit (note 1)	Cost of audit plus 10% interest on underpayment (note 2).	Thirty days after billing.	Payable only if audit shows an understatement of at least 2% of gross sales for any month.
Renewal Fee (note 1)	\$1,000	Thirty days before renewal.	
<p>Note 1: All fees are imposed by and are paid to Belmont. All fees are non-refundable.</p> <p>Note 2: Interest begins from the date of the underpayment.</p>			

ITEM 7: ESTIMATED INITIAL INVESTMENT

Item 7 of the amended Rule requires franchisors to set out in a prescribed tabular format a franchisee’s entire estimated initial investment – *i.e.*, all the expenses required by the franchise agreement and all other costs necessary for a franchisee to commence business. These expenses include items that are often paid to third parties, such as rent, equipment, and inventory. Accordingly, Item 7 gives prospective franchisees a much more detailed picture of their likely investment than Item 5 (initial fees) and Item 6 (other fees paid to the franchisor or affiliates).¹³

Item 7 does not prescribe an exhaustive list of the types of fees or expenses that must be included in the table. The number and types of fees will necessarily vary depending upon the nature of the franchised business. However, Item 7 does list expenses that are typical, such as the initial franchise fee; training expenses; real property (whether purchased or leased); equipment; beginning inventory; and business licenses and related fees. In addition to these typical expenses, franchisors must itemize and identify any other specific required payments such as additional training, travel, and advertising expenses that franchisees will incur to begin operations.

Most of the expenses to be disclosed in Item 7 cover only the period prior to the date the franchise opens. Item 7, however, also requires franchisors to include in the table a category called “Additional funds - [initial period].” In this part of the chart, franchisors must list any other required expenses that franchisees will incur both before operations begin and during “the initial period” of operations.

¹³ The listing of expenses in Item 7 – including the listing of expenses during the “initial period” alone – does **not** constitute a financial performance representation that will trigger an Item 19 disclosure. The original Rule and UFOC Guidelines defined “performance claims” or “earnings claims” to include cost or expense information. Accordingly, there was some uncertainty whether a franchisor’s disclosure of expenses in Item 7 gave rise to an Item 19 performance claim. Under the amended Rule, the definition of “financial performance claim” has been revised to eliminate coverage of costs or expenses standing alone. Accordingly, the listing of expenses in Item 7 alone does not trigger any Item 19 disclosure obligation.

The “initial period” of operations may vary from franchisor to franchisor. In general, a reasonable period is at least three months. Franchisors may use a longer period that is reasonable for the industry. Franchisors must disclose the specific initial period used, and describe the factors, basis, and experience they considered or relied upon to calculate their estimate of “additional funds.” Note that the “initial period” requirement covers only the “additional funds” item in the Item 7 chart.¹⁴ The other items in the chart pertain only to the period up to the date the franchised outlet opens for business.

For each item listed in the Item 7 chart, franchisors must disclose:

- the amount of the payment;
- the method of payment;
- when the payment is due; and
- to whom the payment is to be made.

If the amount of a payment is unknown, then franchisors may use a low-high range based upon the franchisor’s current experience. For real estate costs that cannot be estimated by a low-high range, franchisors may describe the approximate size of the property and building, and the probable location of the building (*e.g.*, strip shopping center, mall, downtown, rural, or highway).

Item 7 requires franchisors to state, in footnotes, whether each payment is non-refundable, or the circumstances when the payment is refundable. In addition, if the franchisor (or affiliate) finances part of the initial investment, the amount financed, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments must be disclosed. The amended Rule permits franchisors to refer to Item 10 (financing) for additional details.

¹⁴ The additional funds item line generally does not include a franchise owner’s salary or draw. The appropriate place to describe owner’s salary is in a footnote to the Item 7 chart.

Item 7 reflects the typical initial investment made by a prospective franchisee buying a new or existing franchised outlet. On occasion, a franchisor may sell company-owned outlets to prospective franchisees. Ordinarily, the investment made in purchasing a company-owned store need not be reflected in the Item 7 estimated initial investment disclosure. However, if in the preceding fiscal year, the sales price of a company-owned outlet exceeded the highest initial investment for franchised outlets sales, then the franchisor should disclose that fact in a footnote in Item 7. Specifically, the footnote should indicate by how much the sale of company-owned outlets in the preceding fiscal year exceeded the highest initial investment for the sale of a franchised outlet.

Sample Item 7: Estimated Initial Investment

ITEM 7: YOUR ESTIMATED INITIAL INVESTMENT				
(Column 1) Type of expenditure	(Column 2) Amount	(Column 3) Method of payment	(Column 4) When due	(Column 5) To whom payment is to be made
Initial franchise fee	\$15,000 (note 1)	Lump sum	At signing of franchise agreement	Belmont Mufflers, Inc.
Travel and living expenses while training	\$2,500 to \$5,000	As incurred	During training	Airlines, hotels, and restaurants
Real estate and improvements	(Note 2)	(Note 2)	(Note 2)	(Note 2)
Equipment	\$40,000 (note 3)	Lump sum	Prior to opening	Belmont or vendors
Signs	\$2,200	Lump sum	Prior to opening	Abbey Sign Company
Miscellaneous opening costs	\$8,000 (note 4)	As incurred	As incurred	Suppliers, utilities, etc.
Opening inventory	\$8,800 (note 5)	Lump sum	Prior to opening	Belmont or vendors
Advertising fee - 3 months	\$500	As incurred (% of gross sales)	Monthly	Belmont
Additional funds - 3 months (note 6)	\$23,000 to \$45,000	As incurred	As incurred	Employees, suppliers, utilities
TOTAL (note 7)	\$100,000 to \$124,500 (note 8) (Does not include real estate costs)			

Notes:

- (1) See Item 5 for the conditions when this fee is partly refundable. We do not finance any fee.
- (2) If you do not own adequate shop space, you must lease the land and building from us. Typical locations are light industrial and commercial areas. The typical Belmont Mufflers Shop has 8,000 square feet. Former three-or-four-bay gasoline service stations have been converted into a Belmont Mufflers Shop. Rent is estimated to be between \$52,000 - \$120,000 per year depending on factors such as size, condition, and location of the leased premises.
- (3) This payment is fully refundable before equipment installation. After installation, we deduct \$3,000 installation costs from your refund.
- (4) This includes security deposits, utility costs, and incorporation fees.
- (5) This payment is fully refundable before we deliver your inventory. After delivery, we will deduct a 10% restocking fee from your refund.
- (6) This estimates your start-up expenses. These expenses include payroll costs. These figures are estimates and we cannot guarantee that you will not have additional expenses starting the business. Your costs will depend on factors such as: how much you follow our methods and procedures; your management skill, experience and business acumen; local economic conditions; the local market for our product; the prevailing wage rate; competition; and the sales level reached during the initial period.
- (7) Except as indicated, we do not offer direct or indirect financing to franchisees for any items.
- (8) We have relied on our 24-years of experience in the muffler business to compile these estimates. You should review these figures carefully with a business advisor before making any decision to purchase the franchise.

ITEM 8: RESTRICTIONS ON SOURCES OF PRODUCTS AND SERVICES

Item 8 of the amended Rule requires the disclosure of obligatory purchases, restrictions on sources of products and services, and the amount of any revenue franchisors may receive from required suppliers. It also requires the disclosure of purchasing or distribution cooperatives.

Required Purchases of Goods and Services

Item 8 requires the disclosure of any obligation on the part of franchisees to purchase or lease goods, services, or supplies from specific suppliers in the establishment or operation of the franchised business. Such purchases include, for example, fixtures, equipment, inventory, computer hardware and software, real estate, and any other purchase necessary to establish or

operate the franchised business. Required purchases can be supplied by the franchisor, its designee, suppliers approved by the franchisor, or suppliers with products that meet the franchisor's specifications. The obligation to purchase the items may be imposed by the franchise agreement or by the franchisor's actual practice, such as requirements in the franchisor's operating manual. Franchisors may explain in Item 8 the reason for any particular purchase requirement.

Item 8 need not include the purchase or lease of goods or services that are already provided to franchisees as part of the initial franchise fee, such as initial training, which have been disclosed in Item 5. Similarly, fees disclosed in Item 6 need not be repeated in Item 8.

Optional Purchases

Item 8 covers only required purchases and leases of goods and services that are source-restricted, meaning that the franchisee must make the purchases from a specific supplier or limited group of suppliers. This may include purchases or leases from the franchisor or the franchisor's affiliate if the franchisor or its affiliate is the only (or one of the only) approved suppliers, or its products are the only (or among the only) ones that meet the required specifications. Where franchisees have total discretion to purchase or lease items from *any source*, but elect to purchase them from the franchisor, such purchases need not be disclosed in Item 8. For example, a franchisee of a fast food chain may buy generic drinking straws from a variety of suppliers. If the franchisee opts to buy straws from the franchisor, then the franchisor need not include such purchases in Item 8.

Approval of Alternative Suppliers

For each required purchase, Item 8 requires franchisors to disclose whether and, if so, how it may grant franchisees the right to use alternative suppliers. Specifically, the franchisor must disclose:

- Whether the franchisor’s criteria for approving suppliers are available to franchisees;
- Whether the franchisor permits franchisees to contract with alternative suppliers who meet the franchisor’s criteria;
- Any fees and procedures necessary to secure approval from the franchisor to purchase from alternative suppliers;
- The time period in which the franchisor will notify the franchisee of approval or disapproval of an alternative supplier;
- How approvals are revoked; and
- Whether the franchisor issues specifications for goods or services and, if so, how the franchisor may modify the specifications.

Ownership Interest in a Supplier

Item 8 requires franchisors to disclose whether any officer of the franchisor owns an interest in a required supplier. For purposes of this disclosure, an “officer” is any person with management or policy-making authority. The term “an interest” is to be read broadly to include any percentage of direct ownership from which the officer derives income or other financial benefits. Accordingly, it would include ownership of stock in the supplier-company. It would not include, however, shares of a mutual fund or stock held in a blind trust, for example, where the officer does not exercise control over the specific investment in the supplier-company.

Revenue Derived from a “Supplier”

Item 8 requires disclosure of whether the franchisor or any of its affiliates will or may receive revenue or other material benefits from required purchases or leases by franchisees from the franchisor, its affiliates, or a third-party supplier. The term “supplier” is intended to capture all third parties in the manufacturing and distribution chain who may make payments to the franchisor or any of its affiliates when their goods are sold to franchisees. For example, Belmont Mufflers may require its franchisees to purchase office supplies from a specific vendor. Belmont must disclose whether it receives revenue or material benefits not only from that

vendor, but also from the manufacturer of the office supplies or from any other entity in the distribution chain. The specific manufacturer or distributor who makes such payments, however, need not be identified.

Payments to Third Parties

If suppliers make payments to an advertising fund or a trademark-specific franchisee association, or any other third party controlled directly or indirectly by the franchisor or an affiliate, such payments must be reported in Item 8. On the other hand, where payments are made to independent third parties, such as an independent advertising co-op, disclosure is not required.

Benefits

Any payment or benefit that a franchisor may receive as a result of franchisee purchases must be disclosed in Item 8. For example, if, as a result of requiring franchisees to use a specific supplier, the franchisor receives a “special deal” or “volume discount” from that supplier benefitting company-owned outlets, but not franchised outlets, this benefit must be disclosed. However, franchisors need not report ordinary sales or volume discounts that are offered by the supplier to all buyers, including franchisees.

Extent of Required Payments

Item 8 requires a description of the “precise basis” upon which the franchisor or its affiliates may derive revenues or other benefits from suppliers. This description must include a statement of:

- The franchisor’s total revenue;
- The franchisor’s revenues from all required purchases and leases of products and services by franchisees;
- The percentage of the franchisor’s total revenues that comes from purchases or leases required by the franchisor;

- The revenues received by affiliates of the franchisor from purchases or leases required by the franchisor; and
- The estimated portion of the franchisee's required purchases and leases to all purchases and leases by the franchisee in establishing and operating the franchise.

The total revenue calculation should be taken from the franchisor's statement of operations (or profit and loss statement) from the most recent annual audited financial statement attached to the disclosure document. In some instances, a franchisor may not have audited financial statements – *e.g.*, the franchisor, a start-up company, may be phasing-in audited financials as permitted under the amended Rule. Where the franchisor or an affiliate does not have audited financial statements, the franchisor should disclose the sources of financial information it used to compute its own or an affiliate's revenues.

Aggregate Reporting

Payments to franchisors from suppliers may be disclosed either as a percentage or as a flat dollar figure on an aggregate, not individual supplier, basis. For example, one supplier may make payments of 1% or a flat payment of \$1,000, while another may make payments of 5% or \$5,000. In such circumstances, the franchisor should disclose receiving payments ranging from 1% - 5% or, if it uses the flat-fee alternative, \$1,000 to \$5,000. A "payment" for this purpose includes the sale of similar goods or services to the franchisor at a lower price than to franchisees.

Cooperatives

Item 8 calls for the disclosure of any purchasing or distribution cooperatives. If a franchisee is required to participate in a purchasing or distribution cooperative, then the franchisor must identify the cooperative. If participation is voluntary, the franchisor need not identify the cooperative, but it should disclose that one or more of these cooperatives exist.

Negotiated Prices

Item 8 requires franchisors to disclose whether they negotiate purchase agreements with suppliers, including price terms, for the benefit of franchisees. However, the specific price terms negotiated need not be disclosed.

Sample Item 8: Restrictions on Sources of Products and Services

ITEM 8: RESTRICTIONS ON SOURCES OF PRODUCTS AND SERVICES

Required purchases

You must purchase your pipe bending machine, hoist, cutting torch, mufflers, exhaust pipe, and other supplies under specifications in the operations manual. These specifications include standards for delivery, performance, design, and appearance. Our specifications are formulated by our engineering department and may be modified periodically, in consultation with the Belmont Franchisee Advisory Council.

Required and approved suppliers

You must purchase required equipment from Belmont or an approved supplier. Belmont's affiliate, Belmont Muffler Manufacturers, Inc., is an approved supplier of mufflers. Our President, Jane Doe, owns an interest in Belmont Muffler Manufacturers, Inc. We have also approved three other suppliers of mufflers and exhaust pipe, as listed in our operations manual.

Approval of alternative suppliers

Belmont may approve other suppliers of mufflers and exhaust pipe who meet the specifications set forth in the operations manual. If you would like to purchase these items from another supplier, you must request our "Supplier Approval Criteria and Request Form." Based on the information and samples you supply to us and your payment of a \$500 fee, we will test the items supplied and review the proposed supplier's financial records, business reputation, delivery performance, credit rating, and other information. Our review typically is completed in 30 days. Approval of alternative suppliers may be revoked if our engineering department determines that their mufflers and exhaust pipe fail to satisfy the specifications set forth in the operations manual, as it may periodically be updated.

Revenue from franchisee purchases

In the year ending December 31, 2007, Belmont's revenues from the sale of equipment to franchisees was \$500,000, or 5% of Belmont's total revenues of \$10,000,000. The cost of equipment and supplies purchased in accordance with our specifications will represent 50-60% of your total purchases in establishing the business and 20-30% of your total purchases during operation of the business.

In the year ending December 31, 2007, Belmont Muffler Manufacturer's Inc.'s revenues from the sale of mufflers to franchisees was \$2,000,000. The purchase of mufflers from Belmont Muffler Manufacturers will represent 10 to 15% of your overall purchases in establishing and operating the business. Belmont Muffler Manufacturers, Inc., pays us a .05% rebate on all mufflers purchased from franchisees.

One of the three approved suppliers of mufflers and exhaust pipe pays Belmont a rebate of 1% of all franchisee purchases.

Cooperatives

We do not have any purchasing or distribution cooperatives.

Negotiated prices

We negotiate purchase arrangements with Belmont Muffler Manufacturers, Inc., including the price terms.

Material benefits

We do not provide any material benefits to you if you buy from sources we approve.

ITEM 9: FRANCHISEE’S OBLIGATIONS

Item 9 of the amended Rule requires the disclosure of a franchisee’s principal obligations in the prescribed tabular format that references the franchise agreement or other relevant contracts, and the disclosure document sections where more information about the particular obligation can be found. If a particular obligation is not applicable, franchisors should simply state “Not Applicable” at that place in the chart. Franchisors should include additional obligations, as may be warranted for their particular franchise system, in the “other” section of the chart.

Sample Item 9: Franchisee’s Obligations

ITEM 9: FRANCHISEE’S OBLIGATIONS		
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	Section 2A of franchise agreement	Items 6 and 11
b. Pre-opening purchase/leases	Section 3D of franchise agreement	Item 8
c. Site development and other pre-opening requirements	Sections 3A and 3B of franchise agreement	Items 6, 7, and 11

Obligation	Section in agreement	Disclosure document item
d. Initial and ongoing training	Section 5 of franchise agreement	Item 11
e. Opening	Section 4 of franchise agreement	Item 11
f. Fees	Section 6 of franchise agreement	Items 5 and 6
g. Compliance with standards and policies/operating manual	Section 8A of franchise agreement	Item 11
h. Trademarks and proprietary information	Section 7 and 11 of franchise agreement	Items 13 and 14
i. Restrictions on products/services offered	Section 12 of franchise agreement	Item 16
j. Warranty and customer service requirements	Section 8B of franchise agreement	Item 11
k. Territorial development and sales quotas	Not Applicable.	
l. Ongoing product/service purchases	Section 9 of franchise agreement	Item 8
m. Maintenance, appearance, and remodeling requirements	Sections 8C and 10 of franchise agreement	Item 11
n. Insurance	Section 13A of franchise agreement	Items 6 and 8
o. Advertising	Section 15 of franchise agreement	Items 6 and 11
p. Indemnification	Section 13B of franchise agreement	Item 6
q. Owner's participation/management/staffing	Sections 4, 5, and 14 of franchise agreement	Items 11 and 15
r. Records and reports	Section 17A of franchise agreement	Item 6
s. Inspections and audits	Section 17B of franchise agreement	Item 17

Obligation	Section in agreement	Disclosure document item
t. Transfer	Section 18 of franchise agreement	Item 17
u. Renewal	Section 20 of franchise agreement	Item 17
v. Post-termination obligations	Section 22 of franchise agreement	Item 17
w. Non-competition covenants	Section 11, 18, and 22C of franchise agreement	Item 17
x. Dispute resolution	Section 24 of franchise agreement	Item 17
y. Other: Guarantee of franchisee obligations (Note 1)	Section 25 of franchise agreement	
<p>Notes:</p> <p>(1) Each individual who owns a 5% or greater interest in a franchisee that is a corporation or other business entity must sign an agreement not to compete (Exhibit H) and an agreement assuming and agreeing to discharge all obligations of the “franchisee” under the Franchise Agreement (Exhibit I).</p>		

ITEM 10: FINANCING

Like Item 10 of the UFOC Guidelines, Item 10 of the amended Rule requires franchisors to disclose all material terms and conditions of any financing arrangements. The required disclosures include:

- The rate of interest, plus finance charges, expressed on an annual basis;
- The number of payments;
- Penalties upon default; and
- Any consideration received by the franchisor for referring a prospective franchisee to a lender.

Franchisors may use the tabular format set forth in the Rule to summarize the financing arrangement, but that format is not required. Disclosure of financing terms and conditions in

Item 10 does not prevent the parties from negotiating different terms and conditions after the disclosure. As discussed above, however, prospective franchisees will have seven calendar days to review any changes in financing terms or conditions if the changes were made unilaterally by the franchisor, because such changes in financing terms or conditions are presumptively material to the franchisee's purchasing decision.

Financing Agreements

For purposes of Item 10, the term "financing agreement" includes any "leases and installment contracts . . . that the franchisor, its agent, or affiliates offer directly or indirectly to the franchisee." Indirect offers of financing include a written arrangement between a franchisor or its affiliates and a lender, where the lender offers financing to a franchisee. It also includes instances where a franchisor or an affiliate receives a benefit from a lender in exchange for financing a franchise purchase, as well as instances where the franchisor guarantees a note, lease, or other obligation of the franchisee. If the franchisor or an affiliate receives a benefit from the lender, the franchisor must disclose the amount or method of determining the payment, the source of the payment, and the relationship of the source to the franchisor or its affiliate. Sample copies of any financing agreements must be included in Item 22.

Interest Rate

Franchisors offering financing must disclose the rate of interest, plus finance charges, expressed on an annual basis, consistent with consumer credit transactions. Indeed, the interest rate disclosures are modeled on the disclosures lenders make under the Federal Reserve's Regulation M (Consumer Leasing), 12 C.F.R. Part 213, and Regulation Z (Truth in Lending), 12 C.F.R. Part 226. These regulations, however, cover personal property leases and credit transactions that are "primarily for personal, family, or household purposes." Accordingly, they generally do not apply directly to lease and financing transactions undertaken in connection with the purchase of a franchise. Nonetheless, franchisors may look to the Truth in Lending and Consumer Leasing regulations for guidance in preparing their Item 10 interest rate disclosures.

Variable Rates

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. Anticipating such a situation, the amended Rule provides disclosure of what the rate of interest, plus finance charges, expressed on an annual basis, was on a specified recent date. A franchisor may include a footnote stating that the interest rate may vary or state a formula by which the rate may change until the financing agreement is signed. Where the rate may change during the life of the loan, disclosure of that fact is required under the Item 10 “catch-all” requirement, which calls for disclosure of “other material financing terms.”

Sample Item 10: Financing

ITEM 10: 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 Default	Loss of Legal Right on Default
Initial Fee	Belmont (note 1)		\$10,000	10	18%	\$180	None	Personal Guarantee	Loss of franchise-unpaid loan	Waive notice. Confess judgment
Land/ Constr			None							
Leased Space	Belmont (note 2)	\$2,000 (security deposit)		7-10	N/A	\$3,000 - \$6,000	None	Personal Guarantee	Loss of franchise; back rent plus 2 months; franchise rights, collection costs incl. attorneys fees	None
Equip. Lease	USA Credit Corp. (note 3)	None	\$5,000	5	15%	\$100	None	Personal Guarantee	Equip. removed; past due payments; \$1000 liquid damages; costs of collection	Lose all defenses
Equip. Purchase	Belmont (note 4)	\$1,250 (25%)	\$3,750	2-7	15%	\$72-\$182	\$500	Personal Guarantee	Loss of franchise, equip. removal; overdue payments; collection costs, incl. attorneys fees	None
Opening Inventory		None								
Other Financing		None								

Notes:

(1) If you meet Belmont's credit standards, Belmont will finance the \$10,000 initial franchise fee over a 10-year period at an interest rate (rate of interest, plus finance charges, expressed on an annual basis) of 18%, using the standard form note in Exhibit E. The only security we require is a personal guarantee of the note by you and your spouse, or by all the shareholders of your corporation. (Loan Agreement, Section) The note can be prepaid without penalty at any time during its 10-year term. (Loan Agreement, Section A.) If you do not pay on time, we can call the loan and demand immediate payment of the full outstanding balance and obtain court costs and attorney's fees if a collection action is necessary. (Loan Agreement, Section B.) We also have the right to terminate your franchise if you do not make your payments on time more than three times during the note term. (Loan Agreement, Section C.) You waive your rights to notice of a collection action and to assert any defenses to collection against Belmont. (Loan Agreement, Section D1.) Belmont discounts and sells these notes to a third party who may be immune under the law to any defenses to payment you have against us. (Loan Agreement, Section D2.)

(2) In most cases, Belmont will sublease the franchised premises to you, but will guarantee your lease with a third party if you have acceptable credit and that is the only way to obtain a location. (Lease Section B.) The precise terms of Belmont's standard lease in Exhibit B will vary depending on the size and location of the premises, but the chart reflects a typical range of payments for Belmont's standard 6 bay franchise outlet, including payment of one month's rent as a security deposit. (Lease Section C.) The only other security we require is a personal guarantee of the lease by you and your spouse, or by all the shareholders of your corporation. (Lease Section D1.) The lease can be prepaid without penalty at any time during its term. (Lease Section D2.) If you do not make a rent payment on time, we have the right to collect the unpaid rent plus an additional two months rent, as liquidated damages. (Lease Section E.) Belmont can also obtain court costs and attorney's fees if a collection agency is necessary. (Lease Section F.) If you are late with your rent more than three times during the lease term, we have the right to terminate the lease, take over the premises, and terminate your franchise. If Belmont guarantees your lease, we will require you to sign the guarantee agreement in Exhibit F. (Lease Section G.) This gives us the same legal rights as the sublessee but requires you to give Belmont the right to approve your lease and pay the rent for you if you fail to pay on time. (Lease Section G.)

(3) If you want to lease the pipe bending machine and other equipment you need, Belmont has arranged an equipment lease (Exhibit C) from USA Credit Corporation of Las Vegas, Nevada. If you choose this option, you will pay \$100 a month for 60 months (5 years) at an interest rate (rate of interest, plus finance charges, expressed on an annual basis) of 15% based on a cash price of \$5,000, with no money down. (Equipment Lease, Section A.) At the end of the lease term, you may purchase the equipment with a one-time payment of \$2,500. (Equipment Lease Section B.) USA Credit requires a personal guarantee from you and your spouse, or from all the shareholders of your corporation, and retains a security interest in the equipment. (Equipment Lease, Section C.) The equipment lease can be prepaid at any time. (Equipment Lease, Section D.) If you do not make a payment on time, USA Credit can demand payment of all past due payments, remove the equipment, and charge you \$1,000 as liquidated damages. (Equipment Lease, Section E.) USA Credit can also cover its costs of collection, including court costs and attorney's fees. (Equipment Lease, Section E.) While Belmont does not know USA Credit's policies, USA Credit may discount and transfer the lease to a third party who may be immune under the law to claims or defenses you may have against USA Credit, the equipment manufacturer, or Belmont. We receive a referral fee of \$500 from USA Credit for every franchisee who leases equipment from it.

(4) If you prefer, Belmont will sell you the pipe bending machine and other necessary equipment on time. (Equipment Purchase Agreement, Section A.) We require a 25% down payment of \$1,250. (Equipment Purchase Agreement, Section A.) We will finance the remainder over a 2-7 year period at your option at an interest rate of 15%. (Equipment Purchase Agreement, Section B.) Payments range

from \$228.11 a month over 7 years to \$821.58 a month over 2 years. (Equipment Purchase Agreement, Section C.) Belmont's standard equipment financing note in Exhibit D must be personally guaranteed by you and your spouse, or by all the shareholders of your corporation, and we will retain a security interest in the equipment. (Equipment Purchase Agreement, Section D.) You may purchase the equipment at any time during the lease period by paying the remainder of the principal plus a \$500 prepayment penalty. (Equipment Purchase Agreement, Section E.) If you do not make a payment on time, we can demand all overdue payments, repossess the equipment, and terminate your franchise. We can also recover our costs of collection, including court costs and attorney's fees. (Equipment Purchase Agreement, Section E.)

Except as disclosed in Note 1, Belmont does not offer financing that requires you to waive notice, confess judgment, or waive a defense against us or the lender, although you may lose your defenses against us and others in a collection action on a note that is sold or discounted, as disclosed in Notes 2 and 3.

Except as disclosed in Note 3, Belmont does not arrange financing from other sources.

Except as disclosed in Notes 1 and 3, commercial paper from franchisees has not been and is not sold or assigned to anyone, and we have no plans to do so.

Except as disclosed in Note 3, Belmont does not receive direct or indirect payments from placing financing.

Except as disclosed in Note 2, Belmont does not guarantee your obligations to third parties.

ITEM 11: FRANCHISOR'S ASSISTANCE, ADVERTISING, COMPUTER SYSTEMS, AND TRAINING

Consistent with the UFOC Guidelines, Item 11 of the amended Rule requires the disclosure of the franchisor's obligations under the franchise agreement to furnish assistance to franchisees. The disclosure requirements encompass pre-opening assistance (*e.g.*, site selection), as well as any ongoing assistance, such as advertising and training, during the operation of the franchise.

Another specific topic that must be covered under Item 11 is any mandatory computer or software purchases and related costs that a franchisee will incur. In this regard, and as discussed below, the amended Rule's Item 11 requires less detailed disclosures about computer system requirements than did the corresponding item in the UFOC Guidelines. The amended Rule's

Item 11 also follows the UFOC Guidelines in requiring either disclosure of the franchisor's operating manual table of contents or access to the operating manual itself.

For each assistance obligation disclosed in Item 11, franchisors must include a citation to the specific section number of the franchisee agreement that imposes the obligation on the franchisor.

Required Statement about the Limited Extent of the Franchisor's Obligation to Furnish Assistance

Under the amended Rule, franchisors must begin their Item 11 disclosure with the following prescribed statement, in bold type:

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

This warning is intended to alert prospective franchisees, and to counter any misrepresentations to the contrary. It also serves to dispel any misconception on the prospective franchisee's part that a minimum degree of assistance is inherent in any franchise offer.

Pre-Opening Assistance

After the standard statement about the franchisor's limited obligations to furnish assistance, the first disclosure topic under Item 11 is the franchisor's pre-opening obligations to the franchisee, including any site location assistance, such as, for example, negotiation of the purchase or lease of the site, site approval requirements, and the typical length of time it takes to open a franchise.

Continuing Assistance

Following disclosure of the franchisor's pre-opening assistance obligations, Item 11 requires disclosure of the franchisor's obligation to provide continuing assistance to the franchisee after the franchise is opened. Many different kinds of assistance must be disclosed, although the specifics will vary depending on the type of franchise.

Optional Assistance

Some franchisors provide pre-opening assistance or ongoing assistance after the opening of a franchise that they are not obligated by the franchise agreement to provide. Such assistance may be included in the Item 11 disclosure, provided that it is set out separately and clearly identified as assistance that is not required by the franchise agreement.

Advertising Assistance

One common and very important type of assistance is advertising. The information required to be disclosed regarding this type of assistance includes, for example:

- whether the franchisor is obligated to conduct advertising;
- the media used for any advertising (*e.g.*, print, radio, television, or Internet);
- the source of the advertising;
- the geographical scope of the advertising (*i.e.*, local, regional, or national);
- whether franchisees must contribute to an advertising fund or spend any specified amount on advertising in their local area; and
- the role of any advertising councils or cooperatives and how they operate.

For any advertising fund to which a franchisee must contribute, Item 11 requires franchisors to disclose who contributes to the fund, whether other franchisees and franchisor-owned outlets contribute on the same basis, who administers the fund, whether the fund is audited, whether its financial statements are available for review, whether franchisees receive a periodic accounting of fund expenditures, and the percentage of the fund, if any, used principally to solicit new franchise sales.

Multiple Brand Advertising

If a franchisor offers more than one branded or trademarked franchise for sale, it should, as a general rule, segregate its disclosures for each brand. Nevertheless, it may be impractical or

unreasonable for the franchisor to segregate advertising funds by brand. In such circumstances, a franchisor may aggregate its advertising fund disclosures across its brands, as long as the disclosure makes clear that the advertising funds are aggregated across brands.

Allocation of Production and Administrative Expenses

Item 11 requires franchisors to disclose the use of advertising funds in the last fiscal year, including percentages spent on production, media placement, administrative expenses, and other described expenses. A franchisor's internal costs associated with advertising production (e.g., supplies, photography, and computer graphics) can be characterized as production expenses. The franchisor, however, must have a reasonable basis for claiming the allocation of production expenses at the time disclosure is made. Similarly, if an advertising fund pays all or part of the salaries of franchisor personnel who are involved in the advertising of the franchise system's products or services, those costs – if reasonable – can be considered a production or administrative expense if the allocation is explained in the Item 11.

Computer Systems

Like Item 11 of the UFOC Guidelines, the amended Rule's Item 11 mandates disclosure of any requirements that franchisees purchase or use electronic cash registers or computer systems, including their hardware and software components. The amended Rule's Item 11 disclosures on this topic, however, are narrower than those in the UFOC Guidelines. Item 11 of the UFOC Guidelines required franchisors to identify each component of hardware and software by brand, type, and principal function, or to identify compatible equivalents and whether they had been approved by the franchisor. By contrast, under the amended Rule, the franchisor need not identify each and every piece of hardware and software by brand, type, and principal function. Nor must the franchisor identify compatible equivalents and explain whether the franchisor has approved them. It is sufficient for franchisors to describe generally:

- the cash register or computer systems to be used, if any;
- any obligation of the franchisor, an affiliate, or third party to provide ongoing maintenance, repairs, upgrades, or updates;

- the cost of purchasing or leasing the system, and the annual cost of any optional or required maintenance, upgrades, or support contracts;
- any obligation of the franchisee to upgrade or update any such system, and any contractual limits on the frequency and cost of that obligation; and
- whether the franchisor will have access to information contained in those systems.

This information about required computer systems is designed to enable prospects to weigh the costs and benefits of purchasing a specific franchise. Further, it is designed to enable prospective franchisees to assess readily whether they may be at a technological advantage or disadvantage compared to franchisees of competing franchise systems.

The amended Rule recognizes that start-up franchisors may be uncertain about which computer systems or software they will expect franchisees to use. Accordingly, Item 11 is flexible. In its Item 11 disclosures, a start-up franchisor may indicate that computer requirements are yet to be determined, if that is the case, or otherwise factually state its policy concerning computer usage. The fact that a start-up franchisor has not finalized its plans for electronic cash registers or computer systems is itself material information to disclose to prospective franchisees.

Operating Manuals

Item 11 requires franchisors to disclose the table of contents of the system's operating manual that franchisees receive, and certain other information about the manual, as of the end of the franchisor's last fiscal year or a more recent date. The table of contents of the operating manual can be included as one of the exhibits in Item 22 of the disclosure document.

The operating manual table of contents need not be disclosed if the franchisor offers the prospective franchisee the opportunity to review the operating manual itself before buying the franchise. It is important to note that merely asking a prospective franchisee to first sign a confidentiality agreement before permitting access to the operating manual will not trigger the disclosure requirement of the amended Rule. While the signing of a confidentiality agreement is "in connection with the proposed franchise sale," it does not bind the prospective franchisee

to purchase the franchise or to undertake other financial obligations, such as the signing of a lease. This assumes, however, that the confidentiality agreement contains no other agreements that, in the absence of the confidentiality agreement, would trigger the obligation to provide the disclosures required by the amended Rule.

Training

Finally, Item 11 requires franchisors to disclose their training program as of the end of their last fiscal year or a more recent date. Some of the training disclosures must be summarized in a table titled, in bold, capital letters, “**TRAINING PROGRAM.**” The table must include a listing of the subject matter of the training, the hours of classroom training on each subject, hours of on-the-job training, and the location of the training. Other required information – such as who may and who must attend training, whether successful completion of training is required, the charges for the training, if any, who pays for any travel and living expenses, and whether additional training or refresher course are required – may be disclosed after the table.

The amended Rule’s Item 11 also calls for disclosure of information about the staff who provide the training. If the franchisor’s training staff is large or changes frequently, the franchisor can use a general description of the background and experience of the staff providing the training. Also, franchisors should disclose here (if not disclosed in Item 2) the corporate officer in charge of training, if any, along with information about his or her experience.

Sample Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training

ITEM 11: FRANCHISOR'S ASSISTANCE, ADVERTISING, COMPUTER SYSTEMS, AND TRAINING

Except as listed below, Belmont is not required to provide you with any assistance.

Pre-Opening Assistance

Before you open your business, Belmont will:

- (1) Designate your exclusive territory (Franchise Agreement, Paragraph 2).
- (2) Assist you in selecting a business site (Franchise Agreement, Paragraph 3). You select your business site within your exclusive area subject to our approval. Your site must be at least 8000 square feet, must have parking spaces, and must have an average of 250 cars per hour driving by. Although not required by the Franchise Agreement to do so, Belmont assists in site selection by telling you the number of new car registrations, population density, traffic patterns, and the proximity of the proposed site to other Belmont Muffler Shops. We must approve or disapprove your site within 20 days after we receive notice of the proposed location. (Franchise Agreement, Paragraph 6.)

Franchisees typically open their shops within four to seven months after they sign a franchise agreement. The factors that affect opening time are the ability to obtain a lease, financing, or building permits, zoning, and local ordinances. Other factors include weather conditions, shortages, and delays in installation of equipment, fixtures, and signs.

- (3) Within 30 days of your signing the Franchise Agreement, assist you in finding and negotiating the lease or purchase of a location for your muffler shop. (Franchise Agreement, Paragraph 4.) You will purchase or lease your store location from independent third parties.
- (4) Within 60 days of your signing the Franchise Agreement, provide written specifications for store construction or remodeling and for all required and replacement equipment, inventory, and supplies. (Franchise Agreement, Paragraph 4.) See Item 8 of this disclosure document.
- (5) Within 60 days of your signing the Franchise Agreement, provide blueprints for your store construction or remodeling and obtain health, sanitation, building, utility, and sign permits for your premises. You pay for the construction and remodeling. (Franchise Agreement, Paragraph 5.)

Post-Opening Assistance

During the operation of the franchised business, Belmont will:

- (1) Develop new products and methods and provide you with information about developments. (Franchise Agreement, Paragraph 8.)
- (2) Telephone you each week for the first 90 days after you open your shop to discuss your operational problems. (Franchise Agreement, Paragraph 9.)

- (3) Hold annual conferences to discuss sales techniques, personnel training, bookkeeping, accounting, inventory control, performance standards, advertising programs, and merchandising procedures. There is no conference fee, but you must pay all your travel and living expenses. These elective conferences are held at our Jackson, Minnesota, headquarters or at a location chosen by a majority vote of all franchisees. (Franchise Agreement, Paragraph 9.)

Advertising

Belmont provides advertising materials and services to you through a national advertising fund (the "National Fund"). Materials provided by the National Fund to all franchisees include video and audio tapes, mats, posters, banners, and miscellaneous point-of-sale items. You will receive one sample of each at no charge. If you want additional copies, you must pay duplication costs. (Franchise Agreement, Paragraph 10.)

You may develop advertising materials for your own use, at your own cost. Belmont must approve the advertising materials in advance and in writing. However, all Internet advertisements must be prepared and posted by Belmont only. (Franchise Agreement, Paragraph 10.)

Belmont occasionally provides for placement of advertising on behalf of the entire Belmont system, including franchisees. However, most placement is done on a local basis, typically by local advertising agencies hired by individual franchisees or advertising cooperatives. Belmont reserves the right to use advertising fees from the Belmont system to place advertising in national media (including broadcast, print, Internet, and other media) in the future. In the past, Belmont has used an outside advertising agency to create and place advertising. Neither Belmont nor its affiliate receives payment from the National Fund. Advertising funds are used to promote the products sold by the franchisee and are not used to sell additional franchises. (Franchise Agreement, Paragraph 11.)

The National Fund is a nonprofit corporation which collects advertising fees from all franchisees. Each franchisor-owned store of Belmont contributes to the National Fund on the same basis as franchisees. All payments to the National Fund must be spent on advertising, promotion, and marketing of goods and service provided by Belmont Muffler. You must contribute the amounts described in Item 6, under the heading "Advertising fees and expenses."

The National Fund is administered by Belmont's accounting and marketing personnel under the direction of the Advertising Council. The Advertising Council acts as the board of directors of the National Fund. The Advertising Council has eight members: the President, Treasurer, Vice President-Marketing, and Vice-President-Operations of Belmont; and four franchisee representatives who are elected by the governing board of the Belmont Franchisee Advisory Council. Belmont may change the number of Advertising Council members, but not the portion of managers/franchisees. We cannot dissolve the advertising council without the approval of the Belmont Franchisee Advisory Council. (Franchise Agreement, Paragraph 11.)

An annual audited financial statement of the National Fund is available to any franchisee upon request. During the last fiscal year of the National Fund (ending on December 31, 2006), the National Fund spent 39% of its income on the production of advertisements and other promotional materials, 36% for media placement, 18% for general and administrative expenses, and 7% for other expenses (the purchase of glassware given to Belmont customers as part of a promotional campaign).

Once your shop opens, you must participate in the local advertising cooperative established in your Designated Marketing Area where your store is located. The amount of your contribution to the local advertising cooperative is described in Item 6 under the heading "Advertising Fees and Expenses."

Each local advertising cooperative must adopt written governing documents. A copy of the governing documents of the cooperative (if one has been established) for your Designated Marketing Area is available upon request. Each cooperative may determine its own voting procedures; however, each company-owned Belmont Shop will be entitled to one vote in any local advertising cooperative. The members and their elected officers are responsible for administration and operation of the cooperative. Advertising cooperatives must prepare quarterly and annual financial statements. The annual financial statement must be prepared by an independent CPA and be made available to all franchisees in that advertising cooperative.

Computer Requirements

Belmont requires you to have a computer system and Internet access. Belmont does not specify specific computer hardware or an Internet supplier. However, you must have Microsoft Word, Access, and Excel programs. Your computer must be in good repair, with sufficient memory to carry out ordinary business functions, as provided in the Operating Manual. You also must buy an electronic cash register from an approved supplier. See Items 7 and 8 of this Disclosure Document. Belmont will not have independent access to the electronic cash register or computer system, but reserves the right to conduct periodic audits of any accounting records contained in such hardware.

Operating Manual

Belmont will loan you a copy of our operating manual that contains mandatory and suggested specifications, standards, and procedures. This manual is confidential and remains our property. Belmont will modify this manual, but the modification will not alter your status and rights under the Franchise Agreement (Franchise Agreement, Paragraph 9.) The table of contents is attached as Exhibit F.

TRAINING PROGRAM

(Column 1) Subject	(Column 2) Hours of Classroom Training	(Column 3) Hours of Training On-The-Job	(Column 4) Location
Real Estate and Development	8	20-30	Franchise Market Area
Administration	24	24	Jackson, Minnesota
Operations Training	40	160	Jackson, Minnesota
Store Opening Assistance	0	80	Franchised Location
Follow-up Training	0	24-40	Franchised Location

Belmont conducts training programs for both you and some of your employees. The training program will include four segments, which are conducted as needed. Belmont does not charge for this training or service, but you must pay the travel and living expenses for you and your employees. All training occurs at Belmont's Jackson, Minnesota, headquarters, the first weekend of each month. Training is conducted by Mark Smith, who has 20 years of experience in operating a muffler shop, 12 years of that with Belmont.

Belmont's Real Estate & Development Training introduces you to the site selection, real estate, and construction and acquisition strategy portions of the business. It will begin promptly after you sign the Licensee Agreement and will include 1 day of orientation and 2-3 days of site visits once a site is identified. You (or if your business is a corporation or partnership, a principal of the business) must attend and complete, to Belmont's satisfaction, Belmont's Real Estate & Development Training.

Belmont's Administration Training provides you with business training and store management training. The program introduces you to the human resources, compensation, fleets, marketing, legal, EH&S, credit, security, training, point of sale, and pricing aspects of the business. The Administration Training will begin approximately 45-60 days before the opening of your initial store, and will include approximately 3 days of classroom instruction and approximately 3 days of on-the-job training at stores operated by Belmont affiliates or licensees. You (or if your business is a corporation or partnership, a principal of the business) must attend and complete, to Belmont's satisfaction, Belmont's Administration Training.

Belmont's Operations Training for your initial manager focuses entirely on store management and is intended to train qualified individuals to manage stores. The Operations Training will begin approximately 45-60 days before the opening of your initial store and will include approximately 5 days of classroom instruction and approximately 20 days of on-the-job training at a store operated by a Belmont affiliate or licensee. Your initial manager must complete, to Belmont's satisfaction, Belmont's store management training program portion of Operations Training before your store opens.

Belmont's Store Opening Training is designed to assist you in the opening of a new store. Store Opening Training will be held at your store, approximately 1 week before the opening of your store, and will include operational training and assistance. The exact duration and timing of Store Opening Training, however, will depend on your preparation,

Approximately 3-6 months after your first store opens, an operations representative will return to your store and provide Belmont's Follow-Up Training.

It is your responsibility to insure that all subsequent managers and employees are trained in Belmont's systems and procedures and that Belmont's systems and procedures are utilized at your store. Belmont may audit your store at any time to ensure compliance with Belmont systems and procedures.

ITEM 12: TERRITORY

Item 12 of the amended Rule, like the corresponding item of the UFOC Guidelines, requires detailed disclosures concerning assigned territories and applicable sales restrictions. Two important topics that must be covered in Item 12, among others, are:

- the conditions, if any, under which a franchisor will approve the relocation of the franchisee's business and the franchisee's establishment of additional outlets; and
- any present plans on the part of the franchisor to operate a competing franchise system offering similar goods or services.

In addition, if a franchisor does not offer an exclusive territory, Item 12 requires the franchisor to include a prescribed statement underscoring that point, and warning about the consequences of purchasing a non-exclusive territory; namely:

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

Item 12 also mandates disclosures on several other specific topics relating to territories. Disclosures about the impact of technological innovation and new market developments must be included here. Specifically, Item 12 requires disclosure of information about the use of the Internet to achieve sales and the use of alternative channels for distributing a franchisor's goods. These disclosures are required regardless of whether the franchisor provides an exclusive territory. In this regard, Item 12 requires a franchisor to disclose whether, under the franchise agreement:

- the franchisor itself can solicit or accept orders from consumers within a franchisee's territory;
- the franchisor reserves the right to use alternative channels of distribution within a franchisee's territory, including Internet, catalog, or telemarketing sales; and
- any compensation a franchisor pays to a franchisee for soliciting or accepting orders from inside the franchisee's territory.

Finally, Item 12 calls for disclosure of similar information describing the extent to which a franchisee will be restricted from soliciting or accepting orders from outside his or her territory, including whether a franchisee has the right to distribute through alternative channels, such as the Internet, catalog sales, telemarketing, or other direct marketing.

Sample Item 12: Territory
(For a Franchise with an Exclusive Territory)

ITEM 12: TERRITORY

You will receive an exclusive territory with a minimum population of 50,000 people. You will operate from one location and must receive our permission before relocating. We will not operate stores or grant franchises for a similar or competitive business within your area.

You are not restricted from selling Belmont products and services to customers residing outside your territory. Except when advertising cooperatively with appropriate franchisees, you are restricted from advertising outside your territory without prior written consent. You may not engage in any mail order solicitations, catalog sales, telemarketing, Internet, or television solicitation programs or use any other advertising media outside of your territory without prior written approval.

We retain the right, in our sole discretion, to offer goods and services identified by brands we control through channels of distribution other than through Belmont Muffler Shops to locations and customers located anywhere, including those residing in your territory. We also reserve the right to sell goods through mail order, catalog sales, telemarketing, Internet, television, newspaper, and any other advertising media to consumers located anywhere, including within your territory.

You do not receive the right to acquire additional franchises within your area.

There is no minimum sales quota. You maintain rights to your area even if the population increases.

ITEM 13: TRADEMARKS

Consistent with the UFOC Guidelines, Item 13 of the amended Rule requires franchisors to disclose whether each of its principal trademarks is registered with the United States Patent and Trademark Office (“PTO”), as well as application, renewal, and other related information. If not, Item 13 mandates the following prescribed statement:

We do not have a federal registration for our principal trademark. Therefore, our trademark does not have as many legal benefits and rights as a federally registered trademark. If our right to use the trademark is challenged, you may have to change to an alternative trademark, which may increase your expenses.

Item 13 also calls for disclosure of other information, including:

- the existence of any pending litigation, settlements, agreements, or superior rights that may limit a franchisee’s use of the trademark; and
- any contractual obligation of the franchisor to protect a franchisee’s right to use the principal trademarks, and to protect the franchisee against claims of infringement or unfair competition.

Item 13 mandates these disclosures because the existence of pending litigation, settlement restrictions, or other potential limitations on the use of the trademark is highly material information. These are all factors on which the value of the trademark to a prospective franchisee may depend. Any one of them ultimately could have a major impact on a franchisee’s ability to continue operating the franchise.

Item 13 permits a franchisor to include an attorney’s opinion regarding the merits of any litigation or of a PTO or similar action if the attorney issuing the opinion consents to its use. The text of the Item 13 disclosures may include a summary of the opinion if the full opinion is attached to Item 22 and the attorney issuing the opinion consents to the use of the summary.

Sample Item 13: Trademarks

ITEM 13: TRADEMARKS

We grant you the right to operate a shop under the name “Belmont Muffler Shop.” You may also use our other current or future trademarks to operate your shop. By “trademark,” we mean trade names, trademarks, service marks, and logos used to identify your shop. We registered the trademark on the United States Patent and Trademark Office principal register on May 11, 1993, as Number 379286.

You must follow our rules when you use these marks. You cannot use a name or mark as part of a corporate name or with modifying words, designs, or symbols, except for those which we license to you. You may not use Belmont’s registered name in connection with the sale of any unauthorized product or service, or in a manner that we have not authorized in writing.

On June 4, 2003, the United States Patent and Trademark Office rejected Belmont’s application to register the mark “Super Mufflers” because the mark was found to be confusingly similar to a previously registered mark.

Our inability to register this mark on the federal level permits others to establish rights to use the Super Mufflers mark. Such use of the Super Mufflers mark does not occur in areas where our franchisees are operating or advertising under the mark, or in the natural zone of expansion for Belmont's shops. In addition, others outside the Belmont system who use the Super Mufflers mark must act in good faith and without actual knowledge of our prior use of the mark. However, if others establish rights to use the Super Mufflers mark, we may not be able to expand into these areas using that mark.

No agreements limit our right to use or license the use of Belmont's trademarks.

You must notify us immediately when you learn about an infringement of, or challenge to, your use of our trademark. We will take the action we think appropriate. While we are not required to defend you against a claim against your use of our trademark, we will reimburse you for your liability and reasonable costs in connection with defending our trademark. To receive reimbursement you must have notified us immediately when you learned about the alleged infringement or challenge.

You must modify or discontinue the use of a trademark if we modify or discontinue using it. If this happens, we will reimburse you for your tangible costs of compliance (for example, changing signs). You must not directly or indirectly contest our right to our trademarks, trade secrets, or business techniques that are part of our business.

Richard R. Roe is currently doing business as Belmont Muffler Shoppe at 4231 Main Street, Reno, Nevada. We believe that this is an infringing use of our federally registered trademark "Belmont Muffler Shop," and we have filed an action to enjoin Mr. Roe and to recover damages. If the court holds that Mr. Roe's use is not infringing, Belmont may not be able to use Belmont's trademark in Mr. Roe's immediate area. ([Belmont Muffler Shop v. Belmont Muffler Shoppe](#), No. 8899 (D. Nev. filed April 15, 2006).

ITEM 14: PATENTS, COPYRIGHTS, AND PROPRIETARY INFORMATION

Like Item 13, Item 14 of the amended Rule follows the UFOC Guidelines in requiring disclosure of information about intellectual property related to the franchise. Franchisors must disclose the types of intellectual property, their ownership rights or licenses in each, details about, and the duration of, their rights, and any legal proceedings, settlements, and restrictions that may impact the franchisee's ability to use such property, among other things. Item 14 permits a franchisor to include an attorney's opinion regarding the merits of litigation or of a PTO or similar action if the attorney issuing the opinion consents to its use. The text of the Item 14 disclosures may include a summary of the opinion if the full opinion is attached to Item 22 and the attorney issuing the opinion consents to the use of the summary.

Sample Item 14-1: Patents, Copyrights, and Proprietary Information

ITEM 14: PATENTS, COPYRIGHTS, AND PROPRIETARY INFORMATION

You do not receive the right to use any item covered by a patent or copyright, but you can use the proprietary information in the Belmont Operating Manual. The Operating Manual is described in Item 11. Item 11 also describes limitations on the use of this manual by you and your employees.

You must also promptly tell us when you learn about the unauthorized use of this proprietary information. We are not obligated to take any action, but we will respond to your notification of unauthorized use as we think appropriate. We will indemnify you for any loss you sustain as a result of any action brought by a third party concerning your use of this proprietary information.

Sample Item 14-2: Patents, Copyrights, and Proprietary Information

ITEM 14: PATENTS, COPYRIGHTS, AND PROPRIETARY INFORMATION

U.S. Patent No. 399442 was issued to CTF International, Inc. on December 4, 1993. It describes a process for exhaust system installation. The process describes the steps in making a straight length of exhaust pipe, bending this pipe, coating the inside and outside of this pipe with our Pipe Protector, and installing the exhaust pipe on a motor vehicle. You will use equipment utilizing this process.

Our right to use or license this patent is not materially limited by any agreement or known infringing use.

You must tell us immediately if you learn about an infringement or challenge to our use of this patent. We will take action that we think is appropriate. You must also agree not to contest our interest in these or our other trade secrets.

If we decide to add, modify, or discontinue the use of an item or process covered by a patent or copyright, you must also do so. Our sole obligation is to reimburse you for the tangible cost of complying with this obligation.

Although we are not obligated to defend your use of these items or processes, we will reimburse you for damages and reasonable costs incurred in litigation about them.

ITEM 15: OBLIGATION TO PARTICIPATE IN THE ACTUAL OPERATION OF THE FRANCHISE BUSINESS

Item 15 of the amended Rule requires franchisors to disclose whether franchisees are required to participate personally in the direct operation of the franchise. Among other things, the amended Rule's Item 15 calls for disclosures stating:

- any obligation for the franchisee to participate directly in the business that arises from the parties' franchise agreement, *or* from any other agreement,¹⁵ *or* from the franchisor's practice;
- whether the franchisor recommends direct participation; and
- if personal "on-premises" supervision is not required, any limitations on whom the franchisee can hire as a supervisor, whether the supervisor must successfully complete training, and any restrictions (*e.g.*, covenants not to compete or trade secrecy agreements) that the franchisee must place on his or her manager.

If the franchisee is not an individual but operates as a business entity – *e.g.*, a corporation or a partnership – Item 15 requires the franchisor to disclose the amount of equity interest, if any, that the on-premises supervisor must have in the franchise.

Sample Item 15-1: Obligation to Participate in the Actual Operation of the Franchise Business

ITEM 15: OBLIGATION TO PARTICIPATE IN THE ACTUAL OPERATION OF THE FRANCHISE BUSINESS

If you are an individual, you must directly supervise the franchised business on its premises.

If you are a corporation, a person who owns at least a 1/3 share of the corporate equity must perform the direct, on-site supervision of the franchised business.

¹⁵ Note that Item 22 requires franchisors to include copies of "all agreements proposed for use or in use . . . regarding the offering of a franchise." This includes any contract that is binding on the owner(s) of the franchise.

**Sample Item 15-2: Obligation to Participate
in the Actual Operation of the Franchise Business**

**ITEM 15: OBLIGATION TO PARTICIPATE IN THE
ACTUAL OPERATION OF THE FRANCHISE BUSINESS**

We do not require that you personally supervise the franchised business, but we do recommend it.

In any case, the business must be directly supervised "on premises" by a manager who has successfully completed our training program. The on-premises manager cannot have an interest or business relationship with any of Belmont's business competitors. If the franchisee is a corporation or a partnership, the manager need not have an ownership interest in it. The manager must sign a written agreement (Exhibit G) to maintain confidentiality of the trade secrets described in Item 14 and to conform with the covenants not to compete described in Item 17.

**ITEM 16: RESTRICTIONS ON WHAT
THE FRANCHISEE MAY SELL**

Like the UFOC Guidelines, the amended Rule's Item 16 calls for disclosure of any restrictions relating to the goods or services a franchisee sells, including:

- any restriction allowing *only* sales of franchisor-approved goods or services;
- any restriction requiring a franchisee to sell *all* goods or services authorized by the franchisor; and
- whether the franchisor has the right to change the types of authorized goods or services and whether there are any restrictions on the franchisor's right to make such changes.

Sample Item 16: Restrictions on What the Franchisee May Sell

ITEM 16: RESTRICTIONS ON WHAT THE FRANCHISEE MAY SELL

We require you to offer and sell only those goods and services that we have approved (see Item 9).

You must offer all goods and services that we designate as required for all franchisees. These required services are muffler inspection, repair, and replacement. Parts, supplies, and equipment used in your Belmont Muffler business must be approved by us (see Item 8).

We have the right to add additional authorized services that a franchisee is required to offer. There are no limits on our right to do so except that the investment required of a franchisee for equipment, supplies, and initial inventory will not exceed \$5,000 per year.

We also designate some services as optional for qualified franchisees. Current optional services are brake inspection, repair, and replacement; tire rotation, wheel balancing and alignment; and rustproofing. To offer optional goods or services, you must be in substantial compliance with all material obligations under the franchise agreement. In addition, we may require you to comply with other requirements, such as training, marketing, or insurance, before we will allow you to offer certain optional services.

As long as you meet your annual agreed sales quotas (see Item 12), we will not restrict you from soliciting any customers, no matter who they are or where they are located. If you do not meet your annual sales quota, we may deny you the right to receive any further fleet business referrals from us and may either keep the fleet business referrals for ourselves or give them to another franchisee. Failure to meet your annual sales quota is a default under your franchisee agreement and grounds for termination of your franchise. (See Item 17.)

ITEM 17: RENEWAL, TERMINATION, TRANSFER, AND DISPUTE RESOLUTION

Item 17 of the amended Rule is substantively similar to Item 17 of the UFOC Guidelines. It requires franchisors to summarize, in the specified tabular format, common provisions of franchisee agreements, including those provisions dealing with termination, renewal, and dispute resolution. The Item 17 table must begin with the following prescribed statement, in boldface type:

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

Discretionary Benefits

If the franchise agreement is silent regarding one or more of the categories enumerated in the prescribed table, but the franchisor voluntarily offers to provide certain benefits or protections to franchisees as a matter of policy, then the franchisor may add a footnote to the table describing the policy and state whether the policy is subject to change. For example, if the franchisor routinely offers to buy back a franchised outlet upon the death of the franchisee-owner, that policy may be added as a footnote to the line in the table for “Death or Disability of Franchisee.”

Renewals

The amended Rule is somewhat different from the UFOC Guidelines in its treatment of the topic of renewals. Specifically, the amended Rule requires franchisors to explain their renewal policy in the “Summary” column of the line in the table titled “Requirements for Franchisee to Renew or Extend.” This requirement is designed to prevent prospective franchisees from being confused or misled about what is meant by the term “renewal” – a term that may be applied differently from one franchise system to another. For example, in many franchise systems, a right of renewal means that the franchisee, upon the expiration of the original term of the franchise agreement, has the right to enter into a new agreement according to the then-current terms and conditions. In other systems, the franchisee may have a simple right to extend the existing agreement under the same terms and conditions for an additional period of time. Regardless, the franchisor must explain in the summary column in the line titled “Requirements for the Franchisee to Renew or Extend” what the term means in its system. If the franchisor’s policy is that franchisees may be asked to sign the then-current agreement, then the franchisor must also include a statement alerting franchisees that the terms and conditions of the renewal contract may differ materially from those of their initial contract. Franchisors have the flexibility to include a statement of their choosing as long as it conveys the idea that the renewal agreement may impose materially different terms and conditions than those in the original agreement.

Sample Item 17: Renewal, Termination, Transfer, and Dispute Resolution

ITEM 17: THE FRANCHISE RELATIONSHIP		
This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this disclosure document.		
Provision	Section in franchise or other agreement	Summary
a. Length of the franchise term	Section 1 (also Section 1 of Lease)	Term is equal to lease term (10 years). (Exhibits A and B).

Provision	Section in franchise or other agreement	Summary
b. Renewal or extension	Section 20	If you are in good standing, upon expiration of your original franchise agreement, you will have the right to renew your franchise for another 10-year term by signing the then current franchise agreement. This means that you may be asked to sign an agreement with terms and conditions that are materially different from those in your original agreement.
c. Requirement for franchisee to renew or extend	Section 20	Sign then-current franchise agreement, pay renewal fee, remodel, and sign or extend lease.
d. Termination by franchisee	None	
e. Termination by franchisor without cause	None	
f. Termination by franchisor with cause	Section 21	Belmont can terminate only if you default.
g. "Cause" defined – curable defaults	Section 21B	You have 30 days to cure: non-payment of fees, sanitation problems, non-submission of reports, and any other default not listed in Section 21A.
h. "Cause" defined – non-curable defaults	Section 22	Non-curable defaults: conviction of felony, repeated defaults even if cured, abandonment, trademark misuse, and unapproved transfers.
i. Franchisee's obligations on termination/non-renewal	Section 22	Obligations include complete de-identification and payment of amounts due (also see r. below).
j. Assignment of contract by franchisor	Section 18	No restriction on Belmont's right to assign.
k. "Transfer" by franchisee-defined	Section 19A	Includes transfer of contract or assets or ownership change.
l. Franchisor approval of transfer by franchisee	Section 19B	Belmont has the right to approve all transfers but will not unreasonably withhold approval.
m. Conditions for franchisor approval of transfer	Section 19C	New franchisee qualifies, transfer fee is paid, purchaser transfer agreement approved, training arranged, release signed by you, and current agreement signed by new franchisee (also see r, below).
n. Franchisor's right of first refusal to acquire franchisee's business	Section 19F	Belmont can match any offer for the franchisee's business.

Provision	Section in franchise or other agreement	Summary
o. Franchisor's option to purchase franchisee's business	None, but see policy described in Note 1	
p. Death or disability of franchisee	Section 19D	Franchise must be assigned by estate to approved buyer within 6 months.
q. Non-competition covenants during the term of the franchise.	Section 11	No involvement in competing business anywhere in the U.S.
r. Non-competition covenants after the franchise is terminated or expires	Section 19C and 22C	No competing business for 2 years within 20 miles of another Belmont franchise (including after assignment).
s. Modification of agreement	Section 8A	No modifications generally, but Operating Manual is subject to change.
t. Integration/merger clause	Section 29	Only the terms of the franchise agreement are binding (subject to state law). Any representations or promises outside of the disclosure document and franchise agreement may not be enforceable.
u. Dispute resolution by arbitration or mediation	Section 29	Except for certain claims, all disputes must be arbitrated in Minnesota.
v. Choice of forum	Section 27	Litigation must be in Minnesota.
w. Choice of law	Section 28	Minnesota law applies.
<p>Notes:</p> <p>(1) Franchisor is not obligated by the Agreement to do so, but, if the franchise is terminated, franchisor's policy is to buy back inventory at fair market value. This policy is subject to change at any time.</p>		

ITEM 18: PUBLIC FIGURES

Item 18 of the amended Rule requires the disclosure of certain information about a public figure's involvement in the franchise system. This covers public figures who lend their name or image to the franchise, control or manage the franchisor, or invest in the franchisor.

Who Qualifies as a “Public Figure”?

A public figure means a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located. Typical public figures include sports stars, actors, musicians, and similar celebrities.

Use of Name, Image, or Endorsement

If a public figure’s name is used as part of the franchisor’s name, the public figure’s image is used as a symbol associated with the franchise, or the public figure endorses or recommends the franchise to prospective franchisees, then the franchisor must disclose any compensation or other benefits given or promised to the public figure. Item 18 is limited to circumstances when a public figure’s identification with a system is for the purpose of selling *franchises*. Merely using a public figure as a spokesperson to promote a system’s *products or services* sold to consumers does not bring a franchisor within the ambit of the amended Rule’s Item 18 requirements.

Management

If a public figure is involved in the management or control of the franchisor, the franchisor must disclose the extent of that involvement, including the public figure’s position in the franchisor and his or her duties in the business structure.

Investment

If a public figure invests in the franchisor, the franchisor must disclose the type and total amount of his or her investment. The “type” of investment includes cash, stock, promissory notes, and any in-kind services performed or to be performed by the public figure.

Sample Item 18: Public Figures

ITEM 18: PUBLIC FIGURES

Belmont has paid Ralph Doister \$50,000 for the right to use his name in promoting the sale of our franchise. This right expires on December 31, 2008. Belmont has produced newspaper ads, a brochure, and a video which feature Mr. Doister. Mr. Doister does not manage or own an interest in Belmont.

ITEM 19: FINANCIAL PERFORMANCE REPRESENTATIONS

Like the original Rule and the UFOC Guidelines, the amended Rule permits, but does not require, franchisors to include representations about financial performance in their disclosure documents.¹⁶ Unlike the original Rule, a franchisor that decides to make such representations must include them in Item 19, not in a separate document. A franchisor electing to make a financial performance representation must, among other things, have a reasonable basis¹⁷ and written substantiation for the representation at the time it is made, and disclose the bases and assumptions underlying the representation in Item 19. The Item 19 disclosures also must include an admonition that a prospective franchisee’s actual earnings may differ. Franchisors should keep in mind not only the affirmative disclosure requirements in Item 19, but the parallel prohibitions against making representations that are not true or are not substantiated at the time they are made. These prohibitions are discussed below, beginning on page 130.

Required Item 19 Preambles

All Item 19 disclosures must begin with a prescribed preamble that informs prospective franchisees about the law of financial performance representations:

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

¹⁶ The amended Rule uses the broad term “financial performance representation,” rather than the original Rule’s more limited term “earnings claim,” out of recognition that some industries, such as hotels, use variables other than earnings to measure performance, such as room occupancy rates.

¹⁷ For a discussion of what is “reasonable,” see the discussion on page 135 below.

This preamble must be included word-for-word as set out above, with no modification in language or punctuation.

If a franchisor elects *not* to make any financial performance representations, then the franchisor's disclosure document must include in Item 19 not only the universal preamble set out immediately above, but also the following additional preamble:

We do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor's management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.

Like the universal preamble, this preamble for those not making financial performance representations must be included word-for-word as set out above, with no modification in language or punctuation.

Note that franchisors that make no Item 19 financial performance representations are prohibited from making any such representations outside of the confines of the disclosure document. This prohibition encompasses any financial performance representations made in any advertisement or on a website directed at prospective franchisees. The making of any such contradictory representations is itself an independent violation of the amended Rule.

Financial Performance Representations: Historical or Projected?

The requirements of Item 19 vary depending upon whether a franchisor makes historical representations (how much existing franchisees have, in fact, earned in the past) or projections (how much an individual prospective franchisee is likely to earn in the future). In fact, Item 19 requires franchisors to state expressly whether any financial performance representation:

- pertains to historic performance of all or a subset of existing franchised outlets or
- is a forecast of future potential performance.

Historic Performance

A franchisor making an historic financial performance representation must state the material facts underlying the representation. Item 19 of the amended Rule specifies six separate elements comprising the material bases for such a representation, each of which must be expressly addressed:

- **The Group Measured –**

Did All Outlets in the System, or Only Some of Them, Achieve the Stated Level of Performance?

A franchisor that makes an historic financial performance representation, in Item 19 must state whether the representation relates to the performance of all its existing outlets or only a subset of them sharing some characteristic (*e.g.*, all in the same geographic region or locale, all occupying free-standing premises as opposed to premises in a shopping center, or all in operation for at least three years). Of course, nothing prevents a franchisor from basing a financial performance claim on system-wide data, such as a survey of all franchised outlets to gather data on average sales. The point is, a franchisor may base a financial performance claim on data from fewer outlets than are in the entire system if these outlets share one or more characteristics in common. The amended Rule permits this, provided the franchisor discloses the characteristics of the outlets from which data are gathered to form the basis of the financial performance representation, and the total number of franchises in the franchise system.

Are the Outlets in the Measured Group Franchised Outlets? Company-owned? Outlets of an Affiliated System with Similar Operations?

The group from which data is gathered need not be comprised of franchised outlets. It may be a group consisting of company-owned outlets, or, in certain

limited circumstances, a group of reasonably similar outlets of an affiliate with operations reasonably similar to those of the franchisor making the offering in question – *with two provisos*.¹⁸ The first proviso is that any financial performance representation a franchisor makes must be reasonable and supported by the data collected from the group. That means the franchisor must have written substantiation of the representation in the franchisor’s possession at the time the representation is made. The second proviso is that the franchisor’s disclosure must make clear whether the claim is based on the experience of company-owned outlets, of outlets of an affiliate with reasonably similar operations, or of franchised outlets in the same system as those being offered for sale.

- **Time Period Measured –**

When Was the Stated Level of Performance Achieved?

Franchisors have the flexibility to use any reasonable time period. For example, a franchisor may wish to disclose sales or profit figures for franchisees over the last two fiscal years. Be mindful, however, that using a time period that is not fairly recent may generate performance results that no longer are relevant to current market conditions. Using data gathered too long ago – even if true when collected – may not provide a reasonable basis for a financial performance representation if it is no longer relevant to current conditions. As one example, a franchisor may have conducted a survey of franchisees between 2000 and 2002. Use of statistics gathered so long ago may be no longer relevant – and is possibly misleading – in

¹⁸ As noted, all financial performance representations must have a reasonable basis. When a franchisor has adequate performance data of its own upon which to base a performance representation, basing a financial performance representation on affiliate information likely would *not* be reasonable. Nevertheless, if the franchisor lacks adequate operating experience of its own, it may base a financial performance claim upon the results of operations of a substantially similar business of an affiliate. As in any case when a financial performance representation is based on a subset of outlets that share a particular set of characteristics, the franchisor must also disclose any characteristics of these outlets that may differ materially from the outlets being offered for sale.

light of all the market changes that may have transpired since then. Likewise, representations based on the reasonably similar operations of an affiliate with reasonably similar operations may prove to be inaccurate or misleading, in a relatively short period of time, based on the actual operating experience of the franchisor's franchisees.

- **Number of Outlets Measured –**

How Many Outlets Are in the Group That Achieved the Stated Level of Performance, and How Many Are in the Entire System?

A franchisor must disclose the number of franchisees that were in the group or subgroup measured as compared to the number in the entire system, during the relevant time period. For example, if a franchisor wishes to base a financial performance representation on all franchisees in Florida during its last fiscal year, the franchisor must state how many franchisees were in the system (*e.g.*, “There were 1000 system franchises in fiscal 2006”) and the number that existed in Florida during that period (*e.g.*, “There were 100 Florida franchisees in fiscal 2006”).

- **Number of Outlets Reporting –**

How Many Outlets in the Relevant Group Supplied the Performance Data Underlying the Representation?

Franchisors must also disclose the number of franchisees in the group about which the financial performance claim is made and from which the financial performance data were gathered. Data could be gathered from all members of a group sharing the specified characteristics, or from fewer than all members of that group. For example, a franchisor may have sent out questionnaires to each of its 100 franchisees in Florida, or may have selected 50 randomly to receive the questionnaires. The franchisor's Item 19 disclosures would need to clearly disclose the number of franchisees who received questionnaires and how they were

selected. The disclosure also could indicate how many responded to the questionnaire.

- **Number and Percentage of Outlets that Achieved the Stated Level of Performance –**

What Proportion of the Group Measured Achieved the Results Claimed?

With respect to the outlets that provided data used to arrive at the representation, franchisors must disclose both the number and percentage that actually attained or surpassed the stated results. For example, suppose that of 100 Florida franchisees who received survey questionnaires about their financial performance, 75 responded and 50 achieved or surpassed the represented level of performance. In that case, the franchisor's Item 19 disclosures would need to disclose clearly both the number (*i.e.*, 50 out of the 100 who received questionnaires) and the percentage of franchisees who achieved the represented results (*i.e.*, 50%).

- **Distinguishing Characteristics –**

What Are the Common Attributes of the Outlets That Achieved the Stated Level of Performance?

The implicit assumption underlying any historic performance representation is that a prospective franchisee may achieve at least the same level of performance – although, of course, there is no guarantee that this will happen. Factors tending to call that implicit assumption into question must be disclosed. Thus, Item 19 calls for disclosure of any characteristic of the group or subgroup on which a financial performance claim is based that might set that group apart from outlets currently being offered for sale. For example, financial performance data collected from ice cream store franchises in Florida might differ significantly from such data collected from ice cream store franchisees in Minnesota or Alaska. Accordingly, if a

franchisor uses a subgroup (*e.g.*, Florida franchisees) as a basis for a financial performance claim, the franchisor's disclosure documents used elsewhere (*e.g.*, in Minnesota and Alaska) must clearly state that the performance results represented in Item 19 are based upon Florida franchisees, and are likely to differ materially from those of the outlets being offered for sale.

Projected Performance

As is the case with historical financial performance representations, financial performance projections must have a reasonable basis, and must disclose the material bases and assumptions upon which the projection is based. The amended Rule does not enumerate specific factors that must be addressed in describing the bases for a projected financial performance representation. Nevertheless, if a franchisor makes a performance projection, its Item 19 disclosures must include sufficient facts to enable a prospective franchisee to make an independent judgment as to the validity of the projection. The Item 19 disclosures should include a description of the material information on which the franchisor relied in making the representation. This may include market studies, statistical analyses, franchisee profit-and-loss statements, as well as other types of information that prudent persons customarily rely on in making business decisions.

Assumptions underlying a financial performance representation must be disclosed because they go to the heart of the issue – the probability that a prospective franchisee will achieve performance similar to that projected. Thus, the assumptions underlying a forecast include significant factors upon which a franchisee's future results may depend. These factors include, for example, economic or market conditions that are basic to a franchisee's operation, and encompass matters affecting, among other things, a franchisee's sales, the cost of goods or services sold, and operating expenses.

In this regard, if a projection is based upon the results of franchisees' prior performance, the assumptions disclosed must explicitly encompass any characteristics of the outlets upon which the claim is based that differ materially from the outlets currently being offered for sale. Examples of characteristics that typically make a material difference from one outlet to another

include: geographic location; type of business premises (*e.g.*, free-standing units as opposed to units in a shopping center); the extent of competition in the market area; the services or goods sold; assistance or services supplied by the franchisor; and whether the outlets are franchised or company-owned or operated. More specific guidance in preparing assumptions for performance projections can be gained from the American Institute of Certified Public Accountants (“AICPA”).

Admonition

The amended Rule’s Item 19 requires a clear and conspicuous admonition that a new franchisee’s individual financial results may differ from the results stated in the Item 19 disclosure. While no specific language is required, franchisors can look to the admonitions set forth in the original Rule as a model. These include:

For historical representations –

Some outlets have [sold] [earned] this amount. 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.

For projections –

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.

Availability of Substantiation

If a franchisor elects to make a financial performance representation in Item 19, then it must also include a statement that written substantiation for the representation will be made available to the prospective franchisee upon reasonable request. In this context, the term “reasonable” pertains to time and location. A request is reasonable when the prospective franchisee gives the franchisor sufficient time to produce the substantiation at a convenient

location, possibly at company headquarters or where the substantiation is stored if it contains confidential information or is voluminous. For example, franchisors are not expected to bring substantiation with them to a trade show. Accordingly, a request by a trade show attendee for substantiation that afternoon at the trade show would probably be deemed unreasonable.

Financial Performance Representations on a Specific Outlet Offered for Sale

The amended Rule's Item 19 makes clear that a franchisor not wishing to make financial performance representations may nonetheless offer to show a prospective franchisee the actual operating results of a specific outlet being offered for sale. Such information, however, may only be furnished to potential purchasers of that outlet and no others.

Supplemental Representations

If a franchisor has furnished an Item 19 disclosure, it may furnish a prospective franchisee with a supplemental financial performance representation pertaining to a particular location or pertaining to a particular variation (*e.g.*, a kiosk, as opposed to a standard free-standing restaurant). Any such supplemental representation must be in writing, explain the departure from the financial performance representation set forth in the Item 19 disclosures, and be prepared according to the standards for financial performance claims noted above.

Sample Item 19-1: Financial Performance Representation (Based on Actual Historical Performance Results)

ITEM 19: FINANCIAL PERFORMANCE REPRESENTATION

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

Half of existing Belmont Mufflers franchisees in large metropolitan areas have had at least \$200,000 in annual sales.

Some outlets have sold this amount. 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.

Bases

These sales figures are derived from the actual historical performance of Belmont franchisees in four large metropolitan areas: New York City, Boston, Chicago, and Los Angeles. These sales figures were achieved over calendar years 2005 and 2006.

There are 258 Belmont franchisees in the entire Belmont system, of which 100 are in New York City, Boston, Chicago, and Los Angeles. Of the 100 Belmont Muffler franchisees in these cities, we studied the sales figures from 90 standard 6-bay franchised outlets. Of the 90 franchisees, 50 attained at least \$200,000 in annual sales, which is 50% of the franchisees in these cities.

Assumptions

Our study measured Belmont franchisees' performance in large metropolitan areas. The market where your Belmont Muffler shops is located, however, may be in a smaller urban or suburban area. Accordingly, the results achieved by these franchisees may not be typical for those in your area.

Further, each of the franchises studied has been in business at least three years. A separate market study we commissioned that was prepared by HFG Associates, an independent consulting firm, indicates that Belmont franchisees in their first year of operations are likely to achieve half the sales of those operating in business for three years or more.

Our study, the HFG Associates study, and other financial information that forms the bases for our financial performance representation are available to you upon reasonable request.

Sample Item 19-2: Financial Performance Projection (Based on Projected Results)

ITEM 19: FINANCIAL PERFORMANCE PROJECTION

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

We estimate that the most probable net income for your first twelve months of operation is \$50,000.

This income figure is only an estimate of what we think you can earn. There is no assurance that you'll do as well. If you rely upon these figures, you must accept the risk of not doing as well.

Bases

This projected income figure is derived from the actual historical performance of first-year Belmont franchisees.

There are 258 Belmont franchisees in the entire Belmont system, of which 70 began their first year in operation in calendar years 2005 or 2006. Of these, 54 franchisees responded to our survey and submitted data, and 35 (or 50% of first-year franchisees) reported attaining at least \$50,000 in annual income from their franchises.

Assumptions

Forty-five of the franchisees included in our survey are located in large metropolitan areas. The market where your Belmont Muffler shop will be located, however, may be in a smaller urban or suburban area. Accordingly, the results achieved by these franchisees may not be typical for those in your area.

The above projection also assumes a stable supply of pipe, no additional competition for muffler parts and services, and retail price increases of no more than 3% in the next year.

Our survey and other financial information that forms the bases for our financial performance representation are available to you upon reasonable request.

ITEM 20: OUTLETS AND FRANCHISEE INFORMATION

Like the UFOC Guidelines, Item 20 of the amended Rule requires the disclosure of statistical information on the number of franchised outlets and company-owned outlets for the preceding three-year period. Note, however, that the tables in the amended Rule differ substantially from the version of these tables that may be familiar from the UFOC Guidelines. Item 20 of the amended Rule also differs from the UFOC Guidelines in the requirements for disclosure of contact information for former franchisees. In addition, Item 20 contains several new provisions pertaining to: (1) specific outlets offered for resale; (2) confidentiality agreements; and (3) trademark-specific franchisee associations.

Statistical Information

Item 20 of the amended Rule requires five tables. The first table provides a systemwide summary of outlets, detailing the net changes in the number of outlets – both franchised and

company-owned – over the last three fiscal years. The second tracks transfers of outlets, state by state, over the last three fiscal years. The third shows, state by state, changes in the status of franchised outlets over the last three fiscal years. Similarly, the fourth table displays, state by state, changes in the status of company-owned outlets over the last three fiscal years. Finally, the fifth table projects new outlet openings in each state. It also shows the number of franchise agreements that have been signed but have not yet resulted in the opening of an outlet.

Definitions Used in Item 20

When preparing the Item 20 tables, be aware that the various terms used have specific meanings, as outlined below.

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

General Instructions for Preparing Item 20 Tables

The Item 20 tables are designed to capture changes in ownership status. In some instances, there may be multiple changes in ownership or multiple owners of an outlet over the course of a fiscal year. The amended Rule provides the following instructions in order to characterize properly all such changes in status.

Multiple Events Affecting the Status of a Particular Franchise Outlet

Several changes in the status of a particular outlet may occur over the course of a fiscal year. For example, during a single fiscal year, a franchisee may cease operations and the franchisor may respond by terminating the franchisee's franchise agreement. Where there are multiple events such as these affecting a particular outlet, the amended Rule provides that ***only the last event*** for that specific outlet need be reported. In the example above, since termination was the last event, the change in status should be reported only as a termination. Franchisors are permitted to add a footnote to the chart to explain the series of status changes, but except in the case of multiple franchise owners, as discussed below, are not required to do so.

Table No. 1 – Systemwide Outlet Summary

Table No. 1 of Item 20 presents the total number of all outlets nationwide – both company owned and franchised – operating at the beginning and at the end of each of the franchisor's last three fiscal years. This chart should include all outlets that are substantially similar to those being offered for sale to prospective franchisees. The table is intended to show the net change – positive or negative – in the number of operating franchised and company-owned outlets over time.

**Sample Item 20: Outlets and Franchisee Information
(Table No. 1)**

ITEM 20: OUTLETS AND FRANCHISEE INFORMATION				
Systemwide Outlet Summary For years 2005 to 2007				
(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
Franchised	2005	859	1062	+203
	2006	1062	1296	+234
	2007	1296	2720	+1,424
Company Owned	2005	125	145	+20
	2006	145	76	-69
	2007	76	141	+65
Total Outlets	2005	984	1207	+223
	2006	1207	1372	+165
	2007	1372	2861	+1,489

Table No. 2 – Summary of Transfers

Table No. 2 of Item 20 shows the number of transfers in each state occurring over the last three fiscal years. Transfers occur for a variety of reasons. An existing franchisee may wish to sell his or her outlet in order to retire, because of ill health, or due to a pending move to another state. However, because a transfer to a new owner generally does not change the total number of operating outlets in a system, transfers are reported separately from other changes in ownership.

**Sample Item 20: Outlets and Franchisee Information
(Table No. 2)**

Transfers of Outlets from Franchisees to New Owners (Other than the Franchisor) for years 2005 to 2007		
(Column 1) State	(Column 2) Year	(Column 3) Number of Transfers
NC	2005	1
	2006	0
	2007	2
SC	2005	0
	2006	0
	2007	2
Total	2005	1
	2006	0
	2007	4

Table No. 3 – Summary of Status of Franchisee-Owned Outlets

Table No. 3 of Item 20 shows changes in the status of franchisee-owned outlets in each state over the last three fiscal years. It begins with a baseline, using the number of franchise outlets at the start of the fiscal year. Added to the baseline are any new franchise outlets opened during that fiscal year and any existing company-owned outlets that are sold to a franchisee. Subtracted from the baseline are any outlets that changed ownership for one of four reasons – termination, non-renewal, reacquisition by the franchisor, or cessation of operations/other reasons. Finally, Table No. 3 shows the outlets remaining at the end of the year.

Multiple Owners

During the course of a single fiscal year, multiple changes in an outlet’s ownership may occur. For example, on February 1, 2006, a franchisor may reacquire an outlet from a franchisee and then resell it on March 1, 2006, to a new franchisee-owner. Subsequently, on December 1, 2006, the new franchisee-owner may cease operations. The last of such a series of events should

be reported in Table 3 in the “ceased operations” column, because that was the last change in ownership for that specific franchise outlet during the fiscal year. However, for clarity and full disclosure, the amended Rule requires a footnote in this table describing such multiple events involving multiple owners, and the order in which they occurred. For an example, see the note in sample table 3 below.

**Sample Item 20: Outlets and Franchisee Information
(Table No. 3)**

Status of Franchise Outlets For years 2005 to 2007								
(Col. 1) State	(Col. 2) Year	(Col. 3) Outlets at Start of Year	(Col. 4) Outlets Opened	(Col. 5) Terminations	(Col. 6) Non- Renewals	(Col. 7) Reacquired by Franchisor	(Col. 8) Ceased Operations- Other Reasons	(Col. 9) Outlets at End of Year
AL	2005	10	2	1	0	0	1	10
	2006	11	5	0	1	0	0	15
	2007	15	4	1	0	1	2	15
TX (Note 1)	2005	20	5	0	0	0	0	25
	2006	25	4	1	0	0	2	26
	2007	26	4	0	0	0	0	30
Totals	2005	30	7	1	0	0	1	35
	2006	36	9	1	1	0	2	41
	2007	41	8	1	0	1	2	45
Notes								
(1) One outlet had several changes of ownership during the fiscal year. On February 1, 2006, Belmont reacquired a Texas outlet from its owner-franchisee and then resold it on March 1, 2006, to a new franchisee-owner. On December 1, 2006, however, the new franchisee-owner ceased operations.								

Table No. 4 – Summary of Status of Company-Owned Outlets

Table No. 4 of Item 20 shows changes in the status of company-owned outlets in each state over the last three fiscal years. It also begins with a baseline, using the number of company-

owned outlets at the start of the fiscal year. Added to the baseline are any new company-owned outlets opened during that fiscal year and any outlets reacquired from franchisees during the year. Subtracted from the baseline are any outlets that were closed, sold to a franchisee, or otherwise ceased to operate under the franchisor’s trademark. The resulting number reflects the company-owned outlets remaining at the end of the year.

**Sample Item 20: Outlets and Franchisee Information
(Table No. 4)**

Status of Company-Owned Outlets For years 2005 to 2007							
(Col. 1) State	(Col. 2) Year	(Col. 3) Outlets at Start of Year	(Col. 4) Outlets Opened	(Col. 5) Outlets Reacquired From Franchisees	(Col. 6) Outlets Closed	(Col. 7) Outlets Sold to Franchisees	(Col. 8) Outlets at End of Year
NY	2005	1	0	1	0	0	2
	2006	2	2	0	1	0	3
	2007	3	0	0	3	0	0
OR	2005	4	0	1	0	0	5
	2006	5	0	0	2	0	3
	2007	3	0	0	0	1	2
Totals	2005	5	0	2	0	0	7
	2006	7	2	0	3	0	6
	2007	6	0	0	3	1	2

Table No. 5 – Projected New Outlets (Both Franchised and Company-Owned)

Table No. 5 of Item 20 addresses two issues: franchise agreements signed but outlets not opened, and projected new franchised and company-owned outlets.

Outlets Signed but Not Opened

The amended Rule requires franchisors to report, for each state, the total number of franchise agreements that were signed, but where the outlet had not opened as of the end of the last fiscal year. For example, a franchisor may have signed six agreements with franchisees in California over the last three years. Of the six agreements, four have yet to be opened. Accordingly, the franchisor would report that in California four agreements have been signed but none of the four outlets has opened.

Projected Franchised and Company-Owned Outlets

In addition, Item 20 requires franchisors to report, state by state, the projected number of new franchised and company-owned outlets for the next fiscal year. The amended Rule does not provide specific instructions on how to make these projections. However, such projections must have a reasonable basis. A franchisor may consider historical market trends as well as its own track record.

**Sample Item 20: Outlets and Franchisee Information
(Table No. 5)**

Projected Openings As of December 31, 2007			
(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 Outlets in the Next Fiscal Year
CO	2	3	1
NM	0	4	2
Total	2	7	3

Contact Information for Current Franchisees

Item 20 of the amended Rule follows the approach of the UFOC Guidelines in requiring disclosure of contact information for current franchisees. Franchisors may provide contact

information for all current franchisees, or for all franchisees in the state where they are offering to sell franchises, if there are 100 or more franchises in the state. If not, contact information must be provided for franchisees in contiguous states, and then the next closest states, until contact information for at least 100 franchised outlets can be listed. If a franchisor has fewer than 100 current franchisees, contact information must be provided for all of them.

To protect franchisee privacy, only the name of the franchisee and the address, and telephone number of his or her outlet must be disclosed. In the case of a franchise that may be operated from the franchisee's home, such as an Internet franchise, franchisors may substitute a post office box or current email address for the home address for the same reasons. In that situation, franchisors should list only the telephone number of the franchisee's business, if there is a separate line for the business. If not, a listing of a valid email address will suffice.

Contact Information for Former Franchisees

Like the UFOC Guidelines, Item 20 of the amended Rule requires the disclosure of contact information for every franchisees who:

- has 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
- has not communicated with the franchisor within 10 weeks of the disclosure document issuance date.

In order to protect the privacy of former franchisees, the amended Rule calls for the disclosure of only limited contact information. Specifically, franchisors should disclose only the name, city and state, and current business telephone number of a former franchisee. Only if the current business telephone number is unknown should the last known home telephone number of former franchisees be disclosed. Before disclosing the former franchisee's home telephone number, however, franchisors should first attempt to disclose any current business telephone number for the former franchisee. This is true even if the franchisee no longer conducts a

business of the type operated as a franchisee. For example, a former restaurant franchisee may have become a real estate agent. In such a case, the franchisor should attempt to include the real estate office telephone number. If no current business telephone number exists – such as may be the case when a franchisee retires – then the franchisor may include the last known home telephone number for the franchisee.

If a former franchisee requests that alternative contact information be disclosed – such as an email address, post office address, or personal home address – then it is not a violation of the Franchise Rule for a franchisor to honor the such a request by substituting the contact information provided for the former franchisee’s current business telephone number or last known home telephone number.

Finally, to ensure that prospective franchisees are aware that contact information will be disclosed once they leave the system, franchisors must include the following statement, verbatim, in the Item 20 disclosure of former franchisees: “If you buy this franchise, your contract information may be disclosed to other buyers when you leave the franchise system.”

**Sample Item 20: Outlets and Franchisee Information
(Former Franchisee Contact Information)**

Former Franchisee Contact Information

During the last fiscal year, several Belmont Mufflers franchisees have left the system.

Two Belmont Muffler franchisees voluntarily ceased to conduct business:

John Smith, Denver, Colorado.

Current business telephone number:

(111) 000-0000.

Paul Berg, Austin, Texas

Last know home telephone number:

(222) 111-1111.

One Belmont Mufflers franchisee did not renew:

Alice Harris
Atlanta, Georgia
aliceharris@xxxyyy.com

One additional Belmont Mufflers franchisee has not communicated with Belmont Mufflers during the period 10 weeks.

Mary Peterson
Madison, Wisconsin
Last known home telephone number: (123) 222-2222.

If you buy this franchise, your contact information may be disclosed to other buyers when you leave the franchise system.

Previous Owner Information

The amended Rule requires franchisors to provide certain information if they are selling a specific outlet under their control that was previously owned by a franchisee. Franchisors are not required to make this disclosure, however, if they do not currently own and offer such an outlet for sale. A franchisor also is not obligated to make this disclosure if it assists a current franchisee in selling his or her outlet. Nor does a franchisor have an obligation to make this disclosure if it is selling a unit that has always been a company-owned outlet.

If the franchisor is selling a previously-owned franchised outlet now under its control, it must disclose the following information for the last five fiscal years:

- The name, city and state, current business telephone number, or if unknown, last known home telephone number of each previous owner of the outlet;
- The time period when each previous owner controlled the outlet;
- The reason for each previous ownership change; and
- The time period(s) when the franchisor retained control of the outlet.

If multiple units with previous franchisee-ownership are being sold, the franchisor must provide the required information separately for each one.

The amended Rule gives franchisors the flexibility to include this required information either in the text of Item 20 or in an addendum to the disclosure document. It is possible that a franchisor may not intend to offer a specific unit at the time disclosure is made to a particular prospective franchisee, or that a specific unit may become available only after a disclosure is made. In that case, franchisors need not redistribute revised disclosure documents. Rather, franchisors can comply with this requirement by providing the information in a supplement. Because it is deemed part of the disclosure document, the supplement must be given to the prospective franchisee at least 14 days before the signing of the franchise agreement or payment of any fees – the fundamental disclosure obligation of the amended Rule.

If the sample Item 20 disclosure below were made instead in a supplement, the supplement would be titled: “Supplement to the April 15, 2008, Belmont Disclosure Document.”

**Sample Item 20: Outlets and Franchisee Information
(Previous Owner Information)**

Previous Owner Information

We are offering for sale the Belmont Mufflers unit at:

171 Delfi Street
Arlington, VA 12345

Within the last five years, this specific unit was owned by two franchisees.

January 1, 2002 - March 15, 2003:

Thomas A. Fields
23 Newhampton Circle
Arlington, VA 12345
Current business telephone number: (124) 444-4444
Mr. Fields voluntarily terminated the franchise in order to pursue other interests.

March 16, 2003 - June 5, 2004:

On March 16, 2001, Belmont Mufflers reacquired the unit and operated it as a company-owned outlet until June 5, 2004.

June 6, 2004 - October 20, 2007:

Susan Wadsworth
86 Bratock Road
Arlington, VA 12345

Last known home telephone number: (124) 555-5555.

Ms. Wadsworth was terminated on October 20, 2007, for failure to pay royalties.

October 21, 2007 - to date:

On October 21, 2006, Belmont Mufflers reacquired the unit and continues to operate it as a company-owned unit.

Confidentiality Agreements

In some instances, the amended Rule requires franchisors to disclose if franchisees have signed a confidentiality agreement with the franchisor during the last three fiscal years. If so, franchisors must include the following prescribed statement, verbatim, in Item 20:

In some instances, current and former franchisees sign provisions restricting their ability to speak only about their experience with [name of franchise system]. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you.

What Constitutes a “Confidentiality Agreement”?

The term “confidentiality agreement” encompasses “any contract, order, or settlement provision that directly or indirectly restricts a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor’s system with any prospective franchisee.” A confidentiality agreement typically arises as part of the resolution of a dispute between the franchisor and franchisee.

The requirement to disclose confidentiality agreements is narrow. As noted, it specifically is limited to agreements that restrict a current or former franchisee from discussing his or her personal experience as a *franchisee* in the franchisor’s system. Thus, for example, if a franchisee is also employed by the franchisor as a manager, a confidentiality agreement prohibiting the franchisee from discussing her experience as a manager (as opposed to a franchisee) would *not* trigger this disclosure. Further, a confidentiality agreement that would bar a franchisee from speaking with individuals other than a prospective franchisee – such as competitors or trade press – would *not* trigger this disclosure obligation. This obligation would also not be triggered if a franchisee is restricted from discussing only the specific terms of a settlement, but is otherwise free to discuss his or her experience – including having a dispute with the franchisor.

What about Clauses Designed to Protect Trademarks or Other Proprietary Information?

The definition of “confidentiality agreement” expressly excludes clauses designed to protect franchisors’ trademarks or other proprietary information. Accordingly, a franchisor that requires prospective franchisees to sign a confidentiality agreement in order to receive or to review a copy of the franchisor’s operating manual would not trigger this disclosure requirement.

Optional Additional Disclosures

In addition to requiring the prescribed disclosure statement noted above, the amended Rule permits franchisors, if they wish, to provide additional information that will help a prospective franchisee understand the franchisor’s use of confidentiality clauses. Specifically, franchisors may note the number and percentage of current and former franchisees who, during each of the last three fiscal years, signed agreements containing confidentiality clauses, as well as the circumstances under which such clauses were signed.

Sample Item 20: Outlets and Franchisee Information (Confidentiality Agreement Disclosure)

Confidentiality Agreements

In some instances, current and former franchisees sign provisions restricting their ability to speak openly about their experience with Belmont. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you.

During the last year, Belmont entered into two agreements with franchisees that contained confidentiality restrictions (2 out of 100 franchisees, or 2% of our franchisees). In both instances, the confidentiality restrictions were signed as part of mutually agreed upon settlements of litigation.

Franchisee Associations

The amended Rule requires franchisors to disclosure contact information for trademark-specific franchisee associations. This disclosure requirement pertains solely to associations of franchisees of the franchise brand being offered for sale. It does not pertain to associations of franchisees whose membership is opened to franchisees of many franchise systems, such as “The Texas Association of Restaurant Franchisees.” Nor does it pertain to associations of franchisees under a brand owned by the franchisor that is not the subject of the franchise offering. For example, Belmont Mufflers’ disclosure document need not disclose the existence of a “Belmont Tires” or a “Belmont Windshields” franchisee association.

To be considered a “trademark-specific association,” the association need not include a reference to the trademark in its name. For example, Belmont Mufflers may wish to call its association of muffler franchisees: “Muffler Franchisees of the U.S.” As long as members of the association are franchisees conducting business under the brand being offered in the disclosure document, the association will be deemed a “trademark-specific” franchisee association.

The amended Rule’s disclosure requirements pertaining to franchisee associations differ depending on whether the franchisee association is created, sponsored, or endorsed by the franchisor, or whether the trademark-specific franchisee association is independent of the franchisor.

Associations Created, Sponsored, or Endorsed by the Franchisor

If the franchisor creates, sponsors, or endorses a trademark-specific franchisee association, it must disclose in Item 20 the name, address, telephone number, email address, and Web address of the association. It also must disclose the specific relationship between the franchisor and the association (*i.e.*, that it was created, sponsored, or endorsed by the franchisor).

Note that franchisor sponsorship or endorsement is enough to trigger this disclosure requirement; the franchisor need not have established the association. A franchisor will be deemed to “sponsor” an association if it contributes to the association financially, or provides tangible benefits such as office space, equipment, or personnel. A franchisor will be deemed to “endorse” an association if it takes affirmative steps to promote awareness of the association, its membership, or growth. For example, the franchisor may include a link to the association on its website or routinely report on the association’s activities in its newsletter. Merely recognizing the existence of the association – such as agreeing to meet with one or more of its members or referencing the existence of the association in an email – alone will not be deemed either sponsorship or an endorsement.

Independent Franchisee Associations

The amended Rule requires franchisors to disclose contact information for independent trademark-specific franchisee associations under limited circumstances. An “independent” franchisee association is one that was not created by the franchisor, and is neither sponsored nor endorsed by the franchisor. Typically, such an association is organized and funded by franchisees for the benefit of the franchisees, often without any knowledge of the franchisor.

Franchisors have no obligation to disclose contact information for independent franchisee associations unless each of the following criteria is satisfied:

- the association is organized under state law;
- the association expressly asks for inclusion in the disclosure document; and
- the association timely renews its request for inclusion on an annual basis.

Franchisors obligated to disclose one or more independent franchisee associations may include an optional prescribed statement in their disclosure document noting that the association is an independent one:

The following independent franchisee organizations have asked to be included in this disclosure document:

“Organized under State Law”

To be considered for inclusion in a disclosure document, the independent association must be organized under state law. It need not be incorporated. For example, it can be organized as a trust. The “organized under state law” requirement is interpreted very broadly. However, informal get-togethers by franchisees will not satisfy the “organization under state law” criteria. This will be true even if the informal group of franchisees publishes a newsletter or maintains a website.

Request for Inclusion

A franchisor has no obligation to disclose contact information for an organized independent association unless the association has asked to be included in the franchisor’s disclosure document for the next fiscal year. To be included in the disclosure document, the association must request inclusion no later than 60 days after the close of the franchisor’s fiscal year. Therefore, as an example, if Belmont Mufflers uses the calendar fiscal year, any independent association of Belmont Mufflers franchisees must make their request for inclusion in the Belmont Mufflers disclosure document on or before March 1st of the next year (assuming a non-leap year).

Annual Renewal

Once a valid request is made for inclusion in a disclosure document by an independent association, the franchisor must include the required contact information for the entire fiscal year. The franchisor need not verify the continued existence of the association during the course of the year. However, if the franchisor has knowledge that the association has ceased to exist, it can always add a footnote to the disclosure document alerting prospective franchisees of the change in

status of the independent group. Similarly, the franchisor has no obligation to discover the existence of any new independent associations during the course of the fiscal year. In short, this disclosure is required on an annual basis only and need not be updated quarterly.

Sample Item 20: Outlets and Franchisee Information (Franchisee Association Disclosure)

Franchisee Associations

Belmont Mufflers, Inc., created and supports the Belmont Mufflers Franchisee Association:

1234 Second Street
Jackson, MN 55000.
(612) xxx-xxxx.
Smith@BMFA.org
www.bmfa.org

The following independent franchisee organization has asked to be included in this disclosure document:

Muffler Franchisees of North America, Inc.
2222 Third Street
Albany, NY 11111
(222) 777-8888
Jones@MFONA.org
www.Mufler.org

ITEM 21: FINANCIAL STATEMENTS

Consistent with the UFOC Guidelines, the amended Rule requires franchisors to include in Item 21 copies of their financial statements audited in accordance with generally accepted accounting principals (“GAAP”) for the most recent three fiscal years to show the financial condition of the franchisor. The financial statements of franchisors that own a direct or beneficial controlling financial interest in one or more subsidiaries must also reflect the financial condition of the subsidiaries. Financial disclosures must be in tabular format that compares at least two fiscal years. This provides prospective franchisees with information with which to assess financial trends in a franchise system.

GAAP Requirement

The amended Rule requires franchisors to prepare financial statements according to “United States generally accepted accounting principles, as revised by any future government mandated accounting principles, or as permitted by the Securities and Exchange Commission.” The amended Rule updates the UFOC Guidelines by recognizing that what currently complies with “GAAP” may change as a result of federal government oversight of the accounting profession. Accordingly, it provides that franchisors must use GAAP, as revised by any future government mandated accounting principles.

At the same time, the amended Rule provides flexibility by permitting franchisors to comply with the Rule’s audited financial statement requirement by looking to principles articulated by the Securities Exchange Commission (“SEC”). This is most important for foreign franchisors wishing to sell outlets to be located in the United States. The amended Rule permits foreign franchisors to use United States GAAP or to reconcile their financial statements to United States GAAP, consistent with SEC law.

The SEC currently permits foreign companies registering securities to prepare financial statements using accounting procedures other than United States GAAP if such statements are prepared “according to a comprehensive body of accounting principles.” The company must also disclose the specific comprehensive body of accounting principles used to prepare the statements and explain material differences between the principles and United States GAAP. The company must also reconcile its statements with United States GAAP. For example, through additional notes, foreign franchisors must reconcile figures for net income and total shareholders’ equity for the period presented. Finally, the statements must provide all additional disclosures required by United States GAAP and applicable SEC regulations. Any foreign franchisor may take advantage of the SEC’s standard, whether or not the franchisor registers or intends to register securities. Of course, this approach may change in the future, especially if the SEC and the European Union, as planned, harmonize their accounting standards.

This flexibility, however, pertains solely to the preparation of financial statements. Even if a foreign company reconciles its financial statements to United States GAAP, it must audit the financials according to United States Generally Accepted Auditing Standards (“United States GAAS”), and the auditor must comply with the United States standards for auditor independence.

Parent Financial Information

Item 21 of the amended Rule provides that a franchisor must also disclose the financial statements of any parent corporation in two circumstances: (1) when the parent commits to perform post-sale obligations for the franchisor; or (2) when the parent guarantees obligations of the franchisor. In such circumstances, prospective franchisees may reasonably consider the parent’s financial status in their investment decision-making. Accordingly, the parent’s financial status is material. Also note that where a parent guarantees a franchisor’s performance, Item 21 requires the franchisor to include a copy of the guarantee in the attachments to the disclosure document in Item 22.

Affiliate Financial Information

The amended Rule also permits a franchisor to substitute the financial statements of an affiliate for its own financial statements if the affiliate’s statements meet the Rule’s requirements for audited statements and the affiliate absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor to the franchisee under the franchise agreement. A copy of the guarantee, which need not extend to third parties, must be included in the attachments to the disclosure document in Item 22.

Subfranchisor Financial Information

The amended Rule requires the disclosure of financial information of any subfranchisor. The term “subfranchisor” is limited by the definition in Section 436.1(k) of the amended Rule to circumstances where the subfranchisor steps into the shoes of the franchisor by engaging in pre-sale activities *and* performing post-sale obligations. It does not include those individuals who may be called “subfranchisors,” but who act like brokers or salespersons, having no post-sale commitments to franchisees. Where a person engages in pre-sale activities and commits to

perform under the franchise agreement, his or her financial information becomes material in order to provide prospective franchisees with the opportunity to assess that person's financial condition.

Phase-In of Audited Financial Statements

Like the original Rule, Item 21 of the amended Rule permits franchisors to phase-in the use of audited financial statements over the course of three years. The phase-in applies only to companies that are new to franchising and that do not yet have audited financial statements. If an existing company has prepared audited financial statements in the ordinary course of business before embarking on franchise sales it may not use the phase-in. Moreover, the phase-in is not available to spin-offs, affiliates, or subsidiaries of existing franchisors that have prepared audited financial statements in the past. In short, an existing franchise system cannot avoid the obligation to provide full audited financial statements by forming a spin-off company.

The phase-in works like this: When a new franchisor first prepares a disclosure document to begin selling franchises, it may meet the financial statement requirements by providing only an unaudited opening balance sheet. In the second fiscal year, the franchisor must include an audited balance sheet opinion on its financial condition based on its opening balance sheet and a balance sheet prepared at the end of its first fiscal year. During the third fiscal year, and thereafter, the franchisor must include all required audited financial statements required by the amended Rule.

Note that the amended Rule requires new franchisors to prepare audited financial statements as soon as practical, and mandates that unaudited financial statements must be in a form that conforms as closely as possible to audited statements. This requires the use of GAAP (or SEC-permitted accounting standards), as discussed above. Also, the amended Rule requires that one or more years of unaudited financial statements, as available, should be provided. If the franchisor has not been in business for three years or more, then it must clearly and conspicuously state in Item 21 that the franchisor has not been in business for three years or more and cannot include all the financial statements required by the Rule.

Sample Item 21-1: Financial Statements

ITEM 21: FINANCIAL STATEMENTS

Attached to this disclosure document as Exhibit J are our audited, fiscal year end financials for 2005, 2006, and 2007.

Attached to this disclosure document as Exhibit K are the audited, fiscal year end financials for 2005, 2006, and 2007 of subfranchisor Richard McDonald.

Sample Item 21-2: Financial Statements

ITEM 21: FINANCIAL STATEMENTS

Attached to this disclosure document as Exhibit L are the audited, fiscal year end financials of our parent, CTF International, for fiscal years 2005, 2006, and 2007. Our parent, CTF International has guaranteed our performance with you. A copy of the Guaranty of Performance is included as Exhibit M.

ITEM 22: CONTRACTS

Item 22 of the amended Rule requires franchisors to attach a copy of all proposed agreements relating to the franchise offering that the franchisor provides or for which the franchisor makes arrangements. These include not only the franchise agreement, but leases, options, financing agreements, and purchase agreements. These attachments are part of the disclosure document. Typically, the attached agreements should be the same as those listed in the Table of Contents and in the Receipt.

Sample Item 22: Contracts

ITEM 22: CONTRACTS

The following agreements and other required exhibits are attached to this disclosure document in the pages immediately following:

- A. Belmont Franchise Agreement
- B. Belmont Lease of Premises
- C. USA Credit Corp. Equipment Lease
- D. Belmont Equipment Purchase Note

E.	Belmont Initial Fee Loan Agreement
F.	Belmont Operating Manual Table of Contents
G.	Belmont Confidentiality and Non-Compete Agreement for Outlet Managers
H.	Belmont Non-Compete Agreement for Franchisee Shareholders
I.	Belmont Guarantee of Performance for Franchisee Shareholders
J.	Belmont Mufflers Audited Financial Statements for 2005, 2006, and 2007
K.	Richard McDonald Audited Financial Statements for 2005, 2006, and 2007
L.	CTF International Audited Financial Statements for 2005, 2006, and 2007
M.	CTF International Guarantee of Performance
N.	Receipts

ITEM 23: RECEIPTS

Like the UFOC Guidelines, the amended Rule requires franchisors to obtain a signed receipt for the disclosure document furnished to each prospective franchisee. To facilitate electronic disclosures, the definition of “signature” is very broad, including any means by which a franchisee can authenticate his or her identity. It includes not only a handwritten signature, but the use of security codes, unique passwords, electronic signatures, or similar means of authentication. Accordingly, the amended Rule specifically permits a prospective franchisee to “sign” a disclosure document receipt electronically. For example, a prospective franchisee might “sign” the receipt page of a disclosure document by entering a unique password provided by the franchisor.

When preparing the receipt, franchisors must follow the form of the receipt set forth in Item 23. In addition, Item 23 adopts the current industry practices of including two copies of the receipt at the end of the disclosure document: one that the franchisee retains as part of the disclosure document, and the other that the franchisee must return to the franchisor. The amended Rule’s general recordkeeping requirements, discussed below, also require franchisors to retain a copy of each signed receipt for at least three years to demonstrate compliance.

Required Preamble

Item 23 requires that all receipts begin with the title, “**Receipt**,” in boldface type, and continue immediately with the following prescribed preamble language:

This disclosure document summarizes certain provisions of the franchise agreement and other information in plain language. Read this disclosure document and all agreements carefully.

If [name of franchisor] offers you a franchise, it must provide this disclosure document to you 14 calendar days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

If [name of franchisor] does not deliver this disclosure document on time or if it contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred and should be reported to the Federal Trade Commission, Washington, D.C. 20580 and [state agency].

Name of Seller

Item 23 of the amended Rule requires franchisors to name and provide contact information (principal business address and telephone number) for each specific seller offering the franchise. This includes any company salespersons, subfranchisors, or independent franchise brokers who may deal with a prospective franchisee. Because this information may vary with each franchise offered for sale, a franchisor can comply with this provision either by leaving a blank space in the standard disclosure document that can be filled in by the seller or by including the name(s) and contact information in an attachment to Item 22, which is then referenced in the Item 23 receipt.

Issuance Date

The receipt must include the issuance date of the disclosure document. An “issuance” date is very flexible, meaning any date upon which the franchisor finalizes the current version of the disclosure document for use. States that require registration, however, may use the term “effective date,” to mean the date upon which the state formally approves registration of the disclosure document. Where a franchisor seeks registration in one or more registration states, the franchisor may use, in lieu of an issuance date, an “effective” date to comply with state law. Franchisors obtaining an effective date from a registration state may also use the term “effective date” in non-registration states.

Return of Receipt

The Item 23 receipt requirement is flexible, permitting electronic acknowledgments of receipt. The term “signature” includes not only written signatures, but electronic signatures, passwords, security codes, and other methods that enable a prospective franchisee easily to acknowledge receipt, authenticate his or her identity, and submit the receipt information to the franchisor. Franchisors may include specific instructions on how prospective franchisees should submit the receipt, such as via facsimile or email attachment. Further, the means required for transmitting the receipt need not be the same as the means for transmitting the disclosure document. For example, a franchisor may wish to furnish disclosure documents online, but require a prospective franchisee to print out, sign, and fax back the signed receipt. In short, Item 23 of the amended Rule enables the parties to determine for themselves the most efficient and cost-effective way for the prospective franchisee to transmit the receipt.

Sample Item 23: Receipts

ITEM 23: RECEIPTS

Receipt

This disclosure document summarizes certain provisions of the franchise agreement and other information in plain English. Read this disclosure document and all agreements carefully.

If Belmont offers you a franchise, it must provide this disclosure document to you 14 calendar days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

If Belmont does not deliver this disclosure document on time or if it contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred and should be reported to the Federal Trade Commission, Washington, D.C. 20580 and [state agency].

Belmont's sales agent for this offering is Roger Owens, 111 Capitol Street, Indianapolis, IN (123-555-5555).

Issuance date: April 15, 2008

I received a disclosure document dated April 15, 2008, that included the following Exhibits:

- A. Belmont Franchise Agreement
- B. Belmont Lease of Premises

- C. USA Credit Corp. Equipment Lease
- D. Belmont Equipment Purchase Note
- E. Belmont Initial Fee Loan Agreement
- F. Belmont Operating Manual Table of Contents
- G. Belmont Confidentiality and Non-Compete Agreement for Outlet Managers
- H. Belmont Non-Compete Agreement for Franchisee Shareholders
- I. Belmont Guarantee of Performance for Franchisee Shareholders
- J. Belmont Mufflers Audited Financial Statements for 2005, 2006, and 2007
- K. Richard McDonald Audited Financial Statements for 2005, 2006, and 2007
- L. CTF International Audited Financial Statements for 2005, 2006, and 2007
- M. CTF International Guarantee of Performance

Date: _____ Your name (Please print): _____

Your signature: _____

You should return one copy of the signed receipt either by signing, dating, and mailing it to Belmont at 111 First Street, Jackson, MN 55000, or by faxing a copy of the signed receipt to Belmont at (111) 223-3344. You may keep the second copy for your records.

INSTRUCTIONS FOR PREPARING DISCLOSURE DOCUMENTS

The Rule specifies how the disclosures are to be prepared, what additional information may and may not be included, and what records franchisors must maintain.

Use of “Plain English”

The amended Rule requires franchisors to disclose all specified, material information clearly, legibly, and concisely in a single document using plain English. Section 436.1(o) of amended Rule defines the term “plain English” as:

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

Single Document

The amended Rule allows franchisors to furnish disclosure documents through a wide array of media. At the same time, it requires that disclosure documents be in a format that enables each prospective franchisee to keep the document for future reference. Accordingly, when disclosure documents are furnished as an email attachment or made accessible online, for example, they must be in a format that a prospective franchisee can download onto a computer, a CD-ROM, or the like. The document also must be printable as a single document – it cannot be presented in multiple, discrete parts. For example, a franchisor may not list law suits in Item 3 and then provide a link to external documents that explain the suits in greater detail.

Disclosures Must Address Each Disclosure Item

Franchisors must address each of the 23 disclosure items set forth in the amended Rule. If a particular disclosure Item is not applicable, then a negative response is required that includes a reference to the type of information required to be disclosed by the Item. For example, if no

financing is provided, the franchisor should disclose in Item 10: “We do not offer any direct or indirect financing.”

No Additional Information

The amended Rule prohibits franchisors from including in a disclosure document any information that is not required or expressly permitted, either by the amended Rule itself or by state law. For example, franchisors may not include testimonials or promotional literature in a disclosure document. Nor may they alter or add to prescribed statements set forth in the amended Rule – the prescribed statements must be presented verbatim as specified in the amended Rule.

If literal compliance with a particular disclosure requirement would result in confusing, misleading, or unclear information, additional clarifying footnotes are permitted. For example, multiple ownership changes in the course of a single fiscal year may result in misleading Item 20 franchise outlet statistics. Such changes must be noted in a footnote.

State Requirements

As noted throughout these Guides, franchisors are permitted to include information that state law requires or permits in a disclosure document as long as the requirement is not inconsistent with the requirements of the amended Rule. For example, franchisors may include such information as state law specifies – in the cover page, in the body of the disclosure document, or as an addendum. Franchisors do not need to worry about violating the amended Rule’s prohibition on including additional information as long as there is state authority for including the information – whether that authority is based on a statute, a regulation, a directive or opinion, or at the specific written request of a franchise examiner.

Electronic Disclosures

As a general rule, any disclosures made via electronic media must be identical to documents furnished in “hard copy” – except, of course, for the difference in the physical form in which the disclosures are made available. All required information must be in the disclosure document itself so that downloading or printing the document incorporates all required

information. Accordingly, the amended Rule expressly prohibits the use of electronic features in a disclosure document, such as audio, video, animation, pop-up screens, or links to external information outside of the disclosure document. Thus, for example, a franchisor may not disclose a lawsuit, but then link that suit to an external document that summarizes the suit.

At the same time, the amended Rule does allow non-substantive navigational tools in a disclosure document to aid prospective franchisees in reviewing the document. The amended Rule specifically permits tools such as scroll bars, internal links – such as those linking the table of contents to each specific disclosure item – and search features. It also permits minor non-substantive links to external features that aid a prospective franchisee’s review of the document, such as a link to Adobe™, from which prospective franchisees can download Adobe Reader.™ A franchisor may also link the cover page reference to the *Consumer Guide to Buying a Franchise* with the appropriate link on the FTC’s website.

Multi-State Disclosures

The amended Rule expressly permits franchisors to prepare multi-state disclosure documents. State-specific information may be included in the text of the disclosure document or in attachments to Item 22. A franchisor that is required or allowed by one or more franchise registration states to include information in its disclosure document may, at its option, include that information in all of its disclosure documents, including those for use in non-registration states.

Subfranchisors

As discussed on page 17 above, when a franchise relationship will involve a subfranchisor – a person who acts as a franchisor, engaging in pre-sale activities and having post-sale performance obligations – the disclosure document must include the same information required of the franchisor for the subfranchisor, to the extent applicable. Although the amended Rule requires subfranchisors who prepare disclosure documents to include all required information about the franchisor, it does not assign responsibility for preparation of the disclosures to either the franchisor or subfranchisor, but leaves that determination to them.

Statement of Prerequisites To Reviewing A Disclosure Document

Before a franchisor furnishes a disclosure document to a prospective franchisee, the amended Rule requires the franchisor to:

advise the prospective franchisee of the formats in which the disclosure document is made available, any prerequisites for obtaining the disclosure document in a particular format, and any conditions necessary for reviewing the disclosure document in a particular format.

The amended Rule does not specify how a franchisor should advise prospective franchisees about the prerequisites or conditions for receiving disclosure documents; it allows franchisors to comply in any reasonable manner, provided they do so before the 14-calendar-day deadline for disclosure. Of course, the franchisor always has the burden to prove that it furnished the information to a prospective franchisee by the deadline. Most franchisors will make this information available with the initial franchise application or in the first written contact after accepting a prospect's application. This is the point at which the issue of timely disclosure typically first arises.

As noted previously, the amended Rule permits franchisors to furnish disclosure documents in whatever medium they desire, including electronic media like a CD-ROM, an email, or a website. However, franchisors must advise prospective franchisees of any conditions they must meet in order to review the disclosure document. For example, a franchisor must state whether a prospective franchisee's computer must be capable of reading a certain type of file or whether any specific application is necessary to view the disclosure document (such as Microsoft Word™, Adobe Reader™, or a particular Internet browser).

It is not a violation of the amended Rule if a franchisor does not furnish a disclosure document in the particular format requested by a prospective franchisee. Nevertheless, if a prospective franchisee refuses to accept delivery of a document – regardless of its format – then no franchise sale can be concluded.

Sample Advisory on Disclosure Document Format, Prerequisites, and Conditions

Belmont furnishes disclosure documents electronically via CD-ROM and through a password protected website. To access the website, you will need Internet access and a password from us. The disclosure document is in PDF format. Accordingly, in order to read the disclosure document, your computer must have Adobe Reader.TM

Recordkeeping

The amended Rule imposes two recordkeeping requirements. First, franchisors must retain, and make available to the Commission upon request, a sample copy of each materially different version of their disclosure document for at least three years after the close of the fiscal year when the document was last used. Second, for each completed franchise sale, franchisors must retain for at least three years a copy of the receipt acknowledging that the franchisee received the disclosure document.

Franchisors need retain only copies of materially different versions of their disclosure document. For example, if a franchisor files substantively nearly-identical disclosure documents in one or more of the franchise registration states (*e.g.*, California, Washington, or Hawaii) the franchisor need retain only one copy – *e.g.*, the document registered in California. Further, the amended Rule does not specify how records are to be kept. Therefore, the franchisor may retain copies in the format that is most convenient, whether in hard copy or in an electronic version.

INSTRUCTIONS FOR UPDATING DISCLOSURES

Franchisors must ensure that their disclosure documents are accurate and up to date. To that end, the amended Rule imposes three basic updating requirements: (1) annual updates; (2) quarterly updates; and (3) notification of changes in financial performance information.

Annual Updating Requirement

After the close of each fiscal year, a franchisor must update its disclosure document to ensure that the document is current. These annual updates, including updated audited financial information, must be prepared within 120 days of the close of the fiscal year. After the 120-day period, the franchisor may use only the updated disclosure document and no other.

Quarterly Updating Requirement

Within a reasonable time after the close of each quarter of the fiscal year, a franchisor must prepare and include in Item 22 an attachment to its disclosure document to reflect any material changes to the information the document contains. Material changes include such events as the recent filing of a bankruptcy petition or the filing against the franchisor of a legal action that may have a negative effect on its financial condition.

Note, however, that several of the disclosure requirements in the amended Rule require only annual updating. For example, the franchisor-initiated litigation disclosures in Item 3 need be updated only once a year. Similarly, the statistical information about franchised outlets (such as changes in ownership over the course of a fiscal year) required by Item 20 need be revised only on an annual basis, as is the case for the disclosure of trademark-specific franchisee associations.

In addition, any financial information required to be audited need not be re-audited for a quarterly update. If there is a material change affecting previously audited financial information, a franchisor may furnish unaudited information in the quarterly update, provided that the

franchisor states in the update, in immediate conjunction with the financial information, the fact that the updated financial information has not been audited.

Franchisors are always free to update their disclosure documents more frequently than the Rule requires. For example, if a franchisor furnishes its disclosure document on a website, it could update the disclosures frequently – *e.g.*, monthly – to ensure accuracy. This is not required, but it is permitted if a franchisor wishes to do so. In addition, franchisors may update more frequently if state law requires it. For example, some state laws require immediate updating when a material change occurs.

Each prospective franchisee should receive, at a minimum, the current basic disclosure document and any prior quarterly updates available when the disclosure is made. For example, a prospective franchisee who receives disclosures in August 2008 should receive not only the franchisor's annually updated 2008 disclosure document, but also any quarterly updates for the quarters ending March 31, 2008, and June 30, 2008.

Relationship Between Annual and Quarterly Updates

Because franchisors have 120 days to prepare their annual updates, it is possible that the annual update requirement and the quarterly update requirement may overlap. For example, a franchisor whose fiscal year coincides with the calendar year may wish to sell franchises after the close of its first quarter at the end of March 2008, but before the 120 days have elapsed that are allowed for completion of its annual update by May 1, 2008. In such circumstances, the franchisor should prepare and furnish a quarterly update to its 2007 disclosure document until such time as preparation of the 2008 annual update is completed. The annual 2008 update must include the first quarterly update, either by incorporating information from the quarterly update into the text, or by attaching the quarterly update as an addendum to the 2008 annual update.

Prospective Franchisee's Right to Obtain Updated Disclosures and Any Quarterly Updates

Once a franchisor furnishes its disclosure document to a prospective franchisee, the amended Rule does not obligate the franchisor to make an affirmative offer to provide the most recent annual or quarterly updates of the document to the prospective franchisee on an ongoing basis while he or she is still considering the purchase of a franchise. For example, if a franchisor furnishes a disclosure document to a prospective franchisee on December 5, 2008, the franchisor has no obligation to make an affirmative offer to that same prospective franchisee of an updated disclosure document or any quarterly updates prepared in 2009. However, under the amended Rule, prospective franchisees have the right, upon reasonable request before signing the franchise agreement, to obtain the most recent annual update of a franchisor's disclosure document and any quarterly updates, and it is a violation of the amended Rule for a franchisor to fail to comply with such a request.

When Is a Request "Reasonable"?

Suppose that a prospective franchisee has arranged to sign a franchise agreement in August 2009. That prospect has the right to ask for and receive a copy of the franchisor's 2009 annual update, as well as any quarterly updates prepared for the quarters ending on March 31, 2009, and June 30, 2009. The prospective franchisee's request must be "reasonable." For example, if the franchisor stopped offering franchises at the end of 2008 – after providing the prospective franchisee with its most recent disclosure documents and quarterly updates – it would not be reasonable for the prospective franchisee to ask for a 2009 annual update because the franchisor would no longer be preparing disclosure documents in the ordinary course of its business.

How Long After Updates Before Signing the Franchise Agreement?

Finally, the amended Rule provides that a prospective franchisee can ask for any updates "before the prospective franchisee signs a franchise agreement." This is to ensure that the prospect has the most current information before signing the franchise agreement. Nevertheless, this does not mean that the franchisor must furnish the requested updates 14 calendar days before

the parties sign the agreement. Any reasonable time before execution of the agreement will suffice. It also does not mean that a prospective franchisee may ask for updates repeatedly throughout the sales negotiation process. Rather, the amended Rule contemplates that franchisors need provide the updates only once – a reasonable time before execution of the agreement. It may make good business sense and foster good relations, however, to honor a prospective franchisee’s request for more frequent updates, and nothing in the amended Rule would prohibit that.

Material Changes Relating to Financial Performance Representations

The amended Rule requires that, at the time of furnishing a disclosure document, any franchise seller (including any broker) must notify a prospective franchisee if the seller knows of any material changes relating to a financial performance representation. This obligation arises even if a disclosure document is furnished at a time that falls between quarterly updates. For example, a franchisor may prepare an annual update to its disclosure document that contains an Item 19 financial performance representation. A franchise broker may then furnish that disclosure document to a prospective franchisee on June 1, 2008. If the broker knows of a material change in information underlying the Item 19 representation – such as new survey results that cast doubt on the accuracy of the Item 19 financial performance representation – the broker must notify the prospective franchisee of that fact when furnishing the disclosure document. The term “notify” does not mean furnishing an updated disclosure document all over again. A seller may inform the prospective franchisee of the material change underlying the Item 19 in any reasonable manner, such as by letter, telephone call, or email. Of course, the franchise seller has the burden of proving that such notification was made.

FINANCIAL PERFORMANCE REPRESENTATIONS

The amended Rule prohibits financial performance representations that are not true or are not substantiated at the time they are made. It is important to note that these prohibitions cover not only the franchisor, but any “franchise seller.” The amended Rule defines the term “franchise seller” as follows:

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.

Accordingly, individual franchise sellers – such as brokers – may not be liable for failing to furnish disclosure or for improperly preparing the contents of a disclosure document. Under the amended Rule, only the franchisor and any subfranchisor are responsible for that. Nevertheless, **any** seller can be held liable for the seller’s own violation of the amended Rule’s provisions that prohibit:

- making any financial performance representations unless the franchise seller has a reasonable basis and written substantiation for the representation at the time the representation is made;
- failing to include in any financial performance representation a clear and conspicuous admonition that a new franchisee’s individual financial results may differ from the results stated in the financial performance representation;
or
- making any financial performance representation that is not included in Item 19 of the franchisor’s disclosure document.

What Constitutes a “Financial Performance Representation”?

The amended Rule defines the term “financial performance representation” as follows:

any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by

implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.

Typically, a financial performance representation explicitly states or specifies a particular level or range of actual or potential earnings. It includes statements such as “earn a \$10,000 profit,” “sales volume of \$250,000,” or “earn up to \$25,000 per year income.”

Financial performance representations also include implied representations that suggest – or from which a prospective franchisee easily can infer – a specific level or range of income, sales, or profits. These include statements such as “earn enough money to buy a new Porsche,” and “100% return on investment within the first year of operation.” Mere puffery does not fall within the ambit of the amended Rule’s definition. Examples of what may be considered puffery, depending on the full context, include such statements as “make big money,” “this business is a real cash cow,” or “opportunity of a lifetime.”

Does Cost Information Constitute a Financial Performance Representation?

The presentation of cost or expense data alone is not a financial performance representation. Accordingly, the disclosure of fees, required purchases, and expenses reported in Items 5 through 7 ordinarily will not constitute a financial performance claim that would have to be disclosed in Item 19. Nevertheless, a presentation of cost data, coupled with additional sales or earnings figures, from which prospective franchisees could readily calculate average net profits, is a financial performance representation, and does trigger the Item 19 disclosure obligation.

General Media Representations

Financial performance representations include representations made in the general media, where they are likely to attract members of the public interested in purchasing a franchise system.

The term “general media” is to be read broadly to include all forms of advertising, including radio, television, magazines, newspapers, and billboards. It also includes electronic advertisements such as those placed on a franchisor’s website or on a web site operated by a broker or some other third party. Electronic advertisements include both static advertisements, as well as pop-up screen and banner advertisements.

Unsolicited bulk email sent to the public – sometimes referred to as “spam” – is also a form of general media advertising since these messages are widely disseminated to create interest in the franchisor, possibly leading to franchise sales. This is true even if the messages are sent to members of the public who have expressed an interest in receiving franchise information. There is no material difference between sending email messages to members of the public who happen to have expressed some interest in the area of franchising and including financial performance representations in advertisements in franchise-related magazines or newspapers distributed to subscribers. In both scenarios, the financial performance message contained in the ad constitutes a general media claim and triggers the Rule’s disclosure and substantiation requirements.

***Do Statements in Speeches and Press Releases
Constitute “General Media Representations”?***

Ordinarily, company statements in speeches, press releases, and the like will not be considered “general media representations,” unless they are specifically directed at members of the public interested in purchasing a franchise. For example, financial performance information appearing in a franchisor’s press release or in the investors section of the franchisor’s website ordinarily would not be deemed a general media representation because such information is not necessarily directed at, or intended for, potential franchisees. The mere fact that those interested in purchasing a franchise can find such information in a newspaper or online does not make it a general media claim. However, where a franchisor utilizes financial performance information disseminated, or intended to be disseminated, to the public generally in its franchise promotional materials (*e.g.*, in a brochure or franchisee section of a website), and includes in its franchise promotional materials a reference to general financial information on its website, or otherwise repeats the general financial information to lure potential franchisees (such as in a face-to-face

meeting with an audience of prospective purchasers), such information will be deemed general media financial performance representations.

***What about Statements in SEC filings –
Do They Constitute General Media Representations?***

Publicly filed financial performance information submitted to the Securities and Exchange Commission (*e.g.*, 10-Qs and 10-Ks) are not considered general media representations. In enforcing the amended Rule, the Commission adheres to its historical policy of excluding from general media representations any communications to financial journals or the trade press undertaken in connection with bona fide news stories. Financial performance information provided directly to lenders in connection with arranging financing for prospective franchisees also does not constitute a general media representation.

Specific Requirements Applicable to General Media Claims

Financial performance representations made in the general media are subject to the requirements that apply to all financial performance representations, *i.e.*, that they be truthful and reasonable backed by substantiating written information the franchisor possesses when the representations are made. In addition, general media financial performance representations must state:

- the number and percentage of outlets from which supporting data for the representation were gathered that actually attained or surpassed the represented level of financial performance;
- the time period when the performance results were achieved; and
- a clear and conspicuous admonition that a new franchisee's results may differ from the represented performance.

**Relationship Between General Media Financial
Performance Representations and Item 19 Disclosures**

The amended Rule requires that a franchise seller making a financial performance representation in the general media ensure that a full disclosure of the financial performance representation – including the material bases and assumptions – appears in Item 19 of the

franchisor's disclosure document. A franchisor running an advertisement containing financial performance information at the very least must furnish any prospective franchisees with the required Item 19 disclosures while the advertisement is running. If a franchisor stops running the advertisement and makes no additional financial performance representations in the general media, it nonetheless must continue to disclose information required by Item 19 for a reasonable period of time thereafter. A reasonable period of time is not less than six months.

If a franchisor replaces one advertisement containing a financial performance representation with a new one containing updated financial information, the amended Rule requires that the updated information – not the information used in the initial version of the advertisement – be included in the franchisor's Item 19 disclosures. Updated information is clearly more material to a prospective franchisee than older, perhaps stale, and possibly misleading information. Finally, where a franchisor runs multiple advertisements containing different types of financial performance claims, the franchisor must disclose and provide information for each type of claim in Item 19 of its disclosure document.

Sample General Media Financial Performance Representation

**Our Franchisees Earn
\$50,000 or More Per Year!**

Now, for a limited time in this area, Belmont Mufflers, Inc., is offering an opportunity for a self-motivated individual to join the ranks of independent entrepreneurs who have earned \$50,000 a year.* Small investment needed. Seize the chance!

* * * * *

* We randomly surveyed 50 Belmont franchisees with standard 6-bay outlets. Of the 35 who responded, 25 (or 50% of those surveyed) reported earning net profits of at least \$50,000 from March 1, 2007 - March 1, 2008. There is no assurance, however, that you will do as well.

REASONABLENESS OF A FINANCIAL PERFORMANCE REPRESENTATION

The amended Rule prohibits franchise sellers from making any financial performance representation unless they have a reasonable basis for the representation at the time the representation is made. Written factual information in the seller's possession must reasonably support the representation, as it is likely to be understood by a reasonable prospective franchisee. This factual information must be the sort of information upon which a prudent businessperson would rely in making an investment decision. Obviously, the quality and quantity of information constituting a reasonable basis may vary from case to case. The type of information needed to support and substantiate a financial performance representation will also vary, depending on whether the representation is a projection or a historic report of actual performance.

Financial Performance Representations Based on Projections

With respect to projections of potential performance, franchise sellers should consult with the current standards for projections issued by professional organizations such as the American Institute of Certified Public Accountants, *e.g.*, *Prospective Financial Information: AICPA Audit and Accounting Guide* (2006). As a general matter, the following should be considered when making reasonable forecasts:

- Financial forecasts should be prepared in good faith;
- Financial forecasts should be prepared with appropriate care by qualified personnel;
- Financial forecasts should be prepared using appropriate accounting principles;
- The process used to develop financial forecasts should provide for seeking out the best information that is reasonably available at the time;
- The information used in preparing financial forecasts should be consistent with the plans of the entity;
- Key factors should be identified as a basis for the assumptions;

- Assumptions used in preparing financial forecasts should be appropriate;
- The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions;
- The process used to develop financial forecasts should provide adequate documentation of both the financial forecasts and the process used to develop them;
- The process used to develop financial forecasts should include, where appropriate, the regular comparison of the financial forecasts with attained results; and
- The process used to prepare financial forecasts should include adequate review and approval by the responsible party at the appropriate levels of authority.

This is not to suggest that these points constitute the complete test for whether there exists a reasonable basis for a performance projection. Nonetheless, in the view of Commission staff, projections made in accordance with the standards issued by the AICPA (or its successor) presumptively have a reasonable basis.

Financial Performance Representations Based on Historic Performance

The data underlying a historic performance representation must be subject to independent examination and verification. The data must reasonably support the representation as it is likely to be understood by a reasonable prospective franchisee. For example, a representation that franchisees earn a net profit of \$30,000 per year implies that this figure is representative of the typical experience of the system's franchisees. The representation would not have a reasonable basis if, in fact, only a small minority of the franchisees earn this amount, if profits were due to unusual or non-recurring conditions, or if the franchisees used inconsistent methods for determining and reporting their profits.

Substantiation of Financial Performance Representations

A franchise seller must possess, in writing, the supporting data underlying any financial performance representations at the time it makes the representation. Supporting data can include, for example, market studies, statistical analyses, franchisee profit and loss statements, as well as other types of information that customarily are relied upon by prudent persons in making business decisions. The written material can be in electronic or any other form that is capable of being reviewed. Impressionistic or anecdotal information such as, for example, a rough counting of a show of hands by franchisees attending the franchisor's convention, does not meet the standard necessary to substantiate a financial performance representation.

Data from company-owned outlets may provide a reasonable factual basis for financial performance representations if the representation is properly prepared. When such data is used, a franchise seller must clearly disclose that the representation is based on the performance of company-owned outlets, and the representation must take into account for differences between company-owned and franchised outlets, imputing, where appropriate, differences in costs (*e.g.*, royalty payments) and economies of scale. If a financial performance representation is based upon both types of outlets – franchise and company-owned – the data for each type ordinarily should be separated to avoid potential misrepresentations.

Inclusion of Financial Performance Information in Item 19

All financial performance representations must appear in Item 19 of the disclosure document. It is a violation of the amended Rule for a franchise seller to make a financial performance representation not made in Item 19 that is inconsistent with what appears in Item 19. Thus, a franchisor cannot provide or authorize others to provide prospective franchisees with financial performance information while at the same time stating in Item 19 that the franchisor does not authorize the making of any financial performance representations. Similarly, a franchise broker or other third-party cannot make a financial performance representation unless one already appears in the franchisor's Item 19 disclosures. Franchise sellers make financial performance representations that do not appear in Item 19 at their own risk because they not only face liability for violating the amended Rule's requirement that such representations appear in

Item 19 and its prohibition against inconsistent statements, but also liability under Section 5 of the FTC Act, if such claims are false or deceptive.

Availability of Written Substantiation for Financial Performance Representations

Finally, upon reasonable request, franchise sellers must make available to prospective franchisees – and, upon request, to the FTC – the written substantiation for any financial performance representation made in Item 19. The failure to do so constitutes an independent violation of the amended Rule.

ADDITIONAL PROHIBITIONS

In addition to the prohibitions concerning the making of financial performance representations, discussed above, the amended Rule prohibits seven specific acts or practices. Each of the seven is discussed immediately below.

Prohibition Against Contradictory Information

The amended Rule prohibits a franchise seller from making any statement that contradicts the information disclosed in the franchisor’s disclosure document. This prohibition is necessary to prevent deception and to preserve the integrity of the disclosure document.

Prohibited contradictory statements include those made orally, visually, or in writing. For example, a franchise broker would be in violation of the amended Rule if it stated that the franchisor has never been sued by a franchisee, when, in fact, the franchisor has been sued and has disclosed that information in Item 3. Of course, franchise sellers are always free to disseminate additional *truthful* non-contradictory information to a prospective franchisee, especially if required to do so by state law or at the written request of state franchise examiners.

Prohibition Against Use of “Shill” Testimonials

The amended Rule prohibits the use of fictitious references or “shills.” Specifically, it prohibits franchise sellers from misrepresenting that any person has purchased or operated one of

the franchisor's franchises, when that is not the case, or that any person can give an independent and reliable report about the experience of any current or former franchisee, when that is not the case. The prohibition against the use of shills is also broad enough to cover the use of "institutional shills," companies that purport to provide consumers with "independent" reports on franchisors that are their members. Sometimes the names of these institutional shills invoke, imitate, or allude to the Better Business Bureau – a legitimate organization that actually does perform the services that these unscrupulous operations only pretend to perform. Because information provided by shills is inherently false and unreliable, it is likely to mislead prospective purchasers.

Prohibition Against Failing to Make Requested Early Disclosures

Any prospective franchisee in the process of purchasing a franchise can *request* a copy of the franchisor's disclosure document *at any time* in advance of the point – 14 calendar days before the franchise agreement is executed or a payment is made to the franchisor or an affiliate – when the franchisor *is required to furnish* the prospect with a copy of its disclosure document. Franchisors must honor such requests.

The prohibition on failing to furnish disclosure documents earlier than 14 days in advance of execution of a binding agreement or the making of a payment, if requested, pertains to "prospective franchisees" only. A franchise seller has no obligation to furnish disclosures to competitors, the media, academicians, or researchers. Further, the prohibition applies only to prospective franchisees already in the sales process. This means that a franchise seller would be obliged to furnish a disclosure document to any prospective franchisees requesting it who have submitted a franchise application and who have been notified that they qualify to purchase a franchise. A franchisor need not furnish a copy of its disclosure document to individuals casually seeking general information on the franchisor or to those who have not submitted necessary information to demonstrate that they qualify to purchase a franchise.

Prohibition Against Failing To Furnish Updated Disclosures

The amended Rule prohibits franchise sellers from failing to furnish, upon reasonable request, any updated disclosures prepared under the Rule’s general updating requirements to a prospective franchisee who has previously received a basic disclosure document.¹⁹ This prohibition recognizes that the information contained in a disclosure document may become outdated by the time a prospect relying on it is ready to sign a franchise agreement. For example, a franchisor may have filed for bankruptcy after having furnished its disclosure document to a prospective franchisee. Thus, this prohibition prevents deception through omission of material information, ensuring that prospective franchisees can, if they wish, obtain any updated disclosures prepared by the franchisor, while imposing no new automatic disclosure obligations on the franchise seller.

Prohibition Against Failing To Note Unilateral Modifications

As previously discussed, the amended Rule prohibits franchise sellers from presenting a franchise agreement for signing that has terms and conditions materially different from those in the copy of the agreement attached to the disclosure document in Item 22, unless the franchise seller has informed the prospective franchisee of the differences at least seven calendar days before execution of the franchise agreement. Unilateral modifications of material contract terms by the franchise seller without notice to the prospective franchisee are likely to mislead a prospect who has been relying on the standard agreement attached to the disclosure document or on a previous draft as setting forth the parties’ agreement.

Prohibition of Disclaimers and Waivers

The amended Rule prohibits franchise sellers from disclaiming or requiring “a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments.” This includes the use of integration clauses that purport to disclaim liability for statements authorized by franchisors in their disclosure documents. This

¹⁹ A franchise seller other than the franchisor can satisfy its obligation to provide updated disclosures by promptly forwarding a prospective franchisee’s request for such updates to the franchisor, provided that the franchisor has promised to fulfill any such request promptly.

prohibition is intended to prevent fraud by ensuring the accuracy of information contained in disclosure documents. It is not intended to ban all uses of integration clauses.

Scope of the Prohibition

The prohibition against disclaimers and waivers is designed to address a specific problem: franchisors' use of waivers or integration clauses or similar contract provisions to disclaim authorized statements made in their disclosure documents or in exhibits or attachments to their disclosure documents. By prohibiting this practice, the disclaimer and waiver prohibition preserves the integrity of the material information disclosed in a franchisor's disclosure document, thus preventing deception.

By its terms, the prohibition is limited to waivers or disclaimers pertaining to statements made in the disclosure document and its exhibits or attachments. The prohibition does not reach statements made in a franchisor's advertising or other promotional materials. Note, however, that such statements, like statements made in any other industry advertisements or promotional materials, are already subject to the prohibition in Section 5 of the FTC Act against material misrepresentations. Nor can franchise sellers omit material information necessary to prevent prospective purchasers from being deceived. Moreover, any statement, advertisement, or promotional message that contradicts information contained in the disclosure document violates the amended Rule's prohibition against the making of contradictory statements. For example, it would violate the Rule for a franchisor to use promotional literature containing financial performance claims, while its Item 19 disclosure states that no such claims are authorized. Similarly, if its promotional literature states that exclusive territories are available, when its disclosure document offers no such benefit, the franchisor would be in violation of the amended Rule.

Parties' Ability to Negotiate Contracts Terms

The amended Rule states that the disclaimer prohibition "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 sales negotiations." Without this

proviso, a franchisor might reasonably conclude that it is prohibited from agreeing to any terms or conditions not specifically set forth in the standard agreement attached as an exhibit to its disclosure document. A franchisor need not use an integration or waiver clause, however, to preserve the parties' ability to negotiate contract terms.

As previously discussed, franchise sellers and prospective franchisees may negotiate contract terms without violating this prohibition of the amended Rule. Specifically, the amended Rule provides that no mandatory contract review period is necessary where changes are made at the request of the prospective franchisee. This recognizes that where the prospective franchisee is fully informed about the contractual terms that will govern the relationship before signing the contract, no harm can result. Where changes to the contract are initiated by the franchisor, however, the amended Rule prohibits the franchisor from failing to point out the changes and provides for a limited seven calendar day contract review period. Accordingly, the parties can freely modify the standard agreement attached to a disclosure document without the need of a waiver or integration clause.

Alternatives to Disclaimers and Waivers

Finally, nothing in the amended Rule would prevent a franchise seller from seeking alternative ways to narrow its disclosures to avoid making misleading statements. For example, an ice cream store franchisor may make an Item 19 financial performance representation pertaining to units based in Florida. If the franchisor sells units in southern states, the Florida-based representation may be reasonable. However, if the franchisor were to sell a unit in Alaska, the franchisor might be well advised to provide the prospective Alaskan franchisee with a disclosure document that deletes the Item 19 representation. In the alternative, the statement of bases and assumptions attached to the disclosure document could make clear that the financial performance representation pertains to Florida or other southern states only. The prohibition against disclaimers and waivers also would not prevent a franchisor from having a prospective franchisee sign a clear and conspicuous acknowledgment that the Florida-based performance representation does not apply to states such as Alaska.

Sample Integration Provision

This Agreement and all exhibits to this Agreement constitute the entire agreement between the parties and supersede any and all prior negotiations, understandings, representations, and agreements. Nothing in this or in any related agreement, however, is intended to disclaim the representations we made in the franchise disclosure document that we furnished to you.

You acknowledge that you are entering into this Agreement as a result of your own independent investigation of our franchised business and not as a result of any representations about us made by our shareholders, officers, directors, employees, agents, representatives, independent contractors, or franchisees that are contrary to the terms set forth in this Agreement, or in any disclosure document, prospectus, or other similar document required or permitted to be given to you pursuant to applicable law.

Prohibition Against Failing to Make Promised Refunds

The amended Rule prohibits franchise sellers from failing to make refunds as promised in the disclosure document or in a franchise or other agreement. This slightly revises the original Rule's prohibition against failing to make promised refunds. The original Rule prohibited franchisors and brokers from failing "to return any funds or deposits in accordance with any conditions disclosed pursuant to paragraph (a)(7) of this section." That prohibition was limited to instances where the franchisor or broker made an express refund promise in the disclosure document itself. It is possible, however, that a franchise seller may not make any specific promise in the disclosure document, but may do so either in the franchise agreement, or in a separate contract or letter of understanding. The harm resulting from the failure to honor a promised refund is the same, regardless of where the promise is written. Accordingly, the amended Rule makes clear that the failure to honor any written refund promise will constitute an independent Rule violation.

FRANCHISORS' RIGHTS TO REGULATORY ENFORCEMENT FAIRNESS

The FTC has a longstanding commitment to a fair regulatory enforcement environment. If you are a small business (under Small Business Administration standards), you have a right to contact the Small Business Administration's National Ombudsman at 1-888-REGFAIR (1-888-734-3247) or www.sba.gov/ombudsman regarding the fairness of the compliance and enforcement activities of the agency. You should understand, however, that the National Ombudsman cannot change, stop, or delay a federal agency enforcement action.

The FTC strictly forbids retaliatory acts by its employees, and you will not be penalized for expressing a concern about these activities.