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**Starting a Franchise System:
Practical Considerations, Planning and Development**

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STARTING A FRANCHISE SYSTEM: PRACTICAL CONSIDERATIONS, PLANNING AND DEVELOPMENT

I. INTRODUCTION¹

Starting a franchise system is a collaborative, symbiotic process. Business owner and legal counsel each possess special knowledge, unique skills and a talent for their craft. Nothing is more rewarding than seeing a franchise system blossom from a seed of an idea. It is a special experience in the life of a franchise lawyer; an opportunity to participate in the entrepreneurial process and help a company grow. While this process will draw on all of a lawyer's knowledge, experience and business savvy, it begins with the client.

Each client is unique. Each client is an expert in its own right. Each client takes pride in its business. Your job, from the outset, is to gather from your client and outside sources as much information as you can about the client and its business. This should be the focus of your initial meeting with your potential franchisor client and your pre-meeting preparation. That is, before you start the franchise analysis and education process, listen to and learn about your client. You know franchising; your client knows its business. Let your client tell you in its own words about its business and expansion plans. This type of practical advice is the focus of our paper and presentation.

While this paper will center on representing a start-up franchisor, and touch on many aspects of developing a new franchise system, we do not offer an exhaustive treatise on the subject. We will, however, concentrate on the most pertinent issues encountered when representing a fledging franchisor and, when possible, refer to more detailed works on this broad subject and its constituent parts.² In addition, in the Appendices, we offer a number of practice aids, including sample questionnaires and a franchise application/questionnaire. Finally, we also will discuss the limits of the franchise lawyer's advice, the recommendation and involvement of other knowledgeable professionals, and ways a lawyer should protect him or herself.

II. PRE-MEETING PREPARATION

A. Gather Information Regarding Potential Start-Up Franchisor

As we mentioned, the initial focus of the franchise system development process is learning as much as you can about your client and its business. After you receive that

¹ The authors wish to thank principal Elizabeth Dillon and associate Erin Stein of Gray Plant Mooty for their valuable contributions to this paper.

² A number of quality papers, articles and books have been written on this subject. The following is a list of some of them: Kenneth F. Darrow, Mark Siebert and Phyllis Alden Truby, *The Structural Elements of a Franchise System and Their Economic and Legal Implication for Start-up and Existing Systems*, A.B.A. 30TH ANNUAL FORUM ON FRANCHISING, Tab W2 (2007); James R. Conohan, Kevin P. Hein and Cheryl L. Mullin, *Starting a Franchise System: Special Issues and Considerations*, A.B.A. 23RD ANNUAL FORUM ON FRANCHISING, Tab W11 (2000); Rocco Fiorentino, Marisa Faunce and Michael Seid, *Helping Franchise Systems Succeed: Avoiding the Pitfalls Encountered in the Early Stages of Franchising*, INT'L FRANCHISE ASS'N 41ST ANNUAL LEGAL SYMPOSIUM, Ch. 7 (2008); Michael Seid and Dave Thomas, *FRANCHISING FOR DUMMIES* (2d ed. 2000); *FUNDAMENTALS OF FRANCHISING* (Rupert M. Barkoff and Andrew C. Selden, eds., 3d ed. 2008); Harold Kestenbaum and Adina M. Genn, *SO YOU WANT TO FRANCHISE YOUR BUSINESS* (2008); David J. Kaufmann and David W. Oppenheim, *INTRODUCTION TO THE LAW OF FRANCHISING* (2d ed. 2008).

introductory call or request to meet with the client, you should do all you can to satisfy your curiosity about the client's business. Exploration of its website is easy enough. It certainly should acquaint you with the business, how it is presented to the public and, in some instances, provide a history of the company, introduce the founder and officers and offer a flavor of the "style" of the business. This is a good time to see if the client has "jumped the gun" by making statements on the website about licensing, business opportunities or franchise offerings.

Other sources include Hoovers, press releases and, of course, a general Google search. Not to be overlooked is your client's secretary of state or corporations commissioner, which should provide you with the means to search for the formal registration of the client's business, as well as any state trade name or trademark registrations. The United States Patent and Trademark Office ("USPTO") allows you, through its website,³ to search pending and registered trademarks (using the Trademark Electronic Search System or TESS), or search patent databases, if the concept involves an existing patented product or has the potential to obtain patent protection. Similarly, the United States Copyright Office maintains a website that allows you to search for federally registered copyrights.⁴ If there are existing franchise systems within your client's industry (or a similar industry), it also may be helpful to review the Franchise Disclosure Documents ("FDDs") for these systems. The California Department of Corporations makes available on its website through its Cal-EASI database⁵ all franchise documents filed with its offices. This means that you can quickly access the FDDs of all franchisors that register in California and do not submit exemption filings. Other franchise registration states may also allow you to review FDDs in their offices or offer to copy or email them to you for a fee. Private sources, like FRANdata or UFOCs.com, also sell past and current UFOCs/FDDs. Further, depending on your client's business, there may be various industry or feasibility studies publicly available for your review. The point is to gather as much intelligence as you can.

B. Develop Initial Checklist

Based on the information you gather, we recommend that you develop an initial, pre-meeting checklist that includes the following:

- Basic information about the company, including its business, principal place of business, entity structure and industry.
- Prior period of operation, length of time in industry.
- Current management team.
- Previous expansion efforts.
- Any existing "licenses," "joint ventures" "partnerships," or "business opportunities" granted, that may be unintended franchises.
- What is prompting interest in franchising the existing business?
- What are the company's general expansion plans?
- Registration status of primary trademarks.
- Investigation of industry background, competitors, other franchise systems etc.
- Any unique proprietary property (patents, copyrights, trade secrets, manuals, etc.).

³ United States Patent and Trademark Office, www.uspto.gov (last visited Jul. 31, 2010).

⁴ United States Copyright Office, www.copyright.gov (last visited Jul. 31, 2010).

⁵ California Department of Corporations, www.corp.ca.gov/CalEASI/caleasi.com (last visited Jul. 31, 2010).

In your preliminary calls with the client, you also may want to determine the client's sophistication level by inquiring about its current professional advisors (accountants, consultants and attorneys), composition of the management team, existence of a business plan, knowledge of franchising, current financial statements and the basic operational nature and structure of the business. This will allow you to add to your checklist:

- Current professional advisors.
- Current financial statements and overall financial condition.
- Relationship with current vendors, customers and other stakeholders.

In addition to simply securing preliminary information you will need for your work, you are preparing to demonstrate to the client, at the appropriate time, your interest in its business, your independent knowledge and your access to resources. Remember though to keep this information and the questions it may bring in check until the client has had a full opportunity to educate you about its business.

C. Conduct Internal Conflict Inquires

In addition to gathering external information about your potential franchisor client and its business, it is also important to perform some internal inquiries before your initial meeting. We recommend that you conduct a preliminary conflicts check using all of the persons and entities you know or suspect are associated with the client. In addition, if you or your law firm represent other franchisors in the same industry as your potential franchisor client, you may want to consider whether this will create a problem. While it may not pose an immediate ethical conflict, your potential franchisor client, as well as your existing clients and your colleagues who work with them, may object. Some law firms even go so far as to represent only one franchisor in a particular industry or segregate attorneys working for different franchisor clients in the same industry. Further, if you also represent franchisees, you may want to consider whether this representation creates any conflicts with your potential representation of the start-up franchisor.⁶ Plenty of franchise attorneys represent both franchisors and franchisees, while others make it a point of representing one or the other.⁷

Once you have gathered all the information you can about your client, prepared a checklist and conducted appropriate internal inquiries, you are now ready for your initial meeting. While your client's completion of a detailed questionnaire will be a critical piece in the development of its franchise program, as further explained in Section III.B.9, we recommend that you do not provide a questionnaire to your client until at least the end of your initial meeting.

⁶ See Gary R. Duvall, *Switch-Hitting Franchise Lawyers: Representing Both Franchisees and Franchisors*, 12 THE FRANCHISE LAWYER (Fall 2009).

⁷ For an up-to-date analysis on these and other ethical issues franchise attorneys face, see Rupert M. Barkoff and Andrew C. Selden, *Ethical Issues for Attorneys and Other Professionals in Franchise Counseling*, A.B.A. 33RD ANNUAL FORUM ON FRANCHISING, Tab W13 (2010).

III. INITIAL CLIENT MEETING

A. Location of Meeting

Before we focus on what should be accomplished during the initial meeting, first a word on *where* the meeting should take place. This is simple but important. In a perfect world, all initial client meetings would be face-to-face. A face-to-face meeting, however, may not always be practical or economical, especially if a lawyer is not located in the same city or surrounding area as the prospective franchisor client. As a result, the “initial meeting,” as well as subsequent meetings, may actually be conducted via telephone or videoconference. As a practical tip, Skype Technologies S.A.⁸ offers software that allows its users to make free or low cost video and voice calls. Keep in mind our references to meetings may include videoconferences and teleconferences.

Where a face-to-face meeting with a prospective franchisor client is possible, however, by all means take advantage of it. And, if that meeting can be at the client’s place of business, all the better. Nothing is more important to the client than *its* business and, by meeting the client on its turf, you will begin to develop a broader understanding of the client and their business operations. Therefore, unless the client specifically requests a meeting at your office for privacy sake or just to be away from its office, the best place to conduct the initial meeting, if possible, is at the client’s business. If you do not meet at the client’s place of business initially, do make a point of getting there as soon as you can during the development process. Client visits:

- Send a message to your client that you are truly interested in its business.
- Create a comfort-level for your client.
- Offer you a visual impression of your client’s business.
- Provide you with a first-hand opportunity to observe the actual operations of the business.
- Give you a chance to meet others on the management team.
- Provide you with possible access to existing documents, registrations, vendor agreements, etc.

In our experience, client visits significantly enhance a lawyer’s overall understanding of the franchisor’s concept and ability to draft accurate and meaningful legal documents.

B. Key Areas to Cover at Meeting

There are a number of key areas that should be covered at the initial client meeting.

1. Background and History

Understanding the background and history of your potential franchisor client is essential. A client is usually happy to share with you the details of its business and you should get them to tell you about it early on in the meeting. Use your pre-meeting checklist to confirm, correct and supplement the information you have previously gathered. Before you move on to other topics, make sure you have a firm grasp of the client’s business and operations, how long the client has been in business, prior expansion efforts, the experience of its management team, the client’s market and competitors, and what has caused the client to consider franchising. A solid and

⁸ Skype, www.skype.com (last visited Jul. 31, 2010).

compelling history is a real plus for a start-up franchisor and may prove to be an important sales tool for initial franchise sales.

2. Is Franchising the Best Expansion Approach?

Before you get too far along, you should address whether franchising is the best approach for the client's expansion and whether the concept is "franchise-able." While related, these are really two separate questions. The first focuses on whether the franchise model fits with the client's plans and goals. At this point, we recommend a quick discussion on the elements of a "franchise,"⁹ the pros and cons of franchising in general,¹⁰ and potential exemptions or exclusions that may apply to a particular franchisor.¹¹ This discussion should also go on to explore non-franchise alternatives that may be available to the client, including licenses, business opportunities, dealerships, distributorships, partnerships, joint ventures and management arrangements.¹² You should be prepared to discuss, analyze and advise your client on all the alternatives and the legal implications and complications of each. This is likely not a one-time discussion. As the franchise flower blooms and complications emerge, the client may want to revisit the alternatives. This will become more apparent as you move forward in the process.

3. Is the Concept Franchise-able?

Even if franchising is in line with a client's plans and goals, it does not mean that their concept is "franchise-able." This is a separate analysis that should occur in the initial stages of the process. While much of this analysis is grounded in common sense, the following is a list of some of the factors that you and your client will definitely want to consider:

- Ease with which the concept can be duplicated and adapted to different markets.
- Current and future demand for the client's products and services.
- Competition.
- Success of company-owned units.
- Unit economics/return on investment ("ROI") (further discussed in Section IV.E).
- Strength of trademarks and other critical intellectual property ("IP") (further discussed in Section III.B.4).
- Skills and adaptability of management team (further discussed in Section IV.J).
- Capital (further discussed in Sections III.6, III.8 and IV.P).¹³

⁹16 C.F.R. § 436.1(h) (2007). See also Mary Ann O'Connell, Robert A. Smith and Scott Weber, *What is a Franchise? What Are The Various Types of Franchise Relationships?*, INT'L FRANCHISE ASS'N 43RD ANNUAL LEGAL SYMPOSIUM, Tab 26 (2010); Kenneth R. Costello, Beata Krakus and Kristy L. Zastrow, *From License Agreement to Regulated Relationships: The Accidental Franchise*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W11 (2009).

¹⁰ See Darrow, *supra* note 2; Kestenbaum, *supra* note 2, at 3.

¹¹ See Karen B. Satterlee and Leslie D. Curran, *Exemption-Based Franchising: Are You Playing in a Minefield?*, 28 FRANCHISE L.J. 191 (Spring 2009); Earsa Jackson and Karen Satterlee, *Navigating the Exemption/Exclusion Maze Under the Amended FTC Rule and State Laws*, A.B.A. 31ST ANNUAL FORUM ON FRANCHISING, Tab W11 (2008).

¹² See Darrow, *supra* note 2; Conohan, *supra* note 2; Costello, *supra* note 9.

¹³ For a further description of these and other factors, see Kay Marie Ainsley, Debra A. Harrison and David W. Koch, *The Evolving Franchise System: How To Guide an Emerging System From "Baby Steps" To A "Grown-Up" System*, INT'L FRANCHISE ASS'N 43RD ANNUAL LEGAL SYMPOSIUM, Ch. 10 (2010); Darrow, *supra* note 2; Conohan, *supra* note 2.

It is important that you discuss this topic with your client at the initial meeting to at least make a preliminary assessment as to the franchise-ability of the concept. Just because the concept passes this threshold test, however, does not mean your analysis ends there. You will definitely want to further explore these factors and, depending on the skill-set of the client's management team, will likely want to encourage your client to involve a franchise consultant who can assist it in assessing the business potential of the concept. We discuss the use of franchise consultants and other professional in Section III.B.7.

As franchise counsel, it is incumbent on us to help our prospective franchisor clients conduct this analysis before they embark down the franchise path. Recent data indicates that of the new franchise brands that began franchising in 2009, over 80% of them had less than one year of business experience (fewer than 10% had more than five years business experience), and an estimated 14% of them had no company-owned units at the start.¹⁴ This data is somewhat alarming and begs the question of whether a number of existing start-up franchisors should not be franchising. While we recognize that this may be more of a moral than a legal issue, we also believe that franchise attorneys ultimately should be striving to put their clients in a position to succeed - not fail.

4. Trademark Status

Given that a franchisor's trademark will become the heart of its franchise concept, you must assess early on in your meeting the strength of the client's proposed primary trademark and the status of any related federal and state registrations or applications. Oftentimes clients are not aware of the importance of this crucial element in the franchise development process. Many have been led to believe that a state registration or simple common law "TM" designation is sufficient. Upon review, however, you may determine that the trademark the client wants to use, or is using with its company-owned units, is already registered with the USPTO or with certain states to another party, is currently being used by other parties, or is weak and not likely to be registered by the USPTO. In this case, the client may have to select a different trademark to file with the USPTO. Because trademark protection must logically precede a franchise program roll out, it is imperative that issues related to this essential item be addressed immediately. Also, if other IP is critical to the franchise concept, like a patent, copyright or trade secret, you will want to assess the strength, ownership, registrations and protections relating to those items.

5. Financial Statements

Another top-of-the-list item is to take stock of the current financial statements that are being prepared for the company, if any, and to alert the client from the outset what financial statements it will need to prepare as a franchisor. Clients new to the franchise arena are frequently surprised by the requirements and ultimate costs in the area of financial disclosure. This discussion also figures into an analysis of whether a new, separate entity should be formed exclusively for franchise operations, a topic we discuss in Section IV.A.

A start-up franchisor may phase-in the use of audited financial statements under the FTC Franchise Rule, provided it is new to franchising, is not a spin-off, affiliate or subsidiary of a

¹⁴ Phil Zeidman, Darrell Johnson, John McDonald and Brian Schnell, *A Look Back to Better Understand Our Future*, INT'L FRANCHISE ASS'N 43RD ANNUAL LEGAL SYMPOSIUM, PowerPoint presentation, May 16, 2010.

franchisor, and has not previously prepared audited financial statements in the ordinary course of business.¹⁵ If available, this deferral allows the franchisor to avoid the cost and effort of the preparation of audited financial statements for the first year. Some states, however (like Minnesota),¹⁶ do not allow a franchisor to use unaudited financial statements, while other states (like California and Illinois) allow for the use of unaudited financial statements only if the financial statements are subject to an independent review.¹⁷ Using the audited financial statements of a client's parent or affiliate also may be an option, provided the parent or affiliate is willing to disclose its financial information to the public and guaranty the obligations of the franchisor under its franchise agreements. As further explained below, in some cases, a franchisor also may be obligated to include in its FDD the audited financial statements of certain of its parents.

We think it prudent to advise start-up franchisors to meet with their accountants sooner rather than later to prepare for the future. This inquiry will not only help prevent later delays, but will likely result in the franchisor receiving guidance from its accountants as to how to trim inefficient and incompatible bookkeeping practices while implementing audit-friendly procedures.

6. Initial Development Plan

Once you have covered the areas discussed above, we suggest that you ask the client to describe its initial development plan. Although you are likely to have more experience than your client in this area, the "listening and learning" approach should still be in play. Allowing the client to outline its franchise expansion plan in its own words and concepts may expose you to a new approach that is best for the company. Also, a client who has built its own business is typically used to doing things its own way – so hold on, there is plenty of time to mold the franchise offering into a more legally acceptable approach; allow the client to freely outline their development plan.

If at the end of their explanation, however, your client has not covered all of the essentials, prompt them with appropriate questions. You need to make sure that your client has considered and included the following in its initial development plan:

- Method(s) of development (*i.e.*, single unit, multiple unit, development agent, master franchising).
- Area of development.
- Number of franchised and company-owned units to be developed, and the schedule for that development.

¹⁵ 16 C.F.R. § 436.5(u)(2) (2007); The Amended FTC Rule Statement of Basis and Purpose, 72 Fed. Reg. 15445-15544 (March 30, 2007) ("Statement of Basis and Purpose") at 15511. See *also* WASH. ADMIN. CODE § 460-80-140 (2010).

¹⁶ MINN. STAT. § 80C.04(g) (2006) and MINN. R. § 2860.1400 (1995).

¹⁷ California will allow a start-up franchisor to use unaudited financial statements if the franchisor submits a "Review" report balance sheet. State of California, Department of Corporations, "Guidelines for Franchise Registration," avail. at <http://www.corp.ca.gov/forms/pdf/310111UFDD.pdf>. Illinois will allow a start-up franchisor to use unaudited financial statements only if prepared by an independent certified public accountant in accordance with GAAP. 83 ILL. CODE R. § 200.600 (2002).

- Planned growth of internal staff and infrastructure to support its development plan, and sources of capital to fund that growth.

While often overlooked, we also recommend that you discuss with your client at this early stage their long-term goals and intended exit strategy. While some start-up franchisor owners plan to be in the franchise business for the long haul, others plan to grow their system to a certain point and then sell it or take it public. As a good franchise lawyer, you should make a point of knowing your client's future goals and plans, and using them as a guide during your representation of the client.

7. Use of Franchise Consultants and Other Professionals

Because franchising is a regulated industry, there are a number of legal components involved in the preparation of a new franchisor's start-up program. The preparation of a new franchise program, however, also involves a multitude of non-legal, business issues. While as franchise lawyers we are well-suited to assist our clients with the legal aspects of franchise development, we may not be as qualified to give business advice. In addition, even if you have the requisite background, knowledge and experience to provide business advice, you may want to consider whether your malpractice insurance covers this type of advice. In most cases it will, if it is within the scope of your legal work, although it may not be a bad idea to know the limitations of your coverage in this area.¹⁸ Further, you should be mindful of the potential limitations of the attorney-client privilege when providing advice that is predominantly business rather than legal in nature.¹⁹

This is not to say, however, that you should completely abandon your client on these issues. Instead, you should stress the importance of having knowledgeable and experienced individuals address the business issues, and alert the client that there are franchise consultants available to help it with these business issues if it does not internally possess the appropriate level of knowledge and experience. There are many franchise consultants offering a variety of services, including determining whether the existing business even has a chance of success using the franchise model. In addition, consultants specialize in manual drafting, sales brokering, marketing, training development, e-learning, software development, accounting systems, advertising programs, and insurance plans, just to name a few. Over time, you will most likely get to know and work with a number of franchise consultants, and can draw on these relationships for referrals. You also can seek quick referrals through the ABA Forum on Franchising ListServ.²⁰ Further, lists of franchise consultants and other professionals can be found using simple Google searches or by accessing various publications, like the International Franchise Association's *Franchising World*, that annually publish lists of franchisor suppliers.²¹ As a franchise lawyer, you owe it to your new client to inform it of the availability of these services.

¹⁸ See Michael H. Seid and Leonard D. Vines, *The Respective Roles of the Franchise Consultant and the Franchise Lawyer in Structuring the Franchise System*, A.B.A. 30TH ANNUAL FORUM ON FRANCHISING, Tab W18 (2007).

¹⁹ *Id.*

²⁰ ABA Forum on Franchising, List Serv <http://new.abanet.org/Forums/franchising/Pages/ListServ.aspx> (last visited Jul. 31, 2010).

²¹ *Franchising World*, IFA's 2010 Supplier Source Book (Oct. 2009).

Your client will likely already be working with an accountant. It is important, however, that your client confirm that its accountant understands franchising, or is willing to learn what is required, so that there are no delays in obtaining the necessary financial statements and accountant's consents when they are needed. In addition to the preparation of financial statements mandated by FDD Item 21, an accountant experienced with the company, may also offer insights into the development of FDD Items 5 (Initial Fees), 6 (Other Fees), 7 (Estimated Initial Investment), 8 (Restrictions on Sources of Products and Services), 10 (Financing) and 19 (Financial Performance Representations);²² thus assisting with the long-range financial planning for the sustainability of the system. Further, your client may already have in place other attorneys to assist it on non-franchise issues, such as trademark registrations, general corporate work, employment matters and litigation. While your client may transfer some of this work to you, it is not uncommon that the client will hire you only for the franchise work. What this whole structure means, is that you will most likely be working with your client, along with franchise consultants and other professions it hires, to develop and launch its franchise program. Although this can create some scheduling and communication issues, these other parties often provide valuable information and, in some cases, detailed reports, which can be a big help in preparing the FDD and other franchise documents.

8. Overall Budget

Before you get too deep into the process, it is imperative that you have a frank discussion with your client regarding your fees, as well as the potential fees of any franchise consultants and other professionals. As explained above, your fees will not be the only fees that the client will incur in the preparation of its franchise program, and the client should be encouraged to establish an overall budget. This is important in determining how much capital your client will need and, ultimately, whether the franchise approach makes good economic sense. The investment necessary to set up and launch a franchise program the "right way," is fairly significant. While smaller, cash-strapped companies may be able to cut corners and get franchise documents prepared on the cheap, they may very well be dooming themselves and their franchisees because of their failure to properly vet the concept and protect their interests.

a. Your Legal Fees; Engagement Letter

From the outset, you need to agree upon the services you will provide and your fee for those services. In the current economy, franchise lawyers (like everyone else) are being asked to do more for less. The preparation of FDDs is also being seen more and more as a commodity, rather than an art. Accordingly, prospective start-up franchisor clients are often requesting flat or capped fees, and looking for the absolute lowest price – regardless of reputation, expertise or past experience. Given this environment, a franchise lawyer must stress his or her expertise to the client and the value this brings to the equation. Doing things right from the beginning should be of paramount importance to all start-up franchisors. The lawyer must then come up with a fee that is acceptable to the lawyer and his or her client, consistent with the overall budget, and still allows the lawyer to put in the time necessary produce quality documents tailored to the client. This can be a careful balance. Weighing into the analysis is the fact that some franchisor lawyers may be willing to treat FDD preparation as a loss leader; investing in what they hope will be a long term relationship with the start-up franchisor. Whether you decide to engage in this practice is your choice, although we recommend you proceed with caution as the future success of your client is never certain.

²² See 16 C.F.R. §§ 436.5(e)-(h), (j) and (s).

Whatever fee arrangement you ultimately agree upon, we strongly recommend that you memorialize it in your engagement letter with the client. To ensure that there is no confusion, include in your engagement letter a schedule of the services that are covered, and the services that are not covered. We also advise that you clarify whether any flat fee or cap covers things like preparing software license agreement or other documents other than the franchise agreement, state filing fees, photocopies, overnight deliver services and responding to comment letters.

b. Fees For Franchise Consultants and Other Professionals

In most cases, you will have little control over the fees your client pays its other lawyers, franchise consultants and accountants. It is important, however, to have a general sense of the other third parties involved and how the work being performed by these parties may impact your work and fees. At the end of the day, the fees being paid to outside suppliers are all coming from the same pot.

9. Franchise Program Development Questionnaire

It is tempting in the initial meeting to press on to a discussion of the FDD and its 23 categories of information, but, in most cases, we recommend setting up a follow-up meeting to commence the FDD preparation process. The end of the initial meeting, however, is a good time to provide a quick overview of the FDD and to provide your client with sample FDDs, if it is not familiar with the format and general content. It also is a good time to introduce and deliver to the client the questionnaire you plan to use. We have included a sample franchise program development questionnaire as Appendix A, although you will want to tailor it to fit your own style. Whatever the form, the use of a questionnaire is a must. The preparation of an FDD can be a long and arduous process. Extracting information from clients is often tedious. A questionnaire will keep you and the client on track and will serve as a great organizational tool. Even if your client uses a franchise consultant with its own form questionnaire, we still recommend that you send the client your questionnaire. This will help ensure that you receive all information you need to prepare the franchise documents.

By doing more with the questionnaire at the initial meeting than simply introducing it, however, you run the risk of overwhelming the uninitiated client. Both of you need to absorb the information provided and do a little homework before moving forward. For some clients, you may want to ask them to complete the questionnaire as best as they can and return it to you. For others, it may make more sense to walk them through the questionnaire after they have had a chance to review it. It really depends upon the sophistication of the client and your preference, and whether the client intends to use a franchise consultant. Either way, the questionnaire will help your client acquaint itself with the information you will need for the FDD and franchise agreement, which will likely cause the client to encounter issues it has not yet considered. While we do not recommend providing a questionnaire to your client before you have worked through the issues described above in this Section III.B, if you feel compelled to introduce a questionnaire earlier in the process, use it initially as a tool to guide discussion and not as a document that is to be completed and returned to you.

10. Other Areas

While you may have inundated your client with questions and information at this point in the initial meeting, you also may want to consider briefly touching on the following other areas:

- How the “franchised business” will be different from the business the company currently operates.
- Overall franchise sales requirements – FDD preparation and disclosure, state registrations, timelines and general do’s and don’ts.
- Homework assignments for client before the next meeting (*i.e.*, gather additional information, complete questionnaires, provide trademark registrations and corporate records, etc.).

The initial meeting is meant to lay the groundwork for your client’s new franchise program. It is through subsequent meetings and discussions that the franchise program will begin to take shape.

IV. FURTHER CLIENT MEETINGS

Assuming you have solidified your relationship with the client, conducted any additional conflicts checks, determined that the concept can be duplicated through the franchise model, eliminated alternative expansion methods, and entered into an engagement letter, you are ready to begin the process of structuring the franchise entity and developing the FDD, franchise agreement and other agreements. But, where to begin?

Unless the client has read numerous FDDs (some have) or been previously employed by a franchise system, it will be obvious that there are many aspects of franchise development that the client may simply be unaware of or may have overlooked. Further, even if the client has focused on some of the essentials, the client may be initially unprepared to deal with the questions and issues that arise as you dig deeper to understand the business mechanics and educate it on franchise nuances. This is where the completed questionnaire can be of value and when it is appropriate to begin the client education process. Just like anything else, focus on the low-hanging fruit of known information. By this time, you should have a fairly good idea of what information is ready and available, so start there.

A. Entity Selection: Will Existing Entity Suffice or Should New Entity Be Formed?

A fundamental threshold issue is whether the existing legal entity will serve as the franchisor or should a new entity be formed?

Many factors will come into play here, mostly based on the ownership and history of the existing entity. As franchise lawyers, we must strain the company’s history through the franchise filter. Most importantly, how will this history (current ownership and management included) look in the context of FDD Items 1 (The Franchisor, any Parents, Predecessors and Affiliates), 2 (Business Experience), 3 (Litigation), 4 (Bankruptcy), 8 (Restrictions on Sources of Products and Services), 13 (Trademarks), 14 (Patents, Copyrights, and Proprietary Information), 18 (Public Figures), 19 (Financial Performance Representations) and 21 (Financial Statements)?²³ At the same time, the client needs to consider the business aspects of these issues: for instance, how will its initial marketing of franchises proceed if its Business Experience/Litigation/Bankruptcy picture is severely clouded?

²³ See 16 C.F.R. §§ 436.5(a)-(d), (h), (m), (n), (r), (s) and (u).

Keep in mind in establishing your client's new corporate structure that, even if the client elects to form a new entity to act as the franchisor, the franchisor entity may still have disclosure obligations relating to its predecessors, parents and affiliates. Critical to this analysis is whether a parent's audited financial statements are still required to be disclosed in Item 21 even if a franchisor includes its own audited financial statements.²⁴ FTC FAQs 4 and 16 make clear that a parent's financial statements are not only required to be included in Item 21 if the parent "guarantees the franchisor's obligations," but also if the parent "commits to perform post-sale obligations for the franchisor."²⁵ In addition, FTC FAQ 30 establishes that a parent's financial statements are required to be included in Item 21 if the parent "is the sole supplier of a good or service without which a franchise cannot be operated."²⁶ The above examples illustrate the importance of taking into account the disclosure obligations under the FTC Franchise Rule when establishing a client's new corporate structure and determining which entities will provide products and services to its franchisees. Generally, there are far fewer disclosure issues relating to affiliates than there are with parent entities.

In addition to the franchise aspects, other practical issues may be involved: (1) If there are multiple owners, do they all want to be owners of the franchise entity?; (2) What liability concerns arise regarding the primary assets if a franchise dimension is added?; and (3) Are the client's current officers and managers the right people to develop and sustain a franchise system?

Yes, this is a lot to process. This is why it is crucial to have a thorough understanding of the client's existing business and to plan to carry on the discussion of the "entity issue" beyond an initial session.

Theories and approaches abound on the best way to determine whether to use an existing entity or form a new one. And further, if your client elects to form a new entity to act as the franchisor: (1) How should the ownership be structured (a commonly-owned affiliate, subsidiary or perhaps new parent)?; (2) What type of entity should be used (a corporation, partnership, limited liability company or partnership, or other entity); and (3) Where should the entity be formed? Naturally, the answers lie in the facts and circumstances presented and a full discussion of this topic would detain us far too long. We do, however, offer a few of our own views.²⁷

There is a lot to be said for starting with a relatively clean slate. Even when the franchise filter reveals no obvious disclosure or marketing barriers, we believe that the balance should tip in favor of forming a new entity. Asset protection of the existing business (as well as the new entity), ownership re-structuring and a fresh start with new financial statements are chief among the reasons. Also, most of the objections to starting a new entity (loss of continuity, loss of history, current IP ownership, undercapitalization and start-up financial statements) can be overcome through creative but permissible disclosures, licensing or assignment of IP ownership, and a strategic capitalization plan. In addition, as the system progresses, if the

²⁴ 16 C.F.R. § 436.5(u)(i)(v).

²⁵ The FTC's Frequently Asked Questions, known as "Amended Franchise Rule FAQs" ("FTC FAQs"), avail. at <http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml>.

²⁶ *Id.* at FTC FAQ 30.

²⁷ See also Conohan, *supra* note 2, at 27-29.

entities are separated, financial accounting, reporting and tracking will be simplified for each entity and may assist with cleaner financial reporting. Of course, if the existing entity has compelling legal and historic attributes and existing ownership is not concerned with issues of confidentiality and increased liability exposure, utilizing the existing entity may be preferable.

In the mix of this discussion, and a factor that again weighs in favor of separate entities, is the simple fact that operating a franchise system may differ widely from the client's existing operations. If a franchise consultant has not been retained and the client plans to go-it-alone (or if a consultant is involved but has not addressed this topic), it seems appropriate to discuss this business issue and its impact on future operations. Part of what you bring to the table is the ability to look ahead and plan for the future. Too many clients believe that operating a franchise system will be a simple extension of their existing operations. Of course, if there is a slow ramp-up, there may be time to adjust to the new burdens. But, new franchise operators often underestimate the added pressure on operations, training, marketing, accounting, real estate/construction personnel and intermediate managers. Beginning this discussion and at least getting the client to begin the planning, forecasting and budgeting to operate a different or additional business will bring another entity-determinant into better focus. Another resource that should be consulted during this discussion is the client's accountant. Planning for an expansion of services, new employees and franchise-oriented services will impact the accounting, auditing and tax-planning process. Involvement of the client's accountant will also perhaps bring to light other important considerations that you and your client may have overlooked or of which you were unaware. Typically, accountants are advocates for the creation of a new entity, as it generally removes complexities and complications from the mix while putting the new entity on the right path for audit planning and the like.

B. Previous Expansion Efforts

In addition to company-owned units, some potential franchisors may have previously experimented with "non-franchise" expansion. Occasionally some of these attempts or experiments may have succeeded, resulting in joint ventures, partnerships, limited partnerships, distributorships and, yes, even licenses and business opportunities duplicating the concept. A host of reasons trigger these non-franchise efforts: business relationships with family and friends, ignorance of what constitutes a franchise, bad legal advice from non-specialists, reliance on past business customs and "standard" industry practices. Seldom do we see intentional attempts to circumvent the law. And, as we noted, some non-franchise expansions are perfectly legitimate, if done the right way. More often than not, however, these non-franchise expansions are arguably franchises sold in violation of applicable federal and state franchise law. This is by no means uncommon among start-up franchisors. Any franchise lawyer practicing in the area for very long has no doubt had the experience of cringing as its start-up franchisor client mentions the "licenses" it has already granted.

From the outset, you must make yourself aware of all non-franchise arrangements, determine which ones are legitimate and which ones are potentially unlawful, and come up with a strategy for dealing them. As part of your analysis, you will want to consider how many possible franchises were granted, where they were granted (are any franchise registration states involved?), when they were granted (have applicable statutes of limitations run?), the level of success and satisfaction of each possible de-facto franchisee, whether your client was truly unaware of the potential violation of applicable franchise laws or was reasonably relying on the bad advice of counsel, your client's past compliance history, and any related governmental

actions.²⁸ In almost all cases, non-franchise arrangements under the same or similar trademarks will have to be disclosed in a start-up franchisor's FDD, and will likely catch the eye of any state franchise examiner.

Accordingly, you will need to discuss with your client how best to address any past violations where the applicable statutes of limitations have not run. If a franchise registration state is involved, you may want to proactively contact the state to explain the situation and the remedy the client is willing to provide to the licensee/franchisee. In our experience, state examiners are much more lenient with start-up franchisors that bring potential issues to their attention, assuming the violation was not intentional and not indicative of a past pattern of violations.²⁹ Offering to rescind the agreement and pay back any net losses is a common remedy; one that is specifically described in the laws of several of the franchise registration states, including Illinois.³⁰ Illinois and California also have provisions in their franchise laws that allow a franchisor to provide a notice of violation to licensees/franchisees and reduce the time period within which the licensees/franchisees can bring a claim for such violation to 90 days following receipt of the notice.³¹ Fines and other penalties also may be assessed against your client, although, again, these are often less if the client brings an unintentional violation to the attention of the applicable regulating authority.

Aside from potential disclosure and registration implications, company-owned and non-franchised units also must be analyzed from a sales and system perspective. While company-owned units that present operational prototypes for future franchise units may be a big plus, a hodgepodge of poorly run, inconsistently designed "independent" operations can cause havoc – presently and down the road. In addition, depending on the scope and nature of the company's non-franchised expansion, intervention may be necessary. That is, addressing and, perhaps, cleaning up the non-franchised units should be a consideration. As we know, one franchise mantra is "uniformity." And, the common belief is that franchisees are generally happier when they understand that they are being treated equally and equitably compared with others in the system. Hence, although it is not always possible or practical to achieve complete uniformity, starting off with a variety of deals (franchised and non-franchised) can create an immediate systemic challenge.

One approach to address pre-existing non-franchised units is for a start-up franchisor to convert them to franchised units by persuading the owners to execute franchise agreements that mirror the terms that others will be offered. The caveat to this approach, however, is that the franchisor must be prepared to disclose these pre-existing deals in the FDD and to divulge the nature of the conversion. Assuming, of course, that the franchisor can get over the hurdle of convincing the pre-existing units to convert. This typically requires some type of carrot or, at a

²⁸ See Kevin Hein, Troy Bader and Timothy J. Bryant, *How to Say "Yes" to Sales without Saying "No" to Best Practices*, INT'L FRANCHISE ASS'N 43RD ANNUAL LEGAL SYMPOSIUM, Ch. 21 (2010), citing Leonard D. Vines, Gina D. Bishop and Rupert M. Barkoff, *Damage Control for Violations of Registration and Disclosure Obligations*, 24 FRANCHISE L.J. 191 (Winter 2005).

²⁹ *Id.*

³⁰ 815 ILL. COMP. STAT. § 705/26 (2009); see also Natalma M. McKnew and Eric H. Karp, A.B.A. 30TH ANNUAL FORUM ON FRANCHISING, *Restoring the Status Quo Ante: Rescission and Restitution*, Tab 23 (2007) and Charles S. Modell, Leonard B Vines and Kim Goodhard, *Rescission of Franchise Agreements, Law and Policy*, A.B.A. 29TH ANNUAL FORUM ON FRANCHISING, Tab 13 (2002).

³¹ 815 ILL. COMP. STAT. § 705/27; CAL. CORP. CODE § 31300 (2008).

minimum, some favorable disparate treatment than that provided to “new” franchisees. Again, while disclosure of this distinction is recommended (if not required) and may well raise questions in the franchise sales process, it is better to deal with and resolve these variations upfront than allow them to fester as the system grows.

C. What is the Grand Development Plan?

A topic that can greatly impact your approach and your client’s overall development strategy is: How does the client realistically plan to sell franchises? Many times, the seed of the franchise idea sprouts with a simple encounter. A customer walks in the door and asks: “Is this a franchise?” or “Are you selling franchises?” The light goes on and the owner is off to the races, oftentimes with the notion that more prospects will just walk in the door ready to buy. Client education is important here; as well as explaining the development costs associated with selling and managing franchises.

As with the choice of entity analysis and decision, one size does not fit all; no single answer is appropriate for every situation. Novice entrepreneurs should start slowly and deliberately, testing the waters as they go. More sophisticated businesses (those with a large company-owned-based organization or who started a system-to-be-franchised) may want or need to be far more aggressive.

Single-unit development is the slowest and simplest approach and, in many cases, will be the best choice for most start-up franchisors (at least initially). It involves the development of franchises on a unit-by-unit basis under a separate franchise agreement signed for each unit.

However, if a more aggressive approach is in order, your client also may want the option of expanding through multiple unit development. While the nomenclature varies within the franchise community, the three most common forms of multiple unit development are: (1) area development, which generally involves the grant of a designated territory within which a franchisee can develop multiple units under separate franchisee agreements and pursuant to a development schedule; (2) development agent (a.k.a., area representative/director), which generally involves the grant of a designated territory within which a franchisee can develop multiple units for its own account under separate franchise agreements or refer prospective franchisees to the franchisor pursuant to a development schedule, and provide certain pre- and post-sale services to franchisees within the designated territory for a fee from the franchisor; and (3) master franchising, which generally involves the grant of a designated territory within which a franchisee (master franchisee) can develop for its own account, or subfranchise others to develop, multiple units under separate franchise agreements (between the franchisor and master franchisee) or subfranchise agreements (between the master franchisee and its subfranchisees) pursuant to a development schedule.³²

While master franchising is typically reserved for international situations, area development and development agent arrangements are fairly common domestically. To be

³² For a further discussion of these and other multi-unit expansion options, see Leslie D. Curran, Craig S. Prusher and J. Westlake, *Growth Through Multi-Unit Franchising*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W5 (2009); Amy Cheng and Andrew F. Perrin, *Multiunit Franchising - The Risks and Benefits*, A.B.A. 28TH ANNUAL FORUM ON FRANCHISING, Tab W5 (2005); Will Woods, Jacqueline Vlaming and John Dring, *Three-Level Franchise Systems: Area Reps and Development Agents: Do They Make Sense for the Systems You Represent?*, INT’L FRANCHISE ASS’N 41ST ANNUAL LEGAL SYMPOSIUM, Ch. 11 (2008); John W. Fitzgerald and Max J. Schott, II, *Expansion Options: Multi-Unit and Third-Party Arrangements*, FRANCHISING WORLD, at 16-18 (April 2008).

competitive and attract large, multi-brand franchisees, your client may feel that they need to include one or both of these multi-unit expansion models as part of their initial offering. Given that your start-up franchisor client will not have sold any franchises, however, it may be wise for them to grant a few single-unit franchises before even considering multi-unit development, especially through development agents.

It is incumbent upon you to educate your client as to these options, and the added complexity and cost that come with the preparation of additional, multi-unit agreements. The establishment of fees, schedules and territories, as well as the relationship between the multi-unit documents and the other base documents, are among the issues that you will need to discuss with your client if multi-unit development becomes a part of the process. You also will need to analyze how this decision will impact the client's disclosure/registration plan and strategy. Note that in addition to your client's obligation to include information in its FDD about multi-unit expansion, your client's multi-unit franchisees also may be subject to federal and state disclosure and registration requirements if they fall within the applicable definition of a "subfranchisor."³³ Finally, the desired sales approach will lead to the inevitable discussion and selection of personnel. That is, how will the sales process be staffed and handled? Many systems start with an internal sales person, while others are inclined to employ an outside franchise sales broker or network of brokers. Whatever the call, discussion of the sales plan is instrumental to the overall plan of action.

D. Reservation of Rights to Start-up Franchisor

In assisting your start-up franchisor client with its development plan, you also must look to the future in an effort to predict where its business may take it. It is important from the start that a franchisor generally reserve to itself those rights not granted to its franchisees and, where possible, specifically state what those rights may be. FDD Item 12 helps the franchisor focus on this issue by requiring the following disclosures: whether a franchisee receives an exclusive territory, a non-exclusive territory or no territory at all; the restrictions on the solicitation and acceptance of customers within any territories; and the rights of the franchisor and its affiliates, and its franchisees, to use "other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales."³⁴ In our opinion, the more specific you can be about the alternative channels of distribution the better. For example, the franchisor of a QSR restaurant franchise may want to specifically reserve the right to package and sell its branded ice cream or food at grocery stores and other retail outlets, or to open restaurants in non-traditional locations like airports, sports areas, hospitals or universities, regardless of whether these activities take place within a franchisee's territory. We recommend that you also include this same type of language in the grant of rights/reservation of rights sections of your client's franchise agreement. While your client may never exercise these rights or ultimately choose to

³³ While development agents are not included within the definition of subfranchisors under the FTC Franchise Rule, they may constitute subfranchisors under a number of state franchise laws and thus be subject to disclosure and registration requirements. See 16 C.F.R. § 436.1(k); FTC FAQ 9; see e.g., WASH. STAT. § 19.100.010(9); HAW. STAT. 482E-2 (2008). See also David L. Cahn and Jeffrey S. Fabian, *Washington Ruling Raises Area Representative Disclosure*, 13 THE FRANCHISE LAWYER (Winter 2010); Eleanor E. Vaida Gerhards, *When Is a Development Agent or Similar Third Party a Franchisor?*, 29 FRANCHISE L.J. 106 (Fall 2009). In comparison, master franchisees are subfranchisors under the FTC Franchise Rule and state franchise laws and therefore must comply with applicable disclosure and registration requirements. See 16 C.F.R. § 436.1(k); see, e.g., VIR. CODE § 13.1-559 (2009); N.Y. GEN. BUS. LAW § 681 (1989); 85 ILL. COMP. STAT. § 705/3 (2009); MINN. STAT. § 80C.01 (2006); and WASH. ADMIN. CODE § 19.100.160 (1994).

³⁴ 16 C.F.R. § 436.5(l)(6).

license them to franchisees or other licensees, by reserving these rights from the outset, you will give your client the flexibility to take advantage of future growth opportunities.

E. Profit Margin Available to Future Franchises in Light Of Fees, Costs and Royalties

Clients new to franchising may overlook the potential inherent additional costs that franchisees will incur that are not necessarily imposed on them: initial franchise fees, royalties, advertising fees and the like. These costs and fees dig into franchisees' profit margins. This, of course, affects the overall success of individual franchisees and the system as a whole. Working on the franchisee's economic model is another important first step.

In many instances, not enough emphasis or attention is placed on the importance of this process. As lawyers we tend to focus on the "legal" and drafting aspects of the deal and leave the economics to the client and its numbers people. However, this is one "business" issue that franchise counsel should get behind. Even if you cannot play a direct role in analyzing the financial aspects of this process, you need to stress the significance of getting this right. This discussion should involve the client's chief financial officer, outside accountants and, if applicable, a franchise consultant. Make sure the client involves the right people, is able to accurately report current basic costs and expenses and covers all potential costs and expenses that a franchisee may incur.

While this analysis and process will also assist in developing FDD Items 5, 6, 7 and 8 (and may impact considerations concerning Items 10 and 12) it should go well beyond just a franchisee's start-up phase. Developing a healthy franchisee profit margin strategy transcends legal considerations and sales strategy. It is the essence of the system. Further, though scant attention seems to be paid to this, what will be the franchisee's ROI? Take time to focus the client's attention on all aspects of the franchisees' economics. Typically, franchisors make their money not on the initial fees they receive, but on royalties paid by and, in some cases, purchases made by successful franchisees over time.

An adjunct to this analysis is a discussion of what attributes an ideal franchise candidate may possess. Franchising is about making money, for both the franchisor and the franchisees. Selection of the right candidates starts with knowing the short-term and long-term costs and the potential ROI. We will focus more on this later but in order to select suitable candidates the client must nail down the economics of the deal and match them to candidates' financial wherewithal.

This section focuses on the importance of stressing to your client that they take into account potential unit profitability and franchisee ROI in structuring their franchise program. This is not to suggest, however, that franchisees are only concerned with these items. Greg Nathan, a registered psychologist and Managing Director of the Franchise Relationships Institute, found through his research that "franchisee profitability, while important, is only one of the drivers of franchisee satisfaction."³⁵ He discovered that other indices of franchisee satisfaction include: brand development and marketing support from the franchisor; competent, trustworthy and forward-looking franchisor leadership; a feeling that the franchisee is a respected part of the

³⁵ See Greg Nathan, *How to Create Healthier Franchise Relationships and Happier Clients*, 13 THE FRANCHISE LAWYER (Winter 2010); see also Greg Nathan, *Engineering Healthy Franchise Relationships*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab P1 (2009) [hereinafter Nathan].

franchise system; and a sense that the franchisor is concerned for the well being of the franchisee.³⁶ This confirms what many of us in the franchise community have long known: franchising is all about building relationships. It comes as no surprise that at the heart of many of the most successful franchise systems, are healthy franchisor/franchisee relationships. We recommend that you to pass on this wisdom to your clients from the start and emphasize to them the importance of building strong, open and mutually beneficial relationships with their franchisees.

F. Potential Fees and Costs – Initial Franchise Fee, Royalties, Advertising Requirements Etc.

Discussion of franchisees' profit margin and ROI naturally leads to a discussion of the development of the system's potential overall costs, fees, royalties, advertising fees and more. Although we are typically guided, almost by default, by the particulars of FDD Items 5, 6 and 7, our discussion must start well before we fill in the blanks of the mandated charts.

Developing system costs and fees compels an analysis of three distinct economic segments: the franchisor's experience and financial needs, the franchisees' tolerance, and the competition's offerings. Assessment of these competing economic interests must inevitably lead to an acceptable balance that enables the franchisor and its franchisees to succeed while taking on the competition on two fronts: franchise sales and market-based sales.

Just as a franchisee needs to earn a profit and achieve a healthy ROI, so does the franchisor. The franchisor must develop a successful economic strategy and model that may be part of a business plan or overall budget. In addition, there are two phases of the franchisor's economic planning that should receive attention: start-up costs (legal and accounting fees, operation manual development, website and other information technology development costs, initial marketing materials, etc.), and ongoing expenses (franchise sales commissions, training materials and personnel, continuing development of marketing materials, trade show attendance, and so forth). Thus, preparing a budget for each area and activity before any franchise fees are realized is a necessity and will provide a basis for assessing the level of initial and ongoing fees that must be charged.

Staffing and labor is one of the most immediate costs to assess. For the new franchisor, however, this basic overhead item will be difficult to predict. Systems planning a slow-growth approach will likely work with existing staff - but how long will this last? A more aggressive growth plan may require new staff immediately. Initial additional salaries may need to be figured in from the start. Staff salaries and the budgeting issues associated with this inherent cost is just one example of the work ahead of your franchise client in arriving at a sustainable cost structure.³⁷ But, what is the franchise lawyer's role here?

Of course, the easy answer is that as lawyers we need the information to "fill in the blanks." True enough, our job does require that we obtain the financial information needed to fill in FDD Items 5, 6 and 7, but does it end there? Our view is that it is truly just the beginning of the direction and counseling that is necessary to develop and secure accurate cost information from the client. While you do not need to be directly involved in the cost development process,

³⁶ *Id.* See sources cited *supra* note 35.

³⁷ For discussion of staffing, see Darrow, *supra* note 2 at 26-29.

you should provide guidance and direction. If the client is not capable of professionally directing this process, you should encourage the use of a franchise consultant, an outside accountant or, at a minimum, an internal financial staff member. Your duty starts here because you do not just want the information, you want accurate information that will assist the client in developing competitive but profitable fees and cost estimates that will sustain the system and comply with the law. At bottom, the essence of the disclosure and anti-fraud statutes is the provision of fair and accurate information to potential franchisees.³⁸ As franchise counsel you must drive this process to secure fair and accurate information.

Although various FDD Items require assorted cost and fee disclosures, Item 7 is the most comprehensive. It represents a franchisee's estimated initial investment. While the expenses included in Item 7 vary from system to system, seven expense categories must be disclosed: initial franchise fee, training expenses, real property (leased or purchased), FFE Plus (equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements and decorating costs), opening inventory, security deposits and other prepaid expenses and additional funds for any other required expenses that may be incurred before operations begin and for the initial period of operation (a minimum of three months or a reasonable period for the industry).³⁹ The last item, additional funds for the initial period, must also carry a general description (usually placed in a footnote) of "the factors, basis, and experience that the franchisor considered or relied upon in formulating the amount required for additional funds."⁴⁰

As noted earlier, thoroughly engaging your client in this process is crucial to completing the work of gathering and developing accurate cost estimates.

G. Reviewing and Analyzing Data Regarding Competitors

It is critical that your client conduct a thorough review and analysis of data regarding its and its franchisees' potential competitors. This information is not only pertinent to the initial decision of whether or not to franchise, but also likely will dictate to a certain extent the terms of the franchisor's franchise agreement, including the fee structure, length of the initial term, renewal rights, protected territory (if any), and training, financing and other support offered.

If there are other franchisors within the same industry who will be competing with your client for franchisees, your client should obtain and dissect a copy of their FDDs. See Section II.A for tips on obtaining FDDs. These FDDs will obviously contain a wealth of information about the competing offerings and systems. Your client should pay particular attention to any financial performance representations ("FPR") included in these FDDs, not only for the information they contain, but also because of the competitive edge they may provide the competitor if your client elects not to include a FPR in its FDD. More on this issue in Section IV.T.

³⁸ As an example, see California Franchise investment Law, California Corporations Code § 31001, which states in part: "It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law to prohibit the sale of franchises where the sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled, and to protect the franchisor and franchisee by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship." CAL. CORP. CODE § 31001 (2008).

³⁹ 16 C.F.R. § 436.5(g).

⁴⁰ 16 C.F.R. § 436.5(g)(1)(iii).

In addition to FDDs, your client should also gather additional information from other available sources regarding both franchisor and non-franchisor competitors, and the client's industry in general. This is where a franchise consultant can really bring value. Franchise consultants are familiar with existing franchisors and industries, and can help analyze the current landscape of a given market and what that market will bear. Regardless of whether your client uses a franchise consultant, it is important that you ensure that it has conducted this type of analysis as part of the franchise development process. Otherwise, your client's franchise sales efforts may be doomed from the start.

H. Are There Any Special Industry Laws or Regulations?

As we know, franchising is a method of doing business rather than an industry unto itself. By its very nature and application the franchise model cuts across many industries and concepts: lodging, restaurants (fast-food, casual-dining, full-service), automobiles (sales, rental, parts and repair), gasoline, travel, real estate brokerages, financial services, tax and accounting services, pet care, senior care, medical and dental services, vision care, specialty retail shops, home improvement and vitamins, just to name a few. Each business brings its own laws and regulations. Exploring these with the client and through your own due diligence is important for a number of reasons.

Some industries such as the gasoline, automobile and farm implement sectors may have specialized franchise laws. Certain professional areas such as law, medicine and accounting may have ethical and legal restrictions; these may include licensing requirements, trademark use restrictions, advertising restrictions, fee-splitting regulations or prohibitions, limitations on enforceability of covenants against competition, and ownership structure limitations.⁴¹ Investigating the impact of these laws, regulations and ethical limitations is a clear priority. Determining that your client's business may have serious restrictions on duplication can be a deal killer.

Another reason this area must be reviewed is that FDD Item 1 requires a general disclosure of "... any laws or regulations specific to the industry in which the franchise business operates."⁴² Although the disclosure requirement is important, it is clearly trumped by an industry or professional restriction that prevents duplication of the concept. Be alert to this potential crucial impediment and discuss it early with your client.

I. Attributes Required of the Ideal Franchise Candidate

We touched on this briefly in Section IV.E as part of our discussion of the profit margin available to future franchises in light of fees, costs and royalties. Again, while this topic may be perceived as a business item, franchise counsel is well advised to focus his or her client's attention on this significant aspect of franchise development. As we noted, this starts with the client knowing its system's economics, realistic franchisee costs and the potential ROI. The

⁴¹ See David A. Beyer and Leonard D. Vines, *Matter of Honor: Franchising in the Professions*, A.B.A. 26TH ANNUAL FORUM ON FRANCHISING, Tab W9 (2003); Deborah L. Gersh and Karen K. Harris, *Healthcare and Franchising: The Regulatory Maze*, AMERICAN HEALTH LAWYERS ASSOCIATION (1999).

⁴² 16 C.F.R. § 436.5(a)(6)(v).

economic model will be a good starting point but much more needs to be identified before the client is ready to search for candidates.

One technique to jumpstart this process is to encourage the early development of a franchisee application/questionnaire. Although this may seem premature, this hands-on task will force the potential franchisor to begin shaping its concept of the ideal candidate and, perhaps, adjusting some of the goals, requirements, fees, experience and other attributes the client seeks for its system. Further, this process will truly involve the client in the development process, immersing it in the reality of what it is planning to undertake. And, once the sales process begins this will have been time and effort well spent as the client will be ready with the franchisee application/questionnaire and have a firm grasp on the desired attributes. In addition, the client will quickly learn that distribution and completion of the franchisee application/questionnaire before FDDs are provided is an essential time-saving tool as it will separate the tire-kickers from sincere, viable candidates.

We include an example of a franchisee application/questionnaire as Appendix B. As with all form documents, you are cautioned to review and analyze applicable law (particularly those relating to privacy, data collection, security and credit reporting, which are ever-changing) to ensure that the document your client is using is in compliance. The ideal franchisee application/questionnaire also should be customized to address system and industry specifics. For instance, casual and full-service restaurant systems may emphasize previous restaurant operation experience, whereas a hotel system may focus more on investment wherewithal. Some of the items that should be included are:

- Personal background information.
- Educational background.
- Employment and/or investment history.
- Prior experience in the industry or field.
- Prior or current franchise experience.
- Reason for interest in this franchise.
- Financial history/net worth and financing capabilities.
- Management plan and proposed partners/managers.
- Working capital capabilities.
- Existing banking and professional relationships.
- Bankruptcies, criminal/civil litigation history.
- Existing/planned operating business entity.
- Desired location and territory, if applicable.
- Interest in multiple location development.

Like a litigator who crafts a closing argument first when preparing for a trial, the client that develops the franchisee application/questionnaire early in the process begins with the end in mind and will have a good roadmap of where it is headed and what it needs to get there.

We would be remiss here if we did not briefly discuss the primary purpose of the franchisee application/questionnaire: selection of the best franchise candidates. Too often, new franchisors are overly eager to make those first few sales. This can be a big mistake. The foundation of any enterprise is vitally important to its success. A franchise system is no different. If weak franchisees (financially and operationally) are selected initially, the chances for success are lessened and, indeed, may bring down the entire effort. You should make sure your client understands that turnover from hasty sales to under-qualified franchisees will show up in its FDD Item 20, drawing further attention to the issue. Encourage your client to resist the

temptation of just “getting some deals done” and focus on the attributes and criteria that were the basis for the development of the franchisee application/questionnaire. Successful franchisees can quickly become a new franchisor’s best sales tool.

J. Analyze Current Management Teams’ Strength, Weaknesses and Background

Analyzing the strengths and weaknesses of current management and their future franchise roles is a vital but sensitive exercise. This is the team that will take the concept to market and on which the success of the franchise effort is pinned; sensitive because decisions and choices have to be made in matching the right person to new or expanded roles.

It is not uncommon to launch a franchise system with the existing management team, few of whom may have any franchise experience or background. Small- and medium-sized businesses may not have an economic choice but to go with the current team. Larger businesses may be able to attract some franchise specialists or former franchise executives. An established, mature company with multiple company-owned units operating in varied geographical areas will likely be in a better personnel and experiential position than a new company with few locations.

Although the client must put or keep the right people on the bus, franchise counsel must deal with the practical disclosure requirements of FDD Items 2, 3 and 4. Addressing the topics of each director’s, principal officer’s and other franchise-management personnel’s five-year business history as well as their 10-year litigation and bankruptcy history while potentially sensitive must begin sooner rather than later. Some revelations in these areas may cause a re-shuffling of positions and personnel before finalizing the FDD as the primary officers determine the positive and negative aspects of certain disclosures. As a reminder, just because a person is not a formal director or principal officer of the franchisor, does not mean that he or she does not need to be disclosed in Items 2, 3 and 4. Any individual who will have management responsibility relating the sale or operation of franchises must be disclosed.⁴³

This is an area that is definitely conducive to the use of questionnaires. First, you need to establish the universe of individuals who will be a part of your client’s business. To accomplish this task, we recommend that you have an executive officer of the franchisor (preferably the CEO or president) complete a questionnaire that lists all of the following individuals (the franchise team): (1) all of the directors, trustees, general partners and members of the franchisor; (2) all of the officers of the franchisor; (3) all other individuals who will have management responsibility relating to the sale or operation of franchises; and (4) any franchise sellers (both internal and external). Once completed, the executive officer should be required to sign the questionnaire confirming that the list is complete and correct. We have included a sample due diligence questionnaire (for the entire franchise team) as Appendix C.

In addition to this questionnaire, we also recommend that you require each of your client’s franchise team members to complete and sign a separate questionnaire based on his or her own background. The questionnaire should solicit the following information: (1) five-year employment history; (2) 10-year litigation and bankruptcy history; (3) ownership interest in any of franchisor’s approved suppliers (just officers); (4) whether the individual will engage in franchise sales; and (5) whether the individual is aware of any matters that may be material to a

⁴³ 16 C.F.R. § 436.5(b).

prospective franchisee, which are not already included in the franchisor's FDD. You will not only need this information for the preparation of FDD Items 2, 3 and 4, but also the franchise seller disclosure forms required by a number of the franchise registration states. We have included a sample due diligence questionnaire (for individual franchise team members) as Appendix D.

We strongly endorse the use and retention of the above-referenced due diligence questionnaires as part of the preparation of your client's first FDD. We also suggest that you require your client's franchise team to annually complete and sign new due diligence questionnaires as part of the renewal process, and establish a system that obligates all new franchise team members to complete and sign a due diligence questionnaire before they are hired.

K. Reviewing and Verifying Client Information

By its very nature, the preparation of an FDD requires franchise lawyers to rely on the information they receive from their clients. To what extent, however, should franchise lawyers conduct their own due diligence? We think that some level of due diligence is in order, especially when dealing with a start-up system or new personnel. Some have learned the hard way that it is ill-advised to just gather this information verbally or casually. Improper disclosure can quickly lead to civil fines and unwanted enforcement actions that can tarnish the company's reputation for years to come as it is republished in the FDD.

At the risk of over-emphasizing the use of questionnaires, this is another area where we strongly recommend the use of them. First, make sure that the completed franchise program development questionnaire discussed in Section III.9 is signed by an executive officer of your franchisor client (preferably the CEO or president) confirming that it is complete and correct. In addition, once the FDD is in final (or close to final) form, require that an executive officer of your client (again the CEO or president, if possible) review the FDD and verify that it is complete and correct, and that the officer is not aware of any matters that may be material to a prospective franchisee which are not already included in the FDD. Apart from questionnaires, we also are aware that some law firms conduct independent background checks of clients as part of their intake process. There are a number of reasons for these precautions; some are for client protection and others for mere self-protection.

Let's start with client protection. Because civil fines or even criminal action could be imposed or undertaken, utmost care should be taken. Further, an FDD that results in a civil enforcement action and order must be disclosed for 10 years. Finally, if a franchisee or prospective franchisee has been harmed, the omission or misstatement could serve as the basis of a suit. As explained above, the use of simple written questionnaires may avoid all three consequences and others that may arise.

It also is important to protect yourself. If you as counsel rely on the verbal assurances or representations of the franchise development official or chief officer, what proof do you have in the future that this was the source of the potentially inaccurate information? When questions arise and the spotlight is turned on a blemished FDD, you can be sure that finger-pointing will occur. Also, this can turn into an embarrassing situation with state examiners. Even though the FDD is registered in the company's name, the examiners deal with counsel, many times for many years on behalf of the same or different companies. So it is your reputation and established goodwill that can be damaged as much as the franchisor's. In addition, your client may pursue the dreaded claim of malpractice against you. Finally, your client's franchisees may bring claims against you, like negligent misrepresentation, relating to your role in preparing the

client's FDD. The good news for franchisor attorneys is that, absent a lone reported case over 20 years ago,⁴⁴ these claims have historically not been successful against franchisor attorneys, unless the franchisee can demonstrate fraud or intentional misrepresentation by the attorney.⁴⁵ Again, the use of simple written questionnaires may help you avoid all of these consequences.

L. Training Plans, Training Manuals and Other Training Materials

The importance and need for training in a system that wishes to clone or duplicate itself is self-evident. Training should embody the essence of the system and be the client's highest priority. Uniformity is a key element to almost all franchise systems and training seeks to implement the desired consistency. Yet, many new franchise systems have no clear, organized plan. FDD Item 11 essentially presumes that the franchisor has an organized training program.⁴⁶ If a new franchisor does not, one look at Item 11 should serve as compelling motivation.

On the topic of training, Item 11 requires the franchisor to:

- Disclose the franchisor's training program as of the franchisor's last fiscal year-end or a more recent date.
- Describe the training program in a specified tabular chart.
- Place in the chart the subject matter, hours of classroom training, hours of on-the-job training and the training location of each subject.
- Specify the frequency and overall location of training.
- Specify the type of instructional materials and the instructor's experience, including the length of the instructor's field experience and with the franchisor.
- Disclose any charges and the responsibility to pay for travel and living expenses.
- Specify who must attend, how long after franchise execution training must take place and whether franchisees must complete training to the franchisor's satisfaction.
- If training is not mandatory, state the percentage of new franchisees who have enrolled during the preceding 12 months.
- State whether additional training is required.⁴⁷

If the client does not have an existing training regimen or organized approach, sharing this list with your client and its team will bring the requirements into sharp focus. Many clients are assisted by seeing an actual completed chart from a previously drafted FDD – with careful redaction or client-permission you should seek to provide a working prototype.

Training costs can be significant for franchisor and franchisee alike. The franchisor's investment includes staff, materials, facilities, presentations, equipment and other costs. A

⁴⁴ See *Courtney v. Waring*, 237 Cal. Rptr. 233 (Cal. Ct. App. 1987).

⁴⁵ See Conohan, *supra* note 2; Arthur L. Pressman and Gregg A. Rubenstein, *Lawyers Who Prepare FDDs Do Not Take On Potential Liability to Franchise Buyers, Absent Complicity in a Knowingly False Statement*, 12 THE FRANCHISE LAWYER (Fall 2009); Howard E. Bundy, *Are Franchise Lawyers Liable to their Clients' Franchisees for Negligent Misrepresentation?*, 12 THE FRANCHISE LAWYER (Summer 2009); Alexander M. Meiklejohn, *UFOCs and Common Law Claims Against Franchise Counsel for Negligence*, 25 FRANCHISE L.J. 45 (Fall 2005).

⁴⁶ 16 C.F.R. § 436.5(k)(7).

⁴⁷ *Id.*

franchisee may have considerable travel, lodging and salary expenses involved. Everyone is paying for training. And, it is an area of great expectations for franchisees. We have heard more than once that franchisees are underwhelmed by a franchisor's initial training programs. Hence, new franchisors are well-advised to concentrate on the development of a seriously organized and professionally staffed training program. This is truly the franchisee's "first impression" of the level and quality of support and service it can expect to receive. While this topic falls across the legal-advice-to-business-advice line, encourage your client to focus on developing a credible training program; it may avoid a later lawsuit that has its origins in training dissatisfaction.

If the client balks at making a significant investment in traditional "bricks and mortar" training, explore other options. Technological advances offer numerous alternatives: video, teleconferencing, web-conferencing and e-learning. Indeed, today's tech-savvy franchise buyer may expect time-saving and travel-saving technology to be an essential part of the franchise system. The same holds true for training materials: going paperless and electronic will save money in the short-term and long-run as mailing or delivery costs are reduced or eliminated and updates and revisions can be implemented instantaneously. Similarly, this same thinking should be applied to the development of the system's operating manual that we address in the next section.

Encourage your client to put its best training foot forward to achieve one of their most important tasks.

M. Development of Operating Manual

Arguably this topic may take precedence over the client's training plans. For, if we do not have a solid, uniform system infrastructure defined and articulated, what is it that we are training? Though it is fairly clear that a system's procedures, standards, specifications, recipes, design elements and the like go hand-in-hand with training, if an operating manual has not been developed, working on both tasks simultaneously may be beneficial. But we get ahead of ourselves.

As with the FDD training disclosure requirement, FDD Item 11 presumes that an operating manual exists as the franchisor is instructed to disclose the table of contents or offer prospective franchisees the opportunity to view the manual before purchase.⁴⁸

If your client already has a written operating manual you may be off to a good start ... or maybe not. Upon review, you may determine that the existing manual for general internal operations or company-operated locations is not adequate for franchise instruction and enforcement. Chances are that considerable effort will need to be devoted to create a comprehensive operating manual. This is no simple task.⁴⁹

⁴⁸ 16 C.F.R. § 436.5(k)(6).

⁴⁹ For a discussion of the legal aspects relating to the preparation of operations manuals, see Amy Cheng, Craig Dietz and David W. Oppenheim, *Operating Manuals – The Devil is in the Details*, A.B.A. 31ST ANNUAL FORUM ON FRANCHISING, Tab 6 (2008); Brian Cole, Kenneth E. Treat and Dara Solan, *Fixing Things Manually: Updating and Modernizing Franchise Systems Through the Operations Manual*, INT'L FRANCHISE ASS'N 40TH ANNUAL LEGAL SYMPOSIUM, Ch. 17 (2007); Scott G. McLester, Susan H. Morton and Karen B. Satterlee, *Operations Manual – Essential to Success*, 24 FRANCHISE L.J. 31 (Summer 2004).

Drafting an operating manual must begin with the client and their staff; a process that must start with the “subject matter experts.” The knowledge must be extracted, culled and refined so that it can be delivered in a useable form. Some areas may be merely instructional while others are mandatory. Some may be recommendations and others directives. For the most part, the client will determine these distinctions. To protect a start-up franchisor client from vicarious liability claims, however, a lawyer should make sure that the client does not cross the line of arguably controlling the day-to-day operations of its franchisees’ businesses. The lawyer should also stress the importance of only providing recommended (and not mandatory) standards in certain areas, like employment and security. While this topic goes beyond the scope of this paper, there are a number of informative articles that offer practical advice on how to best position your client to defend vicarious liability claims.⁵⁰

From a subject matter perspective, it is difficult to comprehensively address this topic here given the broad application of the franchise concept. However, we would be remiss if we did not discuss the interrelationship between the topics addressed in the franchise agreement and those covered in an operating manual. This also compels us to address the extent of the lawyer’s role in developing the operating manual.

As with discussions with other clients new to the world of franchising, franchise counsel must begin as teacher, with client as student. Few clients come to the table knowing the demarcation between the obligations customarily placed in a franchise agreement and those appropriate for the operating manual.

Because FDDs containing franchise agreements are fundamentally public documents, the most immediate concern is giving away the store. That is, systems seek to protect their intellectual knowledge from competitors and knock-off artists. Putting too much in the FDD and franchise agreement risks unnecessary exposure. Another factor is the need for operational flexibility. By its nature and purpose, a franchise agreement is a fixed, static arrangement. Franchise agreements can typically last 10 years or more. Much can happen in 10 years. Franchise systems need room for suggestions, change and improvement. In our fast paced world, change is typically required more than every 10 years. Hence, specific proprietary operational items are better placed in the operating manual, subject of course to the disclosure requirements under the FTC Franchise Rule and state laws. This enables the system to protect its acquired knowledge while remaining flexible. So, leave the specifics to the client or a professional hired by the client while making sure the franchise agreement is flexible enough to accommodate the terms of the operating manual. Also, taking time to review the completed operating manual for vicarious liability concerns and other issues before publication is recommended.

Before we leave this topic, it is important to mention that a franchisor has the option of disclosing the operating manual’s table of contents in Item 11 or offering its prospective franchisees the opportunity to view the entire manual before buying a franchise.⁵¹ The

⁵⁰ See Heather Carson, Sarah Yatchak and Gordon M. Hadfield, *Franchisor Liability for Acts of the Franchisee*, 29 FRANCHISE L.J. 174 (Winter 2010); Fredric Cohen, Marc Merriweather and Amy Powers, *Keeping Your Distance: How to Avoid or Survive Vicarious Liability Claims While Enforcing System Standards*, INT’L FRANCHISE ASS’N 42ND ANNUAL LEGAL SYMPOSIUM, Ch. 14 (2009); Cynthia M. Klaus, Jason M. Murray and Heather Smedstad, *Vicarious Liability*, A.B.A 31ST ANNUAL FORUM ON FRANCHISING, Tab W10 (2008); Michael D. Joblove and William L. Killion, *Defending Your Life: Protecting Your Unit and Your System in Vicarious Liability Litigation*, A.B.A. 26TH ANNUAL FORUM ON FRANCHISING, Tab W10 (2003).

⁵¹ 16 C.F.R. § 436.5(k)(6).

advantages and disadvantages of these options should be discussed with your client. Our observation is that most franchisors simply opt to place the table of contents in the FDD. However, a number of considerations may weigh against this practice. First, given the public nature of FDDs, a certain amount of proprietary information (albeit likely generic) may leak out. Second, with an evolving start-up system, frequent changes in the operating manual should be anticipated. This means frequent, at a minimum annual, updates to this portion of the FDD or relevant exhibit. Third, savvy buyers may ask to see the manual before purchase in any event. While FDD guidelines do not mandate the disclosure, is it a good business/sales practice to deny this request? Finally, any concerns about franchise prospects “stealing” ideas from an operating manual review can be addressed with a “review-only, no-copy” policy, a controlled, secured environment and a previously executed non-disclosure agreement.

Similar to training, development of a quality operating manual is an important “first impression” relationship-building tool with franchisees. New franchise systems are wise to invest the time and effort to craft this essential cornerstone of their business. And, using new technology to create, publish and update the operating manual should not be overlooked. An interactive electronic manual with embedded video, e-learning modules and web-links can pump-up the learning environment for the entire system.

N. Products, Services and Approved Suppliers

Every system has an established method of doing business. Typically, this focuses on a unique combination of delivered goods and services, something that differentiates one brand from another. The new franchisor is considering expansion because it believes it has a unique product or service or a new twist on an existing one. So it is no surprise that the franchisor has developed a certain look, design, logo, product, service, presentation, method and/or procedure that it wants its franchisees to emulate. In order to take full advantage of these unique elements, franchisors often require their franchisees to purchase at least some key products, services, equipment, signage or supplies from approved suppliers, while allowing them to purchase other more mundane items from any source.

Gathering current information is the first step. Who are the franchisor’s suppliers? Are there any unique, patented, custom-made or trade secreted products or ingredients? Are there any system price-breaks or buying cooperative opportunities? Are there generic items? Are there alternative suppliers? Once you have gathered this information, you must work with your client to discuss not only the restrictions it wants to impose on the products and services offered by franchisees, but also the restrictions it wants to impose on the products and services purchased by franchisees, including the sources of those products and services, and how the revenue that may be generated as a result of the purchase of those products and services fits within your client’s business plan and model.

To insure a uniform image and uniform quality of services and products throughout the franchise system, it is not uncommon for a franchisor to reserve the right to approve the brand, manufacturer, supplier and/or distributor of certain supplies (like proprietary products or ingredients, equipment, signage, advertising and marketing materials, uniforms and logoed materials), and to require franchisees to purchase certain of these supplies from approved suppliers. In some cases, a franchisor also may want to reserve the right to designate the sole supplier (which may be the franchisor or one of its affiliates) from whom a franchisee must purchase certain supplies. For other supplies, the franchisor may only describe the specifications and/or standards the franchisee must meet, without reference to a particular brand, manufacturer, supplier and/or distributor. It is imperative that you discuss this issue with

your client and reserve in the franchise agreement the franchisor's rights necessary to allow it to shape (initially and in the future) the purchasing of relevant supplies within its franchise system. You also will need to ensure that you disclose these rights within the context of FDD Item 8.

If your client reserves the right to require its franchisees to purchase from approved or designated suppliers, you must discuss with the client whether these purchases will generate any revenue and, if so, how that revenue will be spent. For some larger franchisors, the direct and indirect purchase of supplies by franchisees can be a significant revenue producer. Some franchisors reserve the right to keep or spend these revenues as they see fit, while others obligate themselves to contribute these revenues to the ad fund or distribute them to franchisees.

If franchisees may be required to purchase supplies directly from your client or its affiliates and the client or its affiliates may make a profit on these purchases, we recommend that you include in the franchise agreement an acknowledgement of this fact. Your client also will be required to disclose this revenue in Item 8 of its FDD.⁵² In addition, if your client or its affiliates may receive fees, payments, rebates, commissions or other consideration from third party manufacturers, suppliers and/or distributors as the result of purchases by franchisees, we suggest that you include in the franchise agreement a description of this arrangement and how the consideration received may be spent. This information also is required to be disclosed in Item 8 of your client's FDD.⁵³ Because the amount of consideration a start-up franchisor will receive as the result of purchases by its franchisees from manufacturers, suppliers and/or distributors may be unknown at the time of the preparation of the FDD and may change over time, we often include a broad range of the anticipated percentage of each purchase a franchisor may receive from these third parties. Regardless of what you decide in this area, the most important thing is that you have presented the issues to your client and have made decisions with an eye to the future.

O. Advertising Requirements and Advertising Funds

Unless the client has successfully implemented an organized, sustained and effective marketing program capable of being adapted to multiple markets, getting the advertising piece correct right out of the box will be difficult. This is one area where lawyers should play more of a back seat role. That is, marketing and advertising have become so specialized, so nuanced in so many varied media that it requires professional treatment. If the client has not retained a marketing firm, now may be a good time. However, many FDD "technical" matters remain for the lawyer's attention and the client's education. While this section focuses on advertising at the unit level, you should not lose site of the fact that your client will likely also be preparing marketing materials and programs geared towards selling franchises. You will need to make sure that your client prepares and registers these materials and programs in accordance with applicable federal and state laws, and does not run afoul of requirements relating to the use of FPRs and "general media representations."

Advertising is an area that usually requires more conceptualization than other development tasks. Item 11 requires an extensive disclosure describing the advertising program. The process of responding to the FDD requirements may introduce your client to

⁵² 16 C.F.R. § 436.5(h)(6).

⁵³ 16 C.F.R. § 436.5(h)(8).

some unfamiliar terms and concepts. More education is in order here and the client may need time to absorb notions such as advertising cooperatives, national advertising funds, advertising councils, allocations, contributions and so on.⁵⁴ Moreover, as noted, the client will be asked to think years into the future, to predict how the marketing/advertising program should be funded, what media will be used, how the program will operate, who will participate, whether “independent” advertising can occur, and whether commitments can be made to fund certain markets.

Even so, the client must have an existing marketing approach or at least given some thought to the available promotional options. Starting here or with the guidance of a marketing professional will get the ball rolling. The emphasis the FDD places on the typical complexities of establishing advertising funds (national, regional, cooperatives, etc.) and the customary approach taken by many systems (multiple advertising, promotional and production funds), may seem to be overkill for a fledging, start-up system and may tend to push new franchisors into premature decisions in uncharted waters. So, before you overwhelm your client with thoughts of the success of a national advertising program, focus their attention on developing and articulating basic promotional approaches that can realistically propel new franchisees and the system.

This go-slow-start-local approach does not mean you should avoid planning for the future. So provide for the potential establishment of a national advertising fund and regional advertising cooperatives, if appropriate, in the franchise agreement but recommend against immediate implementation. Unless there are some special circumstances or the start-up involves a well-known but previously non-franchised brand or concept, immediate implementation of regional or national advertising funds will only dampen early franchisee success by diverting resources to areas that may bring few results. Hence, marketing programs that concentrate on local advertising or promotion should be encouraged and devised first. In addition, when addressing the to-be-implemented future funds, consider the interrelationship of franchisees’ costs and resources. Unless franchisees are wildly successful, stacking a national percentage and a regional or co-op percentage on top of a local spending requirement can be burdensome. Offer some relief from local advertising expenditures or requirements when future regional and/or national contributions kick in. Finally, national and regional funds should have set prescribed limits; these are typically expressed as a percentage of gross sales.

Another consideration for the new system is the distinction between a “national advertising fund” and a “production fund.” Some systems confuse or mislabel the two. A production fund is commonly used to develop and create promotional items and materials that can be used at all levels; whereas a “national advertising fund” suggests the development of national media opportunities and expenditures. So while it may be premature to implement a “national advertising fund” it may not be premature for franchisees to begin contributing to a “production fund” from which they may receive a more direct benefit. Reviewing these approaches with your client will give it the opportunity to select the best method for the future while keeping the current marketability of franchises in mind.

P. Initial Capital Investment

It is critical that your client has sufficient capital to support its franchise development plans. While the FTC Franchise Rule does not require a start-up franchisor to possess a specific

⁵⁴ 16 C.F.R. § 436.5(k)(4).

level of capital before franchising, many of the franchise registration states will either not allow a franchisor to sell franchises in their state, or will impose additional requirements that must be met before a franchisor may sell franchises in their state, if they believe that a franchisor is undercapitalized.⁵⁵ While these requirements vary among the states, franchisors who are found to be undercapitalized will be not be allowed to sell franchises in these states unless they comply with certain conditions, which may include posting a bond, escrowing initial fees, or deferring the collection of initial fees until the franchise opens or the franchisor has complied with all of its pre-opening obligations.⁵⁶ State examiners also may mandate the inclusion of risk factors relating to your client's financial condition in their FDD. Given this reality, we recommend that, prior to the preparation of the financial statements that will be included in your client's FDD, you discuss with the client how it or its parent's (if a parent's financial statements are being used) "net worth" (or "stockholders equity") may impact their franchise sales in registration states.

So what amount of capital is required in the registration states to avoid fee deferral or other similar conditions? The State of Washington has historically taken the position that a franchisor or its parent (if a parent's financial statements are being used) must have a "net worth" of at least \$100,000 in order to avoid the imposition of additional requirements. Recently, however, one of our clients was required to defer collection of its initial fees in Washington even though it met the \$100,000 net worth threshold. We have heard rumblings that Washington may now be imposing additional requirements on all start-up franchisors regardless of their financial situation. As for the other registration states, in our experience, none of them have set a minimum amount. Instead, they generally look at each situation on a case-by-case basis and focus on the Franchisor's Costs and Source of Funds document,⁵⁷ that franchisors must submit as part of their filings, together with the projected openings for the next fiscal year listed on Table 5 in Item 20 of the franchisor's FDD.⁵⁸ States also may look at the estimated initial investment required for each franchise, as disclosed in FDD Item 7.⁵⁹ You and your client will definitely want to factor in this issue as you finalize your client's franchise sales strategy.

Q. Financing Alternatives for Franchisees

One thread that should permeate everything you discuss with your client is their ability to sell franchises. If the new system's cost-of-entry is out of sync with existing competitors, or the contractual provisions are too onerous, few sales will result. Consequently, keeping the "sale-ability" of franchises front and center during the development process is critical.

In addition to keeping close watch on franchisee start-up costs, an obvious aid to franchise sales is offering franchisees financing alternatives and resources. Very few

⁵⁵ See, e.g., CAL. CORP. CODE § 3113 (2008); 815 ILL. REV. STAT. § 705/15 (2009); VIR. REG. § 5-110-65 (2009) and VA. CODE ANN. § 13.1-561 (2009).

⁵⁶ *Id.*

⁵⁷ North American Securities Administrators Association, Inc. ("NASAA") 2008 Franchise Registration and Disclosure Guidelines (amended and Restated UFOC Guidelines) ("NASAA FDD Guidelines"), available at <http://www.nasaa.org/content/Files/2008UFOC.pdf>, at Form B.

⁵⁸ 16 C.F.R. § 436.5(t)(3).

⁵⁹ 16 C.F.R. § 436.5(g).

franchisors offer direct financing or seek to arrange it and many third-party financing sources have faded away.⁶⁰ One avenue that remains is The Franchise Registry, a web-oriented partnership between the U.S. Small Business Administration (“SBA”) and FRANdata that offers franchisees expedited loan processing through the SBA.⁶¹ In explaining the SBA-FRANdata partnership, it is noted on the website that “FranchiseRegistry.com is a site that allows franchisees to see which systems are participating in the program, SBA lenders to see details of the SBA approval, and franchisors to submit applications.”⁶² The Franchise Registry is not a pre-approval for SBA financing on particular deals or for a specific system’s franchisees. It may simply expedite the processing of a qualifying loan.

The essence of the Franchise Registry program is streamlined loan processing. This is accomplished through a centralized review of franchisor-worksheets and franchise agreements; eliminating the need for independent review at one or more of the 69 local SBA offices. Franchisors complete a single worksheet, certify that their franchise agreements comply with SBA’s Eligibility Guidelines, submit the information to FRANdata with e-copies of all franchisee-related agreements and pay a \$2,500 application fee.⁶³ In a minimum of 10 weeks, FRANdata conducts an initial review and forwards a recommendation to the SBA.⁶⁴ The SBA makes the final determination which results in the issuance of a certification form that franchisees present to potential lenders and a listing of the franchisor on the Franchise Registry public website. Further, FRANdata places an e-copy of the franchisor’s approved documents on a private website that only the “SBA, SBA Participating Lenders and Certified Development Companies” may access.⁶⁵

Once a franchisor is SBA-approved, no further review is required (unless revisions are made to the submitted documents) and participating lenders may rely on the certification and website listing. Notwithstanding the certification, as noted above, lenders must still independently financially qualify each franchisee-borrower in light of the terms of the deal. But, franchisees can qualify for expedited franchise eligibility review by presenting an application for assistance that includes either a “Certification of No Change or Non-Material Change” or a “Certification of Material Change” from the franchisor’s counsel.⁶⁶ More information about these procedures can be found on the FranchiseRegistry.com site.

One reported issue with the program is the SBA’s mandated revision of certain “standard” or “common” franchise agreement provisions. Fueled by a SBA regulation that franchisees must maintain “the right to profit from its efforts and bears the risk of loss

⁶⁰ See Tim Miller, Scott Pressly and Charlene York, *Franchisor as Finance Coach: Finding Options and Solutions for Franchisee Funding in Today’s Market*, INT’L FRANCHISE ASS’N 43RD ANNUAL LEGAL SYMPOSIUM, Ch. 11 (2010).

⁶¹The Franchise Registry, <http://www.franchiseregistry.com> (last visited Jul. 31, 2010).

⁶² *Id.* at <http://www.franchiseregistry.com/partnership.asp>.

⁶³ *Id.* at <http://www.franchiseregistry.com/faqs.asp>.

⁶⁴ *Id.*

⁶⁵ *Id.* at <http://www.franchiseregistry.com/Partnership.asp>.

⁶⁶ *Id.* at <http://www.franchiseregistry.com/Forms/>.

commensurate with ownership,⁶⁷ the SBA can require addenda modifying the franchise agreement that address how royalties are collected (not allowing a franchisor to estimate royalty funds), the franchisor's consent on transfers (cannot be unreasonably withheld) and the amount of time a franchisor can operate the franchised business upon a franchisee's death or disability. Given today's economic challenges, however, the SBA Franchise Registry-approved process may be one of few financing sources.

Some other sources and programs include: (1) the International Franchise Association's VetFran program ("[t]o honor those men and women who have served in the U.S. military, the Veterans Transition Franchise Initiative...was developed to help them transition to civilian life"),⁶⁸ which offers voluntary discounts or financial incentives from nearly 400 participating franchise companies;⁶⁹ (2) drawing on a qualified retirement account (borrowing funds from a 401(k) plan or an IRA using a "ROBS" transaction (Rollovers as Business Start-ups));⁷⁰ and (3) franchise finance lenders (GE Capital, Franchise Finance is one example).⁷¹ Although some of these resources may not be appropriate for or available to franchisees of a start-up system, your client should be made aware of these options and conduct an independent review.

FDD Item 10 offers guidance concerning required disclosure of financial assistance offered or arranged by a franchisor. If your client wishes to offer financing directly or indirectly, Item 10 should be closely reviewed. "Financing arrangements" under Item 10 can include direct loans, leases, installment contracts, written agreements between a franchisor or its affiliate and a lender for the lender to offer financing to franchisees, an arrangement in which the franchisor or affiliate receives a benefit from a lender, as well as a franchisor's guarantee of a note, lease or other franchisee financial obligation.⁷² Whatever the arrangement, a franchisor must disclose all relevant information about the source, purpose and terms of the financing arrangement. This information may be presented in a table or chart.⁷³ Further, sample financing contracts must be included as an attachment to the FDD.⁷⁴

While financing can be a valuable addition to a franchise sales program, FDD disclosure detail requires a well-formulated program with ready-to-use documents. A franchisor's intention may be to offer a clean and simple program but financing arrangements can quickly become more complicated than desired. In addition, legal fees may have to be adjusted upward to

⁶⁷ SOP 50 10 5(a) http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sops_50105a.pdf; 13 C.F.R. 121.103(i).

⁶⁸ VetFran Directory Introduction, <http://www.franchise.org/Veteran-Franchise.aspx>.

⁶⁹ *Id.*

⁷⁰ See Jeff Elgin, *Finance Your Franchise With Retirement Funds*, ENTREPRENEUR MAGAZINE, April 23, 2010, avail. at <http://www03.entrepreneur.com/franchises/buyingafrenchisecoachjeffelgin/article206310.html>.

⁷¹ See *About GE Capital, Franchise Finance*, <https://www.geffcenter.com/DoingBusinessWithGEFatwire.action> (last visited Jul. 31, 2010).

⁷² 16 C.F.R. § 436.5(j)(1).

⁷³ *Id.* at (j)(1)(i)-(x).

⁷⁴ *Id.* at (j)(1)(i), fn. 7; 16 C.F.R. § 436.5(v).

accommodate unanticipated financing agreements. If you quote a flat fee, make sure your fee agreement is clear about the agreements that are included in that fee.

Moreover, unless the start-up has substantial resources or a well-proven company-operated system, it will be extremely risky to develop a direct financing program or one that involves franchisor-guaranteed financing. Normally, a new system is eager, if not desperate, to receive initial fees and royalty payments. Carrying financing usually means delayed and missed payments, something a fledging system cannot tolerate for too long. If a client is considering some type of direct financing, make sure it seeks additional professional advice to develop a realistic and manageable program.

Working with lenders who can offer franchisee financing may be the better course. But, the recent economic downturn has all but dried-up third-party franchisee financing.⁷⁵ And, according to some industry observers, lenders are now more heavily focused on the strength of the *franchisor* as opposed to the borrowing franchisee. What are the franchisor's current system performance, brand appeal, overall unit economics and financial status as well as the level of management experience in managing a *franchise* system (not just the business of the concept)?⁷⁶ In a risk adverse environment it is easy to understand why lenders will look for a more stable, mature infrastructure than that offered by a start-up.

The reality is, however, that even in good economic times, a start-up system may find it nearly impossible to secure an interested lender – with no proven franchise system track record or unit-level economics, a lender will have very little with which to work. If a cooperative lender can be found however, a realistic program should be developed to maximize franchise sales. This may start off modestly. For instance, if the franchise operation involves inventory, equipment and trade fixtures, perhaps an interested lender can devise a program to offer securitized loans against the hard assets of the venture. That is, if the client is interested in developing a financing program, start with pieces and parts that can be used as security for the loans. Real estate is another area where lender financing can be developed. Nevertheless, being realistic, any third-party financing program will be a long-shot for a start-up.

Three final suggestions, however, may increase the odds of securing some third-party franchisee lending sources: (1) include an Item 19 FPR in the FDD; (2) prepare a Lender's Non-disclosure Agreement for disclosure of the franchisor's current unit economics and other performance indicators (even if an Item 19 FPR is not made); and (3) provide a franchise consultant's strategic and/or analytical report to a potential lender. These strategies may be of value only if the franchisor has substantial or impressive pre-franchise system financials/economics or is in a rapidly developing market with solid projections. While we separately discuss some of these topics more fully in other areas of this paper, their interrelationship to the development of franchisee-lending sources is pertinent here.

R. Discuss Client's Specific Sales Strategy

Above we explored the client's "grand development plan," but as your client gets closer to developing the system and you are drafting the FDD, you also need to focus the client on a specific geographical strategy. In other words: *where* will the franchisor first offer franchises? No

⁷⁵ See Miller, *supra* note 60.

⁷⁶ Telephone interview of Darrell Johnson, President and CEO of FRANdata (May 24, 2010).

single answer or strategy will cover all situations or opportunities. This is truly driven by the capabilities and opportunities of each system. Yet a number of practical and legal factors will aid in the development of a cohesive strategy – and a cohesive strategy is the goal.

First, let us discuss what a new system should avoid doing:

Rule One: Do not *react* to would-be deals.

Rule Two: Do not forget about Rule One.

There is a very practical business reason for Rule One: the client should be driven by a firm, well thought out *business* strategy that takes into account the following elements: training, operational assistance and control, the scope of franchisor's supply chain, vendors' supply chain limitations, critical mass and brand identity through narrow regional development and, finally, cost control. Getting the first franchisees off to a roaring start is crucial. New franchisors should do everything possible to make them successful. Satisfied franchisees are a new system's best sales tool. Too many new systems indicate that they need franchise registrations in multiple states merely because somebody's brother-in-law is reputedly interested in buying a franchise. The practical reality is that new franchisors simply do not have the capacity and experience to successfully operate a scattered, disjointed system. Encourage the new system to devise a geographic sales plan and to stick to it. The management team needs to drive your client's strategy rather than react to would-be opportunities. Plan, do not react.⁷⁷

This approach may be the best legal strategy as well. As alluded to in other sections above, due to a start-up franchisor's initial level of capital investment and limited history, some of the franchise registration states may impose additional disclosure and other requirements, like fee deferral. Knowing this and the fact that only fourteen states require registration (fewer really if we do not count the file-with-no-review-states), it may make economic sense for your client to initially file in only those registration states in which it truly expects to sell franchises.

S. Dispute Resolution Alternatives, Choice of Law, Venue Etc.

Though this is more the lawyer's domain, client involvement in the dispute resolution mechanisms and approach is important. This is when the lawyer has the opportunity to learn about the client's business dispute experiences and gauge its attitude towards business problem-solving, mediation, arbitration and litigation. Some may be keen to taking a business-solution approach to commercial conflicts while others are hardened from scorch-the-earth experiences. Often a client's stance is influenced by its recent won-loss record as well as its prior experiences with business and litigation counsel. It may be difficult to change entrenched attitudes and hopefully you will not need to do so. However, seasoned franchise counsel realizes that conflict avoidance is an art that the start-up franchisor should seek to perfect. The last thing a start-up system needs is a string of lawsuits, especially those that make it into the FDD.

Conflict resolution is more than how, when and where – it is an attitude that must be honed or checked from the inception of a franchise program.⁷⁸ An attitude of mutual respect and

⁷⁷ For additional guidance on the sales process and to obtain some great sales tips, see Hein, *supra* note 28.

⁷⁸ See Nathan, *supra* note 35.

caring will fuel a healthy franchisor-franchisee relationship much more quickly than threats and intimidation. Thus, if your client tends towards the negative side of conflict resolution a discussion about the need to care for franchisees, maintaining a flexible attitude and keeping an open mind may be in order. Unless you plan to generate most of your fees through litigation (which will not last too long with a start-up), counseling the new franchisor in business-solution conflict resolution is invaluable.

Once you have the client in the right frame of mind, it is time to get down to the details.

While we do not seek to duplicate or recount the numerous articles and presentation devoted to these related topics,⁷⁹ we stand upon the shoulders of our colleagues in offering some practical guidance for the new franchise system. As we noted above and have stressed in other areas, conflict avoidance should be the priority;⁸⁰ but when conflict results, mechanisms should be put in place to reduce the cost of resolution. Naturally, however, the need to protect the system and take prompt appropriate action cannot be sacrificed purely for the sake of saving a few dollars. This requires a balanced approach that we believe is best implemented by categorizing the nature of disputes and matching them to an appropriate dispute resolution mechanism.

Experience and common sense instruct that not all disputes are the same nor require the “nuclear option” for resolution. For instance, as franchise lawyers, we know that the improper use of a franchisor’s trademark or other intellectual property, especially in rogue franchisee situations, cannot be tolerated; while a failure to use current POS materials or submit timely reports, especially for the first-time violator, should bring a measured, curative response. Thus, we think it wise to consider the various levels of disputes and specify an appropriate mechanism or path for each level. Because some commentators and courts may view this approach as one-sided, unconscionable or unenforceable – giving a perceived advantage to the drafting franchisor – we do advise caution in this area. Going too far in certain instances may result in a ruling that compels litigation. Even so, the worse that can happen is that a matter designated for an alternative dispute approach ends up at the courthouse.

Nevertheless, we believe it is best for the new franchise system to develop, at a minimum, a two-step (mediation⁸¹ and arbitration/litigation) process to resolve most problems. And, if your client is dedicated to a conflict avoidance approach and seeks to be more creative, you may wish to explore early intervention programs such as mandatory communication, ombudsman program, franchisee advisory boards or peer panels.⁸² Again, however, we feel it is necessary for franchisors to protect certain “sacred areas” with equitable and injunctive powers (unauthorized trademark use, theft of trade secrets, establishment of competitive businesses

⁷⁹ Visit the ABA Annual Forum on Franchising’s Index of Program Materials from 1991–2009 at <http://new.abanet.org/Forums/franchising/Pages/CLEPrograms.aspx> and see the Articles under the topic heading of FRANCHISOR / FRANCHISEE RELATIONSHIPS.

⁸⁰ For more expansive and creative conflict avoidance techniques, see Dean T. Fournaris, Sherin Sakr and Sue Vandittelli, *Establishing Effective Early Intervention Programs to Manage Day-to-Day Disputes, System Standards Compliance and System Changes*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W17 (2009).

⁸¹ See Peter Klarfeld, Michael Lewis and Peter Silverman, *Mediating Franchise Disputes*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W12 (2009).

⁸² Fournaris, *supra* note 80.

and the like), but counsel that other defaults and violations may be better managed in mediation and arbitration settings. Keep in mind, however, that while we may recommend certain mechanism and avenues of resolution, those most suitable for your client, the nature of the franchise system and other intangibles may take precedence.

Much has been written, debated and opined about the pros and cons of arbitration and litigation of franchise disputes.⁸³ We can only amplify what has already been articulated.

Arbitration, especially with renewed interest in the Federal Arbitration Act⁸⁴ in the late 1980's and early 1990's, was reputedly favored by many franchise systems in the late 90's and early 2000's, and according to some commentators, this interest has not waned significantly.⁸⁵ From the franchisor perspective, the benefits of arbitration are said to include: cost and time savings, more control over the proceeding, more control over venue of proceeding, limited or streamlined discovery, ability to limit class action proceedings, no jury, limited judicial intervention and finality with limited appellate review. The shortcomings of binding arbitration are: judicial intervention concerning the enforceability of mandatory arbitration clauses, unpredictable procedural rulings, unanticipated expense and costs that may equal the cost of litigating and uninformed arbitrators or rulings that stray from established law or custom in the industry. The pluses and minuses of arbitration should be carefully reviewed with the client.

On the other hand, if arbitration is not required by the franchise agreement or voluntarily agreed to by the parties, all disputes will be resolved in court. Litigation still remains the preferred means of dispute resolution for many franchise systems and their counsel.⁸⁶ Numerous reasons support this choice: comfort, tradition, perceived certainty, early court intervention when injunctive relief is required, thorough and extensive discovery, no upfront arbitration fees or payment for the judge's service, and the ability to appeal. Of course, as we noted above, litigation costs can be expensively draining for a new system, the time investment can be a distraction from the core business and, depending on the subject of the dispute, an unrewarding and unproductive experience. In addition, litigation does not offer the same ability to limit class action proceedings as arbitration does, which may prove critical as the franchise system grows. Nevertheless, litigation may be the preferred route especially if the new franchisor is well capitalized and works with efficient counsel.

Finally, a discussion of dispute resolution would not be complete without a word about venue selection and choice of law. While a discourse here about the pros and cons of both subjects may prove interesting, it is not of great relevance when counseling the new franchisor.

⁸³ Christopher R. Drahozal and Quentin R. Wittrock, "Is There a Flight from Arbitration?", 37 HOFSTRA L. REV. 71 (2008); Julianne Lusthaus, Mary Leslie Smith and Quentin R. Wittrock, *Is Franchising Abandoning Arbitration? Current Trends in Arbitrating Franchise Disputes*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W16 (2009); Bethany L. Appleby, Richard L. Rosen and David L. Steinberg, *Inside a Franchise Arbitration*, A.B.A. 31ST ANNUAL FORUM ON FRANCHISING, Tab W22 (2008); Edward Wood Dunham and Michael J. Lockerby, *Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes*, A.B.A. 28TH ANNUAL FORUM ON FRANCHISING, Tab L3 (2005); Audra Terrell, Charles Miller and Jonathan Perlman, *Advanced Issues in Arbitration*, INT'L FRANCHISE ASS'N 41ST ANNUAL LEGAL SYMPOSIUM, Ch. 14 (2008).

⁸⁴ The Federal Arbitration Act, 9 U.S.C. § 1-16 (2010).

⁸⁵ Drahozal, *supra* note 83; Lusthaus, *supra* note 83.

⁸⁶ See Michael D. Joblove and Robert Zarco, *Fundamentals 201: Franchise Litigation*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W4 (2009).

Few, if any, franchisors voluntarily select the venue of their franchisees' locations, but instead choose a venue within the state in which they are located. There are many reasons for this but the bottom line is simple leverage: to deter the initiation of disputes to begin with, keep disputes close to home if they arise and reduce the cost of travel and expense of out-of-state counsel. Franchisors also tend to establish the law of the state in which they are located as the governing law, the thought being that they and their counsel know the law and want to gain whatever perceived advantage it may provide. Franchisors located within registration states, however, may seek to avoid the application of their state's franchise law by selecting the law of the state in which their franchisees are located. Thus, if your client is located in a registration state you may want to explore this alternative. Otherwise, when counseling a new franchisor, go with the flow; select its locale as the venue and the law of its state as governing law.

T. Inclusion of Financial Performance Representation ("FPR") in Item 19

An important issue to discuss with your start-up franchisor client that will impact the sales process is whether it wants to include a FPR in Item 19 of its FDD. A FPR is defined under the FTC Franchise Rule as "any representation, including any oral, written, or visual representation, to a prospective franchisee...that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits or net profits."⁸⁷ A FPR can be based on the historic performance of existing outlets or a forecast of future potential performance (although franchisors rarely, if ever, provide FPRs based on forecasts).⁸⁸ While franchisors are not obligated to include a FPR in Item 19 of their FDD, they must do so if they want to provide any FPR information to prospective franchisees.

Throughout the 1990s, most franchise lawyers were wary of advising their clients to include earnings claims in their Uniform Franchise Offering Circulars ("UFOC").⁸⁹ The concern was that by including an earnings claim in its UFOC the franchisor would open itself up to claims from its franchisees based on the content of the earnings claim. In reality, however, most claims brought by franchisees during this period relating to earnings claims were the result of alleged unlawful earnings claims (*i.e.*, earnings claims not included in a franchisor's UFOC) being made by a franchisor's sales team. This is not all that surprising given that earnings claim/FPR information is exactly the type of information prospective franchisees want to see before purchasing a franchise. As a result, over the past decade, more and more franchisors have been including earnings claims/FPRs in their FDDs, although still only about 35% of franchisors currently make use of FPRs.⁹⁰

We are proponents of preparing FPRs, where possible, and using them as a valuable sales tool. This is especially true for start-up franchisors given that prospective franchisees do not have the ability to get FPR information from any other source, like existing franchisees. Essentially, if a start-up franchisor does not include a FPR in their FDD, they are asking their

⁸⁷ 16 C.F.R. § 436.1(e).

⁸⁸ 16 C.F.R. § 436.5(s)(3)(i).

⁸⁹ "Earnings claims" are the predecessor to FPRs under the FTC Franchise Rule. Uniform Franchise Offering Circular ("UFOC") Guidelines (1993). For a thorough description of the evolution of FPRs and current requirements relating to their preparation and use, see FINANCIAL PERFORMANCE REPRESENTATIVES: THE NEW AND UPDATED EARNINGS CLAIMS (Stuart Hershman & Joyce Mazero, eds., 2008).

⁹⁰ See Johnson, *supra* note 14.

prospective franchisees to invest in a franchise based solely on their own due diligence and faith in the fledgling franchisor and brand. This is a difficult sell.

Therefore, we recommend that you review with your client what operational data they have from existing units owned by the franchisor or the franchisor's affiliates. FTC FAQ 8, clarifies that "the [FTC Franchise] Rule does allow franchisors to use affiliate information as a basis for a performance claim in certain narrow circumstances – specifically, when the franchisor lacks an adequate operating experience of its own."⁹¹ This will likely be the case if your client has created a new entity to act as the franchisor. Once you have gathered the relevant operational data, you need to analyze whether it provides a "reasonable basis," for the preparation of a FPR.⁹² If so, you are free to work with your client to prepare a FPR that best fits their business and the data they have collected. In preparing an FPR, you need to make sure that you take into account all of the information contained in FDD Item 19, the FTC Compliance Guide and FTC FAQs 8, 27 and 33, and include all appropriate and allowable disclaimers to protect your client.⁹³ There are a number of quality resources that can help you with this process.⁹⁴

Whatever form you choose, it is crucial in FPRs based on franchisor-owned or affiliate-owned units that you disclose how these units may differ materially from the franchised units being offered.⁹⁵ For example, a franchisee may be required to pay royalties and other fees to the franchisor that franchisor-owned or affiliate-owned units are not required to pay. You also need to make sure that your client can provide written substantiation for any FPR upon a prospective franchisee's reasonable request.⁹⁶ While a FPR can be comprehensive and include a complete pro forma of each franchisor-owned and affiliate-owned unit, a FPR also can be simple and include just average gross sales, or average gross sales, average cost of goods sold and average gross profits of the existing units. A franchisor has a fair amount of flexibility in determining the content of its FPR, as long as it has a "reasonable basis" and is not misleading.⁹⁷ While a prospective franchisee must be cautioned in Item 19 that its "individual financial results may differ from the results stated in the financial performance representation,"⁹⁸ we recommend that you confirm with your client that any FPR it includes in its FDD has the potential of being achieved by new franchisees either initially or over time, as applicable.

⁹¹ FTC FAQ 8.

⁹² 16 C.F.R. § 436.5(s)(3).

⁹³ 16 C.F.R. § 436.5(s); Franchise Rule Compliance Guide at 85-94; FTC FAQs 8, 27 and 33.

⁹⁴ See Hershman, *supra* note 63; Anne Connelly, Brian B. Schnell and Andrew Selden, *Financial Performance Representations – Shield or Sword?*, A.B.A. 31ST ANNUAL FORUM ON FRANCHISING, Tab W16 (2008); Joyce Mazero, Rebekah Prince and Peggy Shanks, *Advanced Financial Performance Representations: Preparing & Using FPR's*, INT'L FRANCHISE ASS'N 42ND ANNUAL LEGAL SYMPOSIUM, Ch. 7 (2009); Darrell Johnson, Kay Ainsley and F. Joseph Dunn, *Beyond Gross Sales: Creative Approaches to Financial Performance Representations*, INT'L FRANCHISE ASS'N 40TH ANNUAL LEGAL SYMPOSIUM, Ch. 18 (2007).

⁹⁵ 16 C.F.R. § 436.5(s)(3).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.* at § 436.5(s)(3)(iv).

Further, it is important to remember that, under the FTC Franchise Rule, cost and expense information does not constitute a FPR, unless it is “coupled with additional sales or earnings figures.”⁹⁹ This means that a franchisor can provide to a prospective franchisee average labor and rent costs of its affiliate-owned units, but may not provide average labor or rent costs as percentage of gross sales or gross profits unless this information is included in Item 19 of its FDD. In addition, blank pro forma do not constitute a FPR,¹⁰⁰ so your client may want to prepare one as an additional aid to prospective franchisees. You should ensure, however, that your client understands that they run the risk of turning a blank pro forma into a FPR if they assist a prospective franchisee in completing it or review and comment on it after it is completed.

Through the use of a FPR, cost and expense information and a blank pro forma, a start-up franchisor can at least provide some items to a prospective franchisee that will allow it to begin to assess the franchise being offered. While the preparation of a FPR may add to the cost and complexity of the FDD, it will likely help your client’s franchise sales. It may even be considered a necessity if your client is up against other franchisor competitors who have a FPR in their FDDs. In addition to the sales aspect, the inclusion of a FPR in your client’s FDD also may assist their franchisees in obtaining financing. Regardless of what you and your client decide regarding the FPR issue, we cannot over-emphasize the importance of educating the client as to the implications of this decision on the sales process.

U. Preparation of Agreements Other Than Franchise Agreement

While the franchise agreement is obviously the key document between a franchisor and its franchisees, there may be other agreements relating to the relationship you will need to prepare. For example, if your clients makes use of one or more of the of the multi-unit expansion options described in Section IV.C, you will be obligated to draft the appropriate agreements. In addition, depending on the nature of your client’s business, you may be required to create other documents including the following: technology-related agreements, leases/subleases, construction/renovation agreements, financing and security agreements, supply agreements, telephone number assignments, marketing co-op agreements, national account participation agreements, test agreements and management agreements.¹⁰¹ Most likely, all of these documents will need to be included as exhibits to the FDD and referenced in FDD Item 22.¹⁰² If you and your client elect to prepare and use any other agreements that will be signed before the franchise agreement, like letters of intent, commitment agreements, site selection agreements and franchise applications, be careful to draft them in a way that avoids the creation of a franchise relationship until intended, and does not violate any applicable disclosure and registration requirements.¹⁰³

⁹⁹ Franchise Rule Compliance Guide at 131; see also NASAA Commentary at 19.1.

¹⁰⁰ NASAA Commentary at 19.2.

¹⁰¹ See Nancy G. Gourley and David W. Koch, *The Other Contracts in the Franchise Relationship*, A.B.A. 29TH ANNUAL FORUM ON FRANCHISING, Tab W24 (2006).

¹⁰² 16 C.F.R. § 436.5(v).

¹⁰³ Kevin M. Shelley and Jonathan J. Toronto, *Preliminary Agreements: How to Avoid Unintended Contractual Obligations*, 25 FRANCHISE L.J. 47 (Fall 2005).

In addition to these documents, there may be other agreements that your client and its affiliates will enter into with other third parties, which relate to the franchise system. These agreements may include: IP license agreements, manufacturing agreements, approved supplier agreements, financing agreements and lease agreements.¹⁰⁴ While not required to be included as exhibits in your client's FDD, the existence and terms of these agreements may impact some of the information required to be disclosed.

V. Additional Trademark and IP-related Issues

As you get closer to finalizing your client's FDD, we recommend that you make sure its IP house is in order. At this stage, your client should have settled on the primary trademark or trademarks to be used in the franchise system and filed applications with the USPTO for these trademarks. Remember that if a primary trademark has not been registered with the USPTO, your client must include a specific disclaimer in Item 13 of its FDD.¹⁰⁵ You also may want to consider whether other disclosures are in order if your client's primary trademark is not simply a word mark, but a logo containing a word mark. Further, we suggest that you confirm with your client that all necessary trademark license agreements have been signed by the franchisor and its affiliates so that the trademark ownership and licensing structure described in Item 13 reflects the true ownership of the trademarks. Trademark assignments should also be filed with the USPTO, as appropriate.

In addition to your client's trademarks, we recommend that you inquire as to the status of any other IP that is critical to the franchise concept, like patents, copyrights or trade secrets. As with trademarks, you will want to check on applicable registrations and what steps your client has taken to protect these items. You also will want to confirm that the disclosure in Item 14 of your client's FDD regarding these items is accurate, including the ownership and licensing structure.

V. FINAL MEETINGS AND PREPARATIONS

At this point in the process, you are in the home stretch. The purpose of the final meetings and exchanges are to fine-tune and finalize the FDD, and prepare for the submission of the initial filings. While these topics are the focus of other programs and papers (as referenced below), we offer a few insights.

A. Finalizing the FDD

It is your role as the franchise attorney to make sure that, based on the information provided, the FDD includes all of the disclosures required under the FTC Franchise Rule and applicable state law, including state-specific risk factors and cover pages.¹⁰⁶ Although it is

¹⁰⁴ See Gourley, *supra* note 101.

¹⁰⁵ 16 C.F.R. § 436.5(m)(4).

¹⁰⁶ See Joseph J. Fittante, Susan Meyer and Craig Tregillus, *Fundamentals 201: Drafting a Disclosure Document*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W3 (2009); Robert Sawyer, Jr., Joseph Nugent and Maureen O'Brien, *Disclosure (Under the Revised FTC Franchise Rule and State Franchise Disclosure Laws)*, INT'L FRANCHISE ASS'N 42ND ANNUAL LEGAL SYMPOSIUM, Ch. 30 (2009); Judith M. Bailey and Dennis E. Wiczorek, *Franchise Disclosure Issues*, in *Fundamentals of Franchising*, 95-132 (Rupert M. Barkoff and Andrew C. Selden, eds., 3d ed. 2008).

common sense, we suggest that you have the CEO or other key officer of your client review the final version of the FDD and its exhibits, and verify that is complete and correct, as further described in Section IV.K. While your client may generally begin using its multi-state FDD to offer franchises in non-registration states once finalized, make sure it understands that you may want/need to revise the FDD based on comments you receive from state examiners. This is especially true for start-up franchisors filing for the first time.

B. Reviewing Financial Statements and Accountant's Consents

By the time you are finalizing the FDD, you will likely have had contact with your client's accountant to make sure the accountant will be able to provide the appropriate audited financial statements. Most accountants will want to review your client's FDD before providing their consent, although we have found that the extent of the review and length of time necessary to complete it varies. Be sure that you or your client discusses this issue with the accountant so you can plan accordingly. You should also confirm that the accountant will provide a consent in a form that will be acceptable to the registration states.¹⁰⁷

Oftentimes the audited financial statements and accountant's consent are the last pieces needed before submitting filings. We recommend, however, that you take the time once you receive them to ensure they are consistent with your and your client's expectations, and the related disclosures in FDD Items 8, 20 and 21. Although not mandated under the FTC Franchise Rule, keep in mind that some franchise registration states require the inclusion of unaudited, interim financial statements if your client's initial filing is more than 90 or 120 days after its most-recent fiscal year end.¹⁰⁸

C. Submission of State Filings

Your client's initial development plan will dictate the states in which you will need to prepare and submit filings. Obviously, if your client wants to offer and sell franchises within or to residents of the 14 franchise registration/notice states,¹⁰⁹ you will need to submit initial registration or notice filings in these states. Keep in mind that most of these states require you to file franchise seller disclosure forms for each franchise seller who is offering and selling franchises in that particular state. In addition, seven of these states require the filing of certain franchise advertising before the franchisor uses it.¹¹⁰ Most likely, your client will also be required

¹⁰⁷ For a proposed form document, see NASAA FDD Guidelines at Form F.

¹⁰⁸ See, e.g., 815 ILL. ADMIN. CODE § 200.603 (2002); MD. CODE REGS. § 02.02.0812 (1998).

¹⁰⁹ CAL. CORP. CODE § 3100, *et seq.* (2008); HAW. REV. STAT. § 482E-1, *et seq.* (2008); 815 ILL. REV. STAT. § 705/1, *et seq.* (2009); IND. CODE § 23-2-2.5-1, *et seq.* (2008); MD. CODE ANN. § 14-201, *et seq.* (2010); MICH. COMP. LAWS § 445-1501 (1989); MINN. STAT. § 80C.01, *et seq.* (2006); N.Y. GEN. BUS. LAW § 680, *et seq.* (1989); N.D. CODE 51-19-01 (2001); R.I. GEN. LAWS § 19-28-1.1 (1989); S.D. LAWS § 37-5B-1 (2008); VIR. CODE § 13.1-557 (2009); WASH. CODE § 19-100-010 (1994); and WIS. STAT. § 553.01 (2008). For more information on state registration requirements, see Joseph J. Fittante, Theresa Leets and Rebekah K. Price, *Unique and Often Overlooked Provisions of State Franchise Registration and Disclosure Laws*, A.B.A. 33RD ANNUAL FORUM ON FRANCHISING, Tab W10 (2010); Dale E. Cantone, Halima Madjid and Leonard D. Vines, *Best Practices for State Franchise Registration*, A.B.A. 32ND ANNUAL FORUM ON FRANCHISING, Tab W8 (2009); David Kaufmann, Timothy O'Brien and Theresa Leets, *Registration: How to Swiftly Secure Initial, Amendment and Renewal Disclosure Document Registrations*, INT'L FRANCHISE ASS'N 42ND ANNUAL LEGAL SYMPOSIUM, Ch. 29 (2009); Rochelle B. Spandorf and Mark B. Forseth, *Franchise Registration, in Fundamentals of Franchising*, 125-81 (Rupert M. Barkoff and Andrew C. Selden, eds., 3d ed. 2008).

¹¹⁰ See CAL. CORP. CODE § 31156 (2008); MD. CODE ANN. § 14-225; MINN. STAT. § 80C.09 (2006); N.Y. CODE § 200.9 (2002); N.D. § 51-19-10 (2001); R.I. GEN. LAWS § 19-28.1-12 (2009); and WASH. CODE § 19.100.100 (1994).

to submit one-time exemption notice filings in Kentucky, Nebraska and Texas,¹¹¹ and annual exemption notice filings in Florida and Utah,¹¹² before selling franchises in these states. Further, if your client does not have a federally registered trademark, you may need to comply with certain additional disclosure or registration requirements under other business opportunity laws, including Connecticut, Georgia, Louisiana, Maine, North Carolina and South Carolina.¹¹³

D. Providing General Franchise Sale Compliance Training and Tools to Start-up Franchisor

After bringing your start-up franchisor client through the franchise development process, you should set it on the right path as it begins selling franchises. Accordingly, we strongly urge you to build into your representation some general franchise sales compliance training for your client's franchise sellers, including such basics as the timing of disclosure, method of disclosure (electronic or otherwise), collection of receipts, document retention requirements, limitations on use of FPRs and the ongoing duty to update the FDD. As part of this training, we recommend that you equip your client with charts, checklists, forms and other tools to help them stay organized and comply with ongoing disclosure and registration requirements.¹¹⁴

VI. CONCLUSION

Developing a start-up franchise program is a complex and multifaceted process, requiring the considerable legal and organizational skills of franchise counsel. As the scope of the process reveals, client involvement, as well as the inclusion of other professionals (accountants, franchise consultants, knowledgeable management), is essential. Directing and coordinating the franchise development team to produce a workable, saleable and sustainable system falls to franchise counsel. Start by learning as much as possible about the client's business and determine how best to duplicate and translate its core business into a thriving franchise system.

We have outlined and discussed the essential considerations from start to finish. There is no substitute for the hands-on experience of working with a number franchise start-ups, but we have endeavored to offer a detailed roadmap for the first-time practitioner while also offering enough substance for experienced counsel. Despite the endless possibilities of the application of the franchise model to innumerable business concepts, there is much guidance to be found. We only hope to have added to this excellent body of work in a meaningful way.

¹¹¹ KEN. REV. STAT. ANN. § 367,807 (1996); NEB. REV. STAT. § 59-1722 (2003); and TEX. BUS. & COM. CODE § 51.003(b)(8) (2009).

¹¹² FLA. STAT. § 559.802 (2009).

¹¹³ CONN. GEN. STAT. ANN. § 36b-60, *et seq.* (2009); GA. CODE ANN. § 10-1-410, *et seq.* (2002); LOU. REV. STAT. ANN. § 1821, *et seq.* (2001); ME. REV. STAT. ANN. tit. 36, § 4691, *et seq.* (1991); N.C. GEN. STAT. § 66-94, *et seq.* (2003); and S.C. CODE ANN. § 39-57-10, *et seq.* (2009).

¹¹⁴ See Susan Grueneberg and Dawn Newton, *Best Practices For Establishing a Franchise Compliance Program*, A.B.A. 33RD ANNUAL FORUM ON FRANCHISING, Tab W19 (2010).

APPENDIX A

Franchise Program Development Questionnaire¹

For Use By

("Franchisor")

Date: _____

GENERAL INFORMATION

1. Name and telephone number of the person primarily responsible for strategic planning and development of the company's franchising program:

Name: _____

Title: _____

Phone: _____

Fax: _____

2. Meeting Schedule

A. Date: _____ Time: _____

Place: _____

Purpose: _____

Persons Attending: _____

¹ Based on a document provided by Max Schott, II and Gray Plant Mooty.

FRANCHISOR AND RELATED ENTITIES

3. Legal name of the Franchisor: _____

4. Franchisor's address: _____

5. Franchisor's telephone: (____) _____

6. Franchisor's facsimile: (____) _____

7. Franchisor's e-mail Address: _____

8. Has the Franchisor been formed (either as a corporation, limited liability company (LLC) or other entity)?.....Yes ___ No ___

A. Date of formation _____

B. State of formation _____

C. Please provide copies of the Articles of Incorporation/Organization, Bylaws, Minutes of meetings of Shareholders and Directors and shareholder ledger or any other applicable entity formation documentation.

D. Please provide a diagram of the structure of the Franchisor entity. If the Franchisor is the parent company, please provide a list of shareholders/members and the wholly-owned subsidiaries of the franchisor. If the Franchisor is a wholly-owned subsidiary, please provide the names of intervening subsidiaries up to the holding company and a list of all subsidiaries of the holding company. Please include the names of shareholders/members of the parent company.

9. Have the Franchisor's outside accountants reviewed the proposed structure of the Franchisor?Yes ___ No ___

Comments _____

10. Does the operating company have at least 3 years of audited financial statements?Yes ___ No ___

Comments _____

11. What is the target effective date for the franchise program? _____

12. Describe the Franchisor’s other business activities (if any):

Comments _____

13. Description of Founder/Predecessors:

A. Describe the individual or entity (referred to as a “predecessor”) that founded the concept (if other than the Franchisor), the date the concept was founded and the date of any subsequent transfer of assets related to the concept:

Comments _____

B. Identify any other individual or entity that, within the past 10 years, has owned a majority of the assets representing the concept (including date of acquisition of assets and sale of assets and current status of each such entity or individual):

Comments _____

14. Prior business experience of the Franchisor and related entities:

A. Describe the length of time the Franchisor has conducted a business of the type that the Franchisee will operate. _____

B. Describe the length of time each predecessor or any affiliated entity has conducted a business of the type that the Franchisee will operate. _____

C. Has the Franchisor or any related entity of offered franchises in any similar or other line of business?

..... Yes ___ No ___

15. Will Franchisor’s Parent guarantee the obligation of Franchisor or does Franchisor have an affiliate that has offered or sold franchises in any line of business within the last 10 years? Yes ___ No ___

16. We will need to disclose certain litigation information involving any of the following individuals: the Franchisor; the Franchisor’s parent; the Franchisor’s affiliates; the Franchisor’s predecessor; and the Franchisor’s officers, directors or individuals with management responsibility relating to the franchisees (the “Parties”). As part of this questionnaire, we are asking for more information than may need to be disclosed but we want to get an accurate picture to ensure that we make proper disclosures.

- A. Pending Litigation. Are any of the Parties:
- (1) A defendant in a pending criminal action?..... Yes ___ No ___
 - (2) A defendant to a counterclaim in any pending civil matter? Yes ___ No ___
 - (3) A party to a pending administrative action?..... Yes ___ No ___
- B. Past Litigation. Are any of the Parties:
- (1) Been convicted of a felony? Yes ___ No ___
 - (2) Pleaded nolo contendere to a felony?..... Yes ___ No ___
 - (3) Been held liable in a civil action? Yes ___ No ___
 - (4) Been the named party or the subject of a complaint?..... Yes ___ No ___
 - (5) Been the subject of other legal proceedings? Yes ___ No ___
- C. Administrative Actions. Are any of the Parties:
- (1) Subject to any currently effective injunctive or restrictive order or decree relating to franchises?..... Yes ___ No ___
 - (2) Subject to any currently effective injunctive or restrictive order or decree under any federal, state or Canadian franchise, securities, antitrust, trade regulation or trade practice law as a result of a concluded or pending action or proceeding brought by a public agency? Yes ___ No ___
- D. Within the last year, have any of the Parties been a party to a civil action involving a franchise relationship? Yes ___ No ___
- E. If the answer to any of the questions in A, B, C or D above is "Yes," please provide the following information:
- (1) Court, arbitration office or public agency in which action filed:

 - (2) Date of filing: _____
 - (3) Docket number: _____
 - (4) General nature of claims asserted: _____

- (5) Relationship to defendant or party bringing the action (e.g., former franchisee, supplier, etc.): _____

- (6) For pending actions, describe current status: _____

- (7) For actions no longer pending, please provide the disposition of the case, including the terms of settlement. _____

- (8) For orders or decrees, please summarize the nature, terms and conditions of the order or decree: _____

Note: You may be asked to provide copies of the pleadings. If there is a lot of information to report please contact us directly rather than filling out E.

TRADEMARKS AND SERVICE MARKS

- 17. Name Franchisee will use for the franchised business: _____

- 18. Is this name a currently registered trademark or service mark? Yes ___ No ___
 If yes, please provide us with a copy of the certificate(s) of registration with the United States Patent and Trademark Office (“USPTO”) and any Secretaries of State.
- 19. List any other trademarks, service marks and/or logos owned by the Franchisor that are registered with the USPTO or any Secretary of State. _____

FRANCHISEE

- 20. What will we call the Franchisee in the Franchise Agreement (e.g., Franchisee, You, Licensee, etc.)? _____

FRANCHISE PRODUCT/SERVICES

21. What products or services will the Franchisee provide? Please describe the franchised business _____ in _____ detail:

22. Describe the general market for the products or services that the Franchisee will offer (for example, is the market developed or developing? Will the goods be sold primarily to a certain group of customers? Are sales seasonal?).

23. Provide a general description of the competition for the goods and services offered.

TERRITORY

24. Will the Franchisee receive a single location from which it will be authorized to operate the franchised business? Yes ___ No ___
If no, describe where the franchisee will be authorized to operate: _____

25. Will the Franchisee receive a protected territory in which to operate the franchised business? Yes ___ No ___
If yes, please answer Items A-E below:
- A. How will the protected territory be defined?
- (1) Radius _____
 - (2) Population _____
 - (3) Competition _____
 - (4) Potential Customers _____

- (5) Statistical Market Area _____
- (6) Designated Market Area _____
- (7) Number of Businesses _____
- (8) Other _____

- B. Will the Franchisee have the right to open more than one location within the territory? Yes ___ No ___
- C. Will the Franchisee have the right to relocate within the territory .. Yes ___ No ___
- D. Will there be a fee payable by the Franchisee for relocation..... Yes ___ No ___
If yes, amount: \$ _____
- E. Will there be any minimum sales requirements or other conditions to maintain exclusivity of the protected territory Yes ___ No ___
Please describe conditions: _____

If yes, please see Royalty Fees on page 10 and add these minimums

FRANCHISOR'S RIGHTS TO DISTRIBUTE PRODUCTS/SERVICES

- 26. Will the Franchisor have the right to sell and/or distribute any products or services to anyone other than the Franchisee? Yes ___ No ___

If yes, please answer Items A-D below:

- A. What products or services? _____
- B. To whom and in what area(s)? _____
- C. Under what name(s)? _____
- D. Will the Company be competing with the Franchisee? _____

E. Will the Company use other franchisees to sell products and/or services?
Please describe: _____

27. Will the Company have any of the following:

Infomercials _____ Mail Order Catalog _____

Internet Marketing _____ Special Promotions _____

Other (describe below)

TERM/FRANCHISEE'S OPTION TO RENEW

28. What will be the length or term of the Franchise Agreement? _____

29. If the term of the lease for the franchised location is longer than the term of the Franchise Agreement, will the term of the Franchise Agreement be extended to coincide? Yes ___ No ___

30. Will the Franchisee have the option to renew the franchise at the end of the term? Yes ___ No ___

If yes, will there be conditions?

If yes, please answer Items A-F:

A. Will the Franchisee have to pay a fee to the Franchisor to reacquire the franchise?..... Yes ___ No ___

If yes, amount: \$ _____

B. Will the Franchisee be required to sign the then-current Franchise Agreement? Yes ___ No ___

C. Will the Franchisee be required to pay the Royalty Fee in the then-current Franchise Agreement?..... Yes ___ No ___

If no, will the Franchisee pay the existing fee or will the new fee be limited to a percentage increase over the existing fee? If a percentage, how much? _____

D. Will the Franchisee be required to pay the Advertising or Marketing Fee in the then-current Franchise Agreement?..... Yes ___ No ___

E. Will the Franchisee be required to pay new fees in the then-current Franchise Agreement not previously paid by the Franchisee in the old Franchise Agreement?.....Yes ___ No ___

F. Will the Franchisee be required to modernize the Business?.....Yes ___ No ___

If yes, please describe: _____

G. Must the Franchisee sign a release as a condition to renewal?....Yes ___ No ___

INITIAL FEE

31. What is the amount of the Initial Fee payable to the Franchisor by the Franchisee? _____

32. If the Initial Fee is a variable based on population or some other criteria, how will it be determined?
.....

33. The Initial Fee is due to the Franchisor:
When the Franchise Agreement is signed _____ When the franchisee opens the franchised business _____

Installments (describe) _____

34. Will the Initial Fee, or any part of the Initial Fee, be refundable to the Franchisee? Yes ___ No ___

If yes, what amount of the Initial Fee will be refundable? _____

If yes, under what circumstances will the Initial Fee be refundable:

Failure to complete training _____

Financial/personal misrepresentation _____

Failure to secure a site for the franchised location _____

If so, within what time period _____

Failure to open within a certain period _____

If so, within what time period _____

How will the amount of the refund be determined? _____

ROYALTY FEE

35. What amount will the Franchisee be required to pay to the Franchisor on a continuing basis?

A. Fixed Fee Amount: _____

B. Percentage of Gross Sales: _____%

(1) Will the Royalty Fee increase during the term of this Agreement?
.....Yes ___ No ___

(2) Will the Royalty Fee be dependent upon Gross Sales volume? (e.g. Royalty Fee decreases at certain sales levels)? Yes ___ No ___

36. Will the Franchisee be required to pay the Franchisor a minimum Royalty Fee? Yes ___ No ___

If yes, then amount: \$_____ per _____

37. When will the Royalty Fee be payable?

Monthly _____ define _____

Weekly _____ define _____

Other _____ define _____

38. Will the minimum Royalty Fee be payable from the date the business opens for operation?..... Yes ___ No ___

If no, please indicate when minimum Royalty Fee payments will begin: _____

39. What is the due date of the Royalty Fee payments? (for example, the first of the month, Wednesday of each week, etc.) _____

40. How will the Royalty Fee be paid?

Check _____ Credit Card _____

Electronic transfer _____ Other _____

41. Will the Franchisee be required to pay the Franchisor a service charge for failure to remit Royalty Fees? Yes ___ No ___

If yes, indicate amount of service charge: _____

42. Will the Franchisee be required to pay the Franchisor interest fees for late remittance of Royalty Fees? Yes ___ No ___

If yes, indicate interest rate: _____

ADVERTISING/MARKETING FEE

43. Will the Franchisor charge an Advertising or Marketing Fee to the Franchisee? Yes ___ No ___

A. Amount of Advertising/Marketing Fee:

(a) Fixed Fee Amount: _____

(b) Percentage of Gross Sales: _____%

(c) With Maximum of: _____%

B. How should we refer to this Fee (Advertising, Marketing, NMF, etc.)? _____

C. Describe how and for what the Advertising/Marketing Fee will be spent by the Franchisor: _____

D. When will the Advertising/Marketing Fee be payable?

Monthly _____ define _____

Weekly _____ define _____

Other _____ define _____

E. What is the due date of the Advertising/Marketing Fee payments (for example, the first of the month, Wednesday of each week, etc.)? _____

- F. How will the Advertising/Marketing Fee be paid?
 Check _____ Credit Card _____
 Electronic transfer _____ Other _____
- G. Will the Franchisee be required to pay the Franchisor a service charge for failure to remit Advertising/Marketing Fees? Yes ___ No ___
 If yes, indicate amount of service charge: _____
- H. Will the Franchisee be required to pay the Franchisor interest fees for late remittance of Advertising/Marketing Fees? Yes ___ No ___
 If yes, indicate interest rate: _____
- I. Will the Franchisor commit to spending part of the Advertising/Marketing Fee in the Franchisee's market? Yes ___ No ___
 (1) How much: _____
 (2) For what type of advertising: _____

- J. Will the Franchisor provide the Franchisee with an annual audit or statement of the expenditures made from the Advertising/Marketing Fund? Yes ___ No ___
44. Will the Franchisee be required to participate in and contribute to a local advertising cooperative? Yes ___ No ___
- A. Amount of the Franchisee's contribution:
 (1) Fixed Fee Amount: _____
 (2) Percentage of Gross Sales: _____
- B. Will the Franchisee receive credit toward the Advertising/Marketing Fee payment to the Franchisor by contributing to the local advertising cooperative?
- C. Frequency of payments to the local advertising cooperative:
 Monthly _____ define _____
 Weekly _____ define _____
 Other _____ define _____

D. Due date of the Franchisee's contribution to the local advertising cooperative:

45. Is the Franchisee required to spend an additional minimum amount toward local advertising?..... Yes ___ No ___

If yes, indicate amount per period: \$_____ per _____

46. Will the Franchisee be required to spend a minimum amount for grand opening of the franchised business? Yes ___ No ___

If yes, indicate amount: \$_____

47. Will the Franchisee be required to use approved or designated media plan or media vendor? Yes ___ No ___

If yes, please describe: _____

48. Will the Franchisee be required to advertise in the yellow pages, white pages and/or on the Internet? Yes ___ No ___

If yes, under what listing(s) or URLs?:

INITIAL INVESTMENT OF FRANCHISED BUSINESS

49. Provide a range for the Franchisee's travel and living expenses for the initial training program:

50. Provide a range of expenses for real estate acquisition (land and building if applicable):

51. Provide a range of expenses for interior and exterior signs for the franchised business: _____

52. Describe the type and range of expenses for miscellaneous opening costs (for example, legal fees, accounting fees, and licenses):

53. Provide a range of expenses for the opening inventory of the Franchised business:

54. Provide a range of expenses for insurance premiums:

55. Provide a description and a range of expenses for leasehold improvements:

56. Provide a description and a range of expenses for equipment and supplies:

57. Provide a range of expenses for a Computer (POS) System:

58. Provide a range of expenses for opening advertising and promotion:

59. Provide a description and a range of expenses for other pre-opening related items:

60. Provide an estimated range of expenses needed to operate the franchised business for a minimum period of three months after store opening, and identify the types of expense likely incurred:
- _____
- _____
- _____
61. Will you require the franchisee to have minimum capital requirements? Yes ___ No ___
- If yes, in what amounts?:
- _____

SITE SPECIFICATION, BUILDING PLANS AND SPECIFICATIONS

62. Will the Franchisor provide building plans and specifications to the Franchisee? Yes ___ No ___
63. Will the Franchisor approve building plans and specifications prepared by the Franchisee? Yes ___ No ___
64. Will the Franchisor provide construction standards and specifications? ... Yes ___ No ___
65. Will the Franchisee be required to retain a licensed architect? Yes ___ No ___
66. Will the Franchisor provide site selection assistance? Yes ___ No ___
- If yes, please describe: _____
- _____
67. Is a site evaluation or feasibility study by a qualified third-party required? Yes ___ No ___
- If yes, who will be responsible for payment? _____

SIGNS

68. Are signs leased or purchased from the Franchisor? Yes ___ No ___
69. Does the Franchisor provide sign specifications and/or names of approved suppliers for the signs to the Franchisee? Yes ___ No ___
- If yes, please provide a copy of the sign specifications.

TRAINING

70. Will the Franchisor provide initial training for the Franchisee?..... Yes ___ No ___

If yes, please answer Items A-F below:

A. Who must attend training?

Franchisee _____

General/Store Manager _____

Other _____

B. Where will training take place? _____

C. When will training take place? _____

D. How long will the training program be? _____

E. What topics will be covered during training (classroom and on-the-job)? _____

We must develop and include in the FDD a chart that summarizes the training program as follows:

Subject	Hours of Classroom Training	Hours of On-the-Job Training	Location

F. Will the Franchisee be required to pay for any or all of the costs associated with its employees attending the initial training program? Yes ___ No ___

If yes, check those costs payable by the Franchisee:

Travel _____ Salaries _____

Lodging _____ Fringe Benefits _____

Other Expenses (describe) _____

71. Will other Franchisees assist or be involved in training? Yes ___ No ___
72. Will new management personnel subsequently hired by the Franchisee attend the Franchisor's training program? Yes ___ No ___
73. Will the Franchisor charge a training fee for new management personnel? Yes ___ No ___
- If yes, amount: \$ _____

OPENING ASSISTANCE

74. What type of initial opening assistance will be provided to the Franchisee? _____
75. Will the Franchisor furnish a representative to provide opening assistance at the Franchised Location? Yes ___ No ___
- If yes, please answer Items A-B below:
- A. How long will representative stay at the Franchised Location? _____
- B. Will the Franchisee be required to pay travel costs and living expenses for Franchisor's representative? Yes ___ No ___
76. Will the Franchisor provide a grand opening promotional package? Yes ___ No ___
- If yes, please answer Items A-B below:
- A. What will the initial opening package include:
- | | |
|----------------------|------------------------------|
| Signs _____ | Gift Certificates _____ |
| Coupons _____ | Direct Mail Pieces _____ |
| Press Releases _____ | Other (describe below) _____ |
- _____
- _____
- B. Will the Franchisee be required to pay the Franchisor for a grand opening promotional package? Yes ___ No ___
- If yes, amount: \$ _____

77. What types of on-going assistance will be provided by the Franchisor to the Franchisee?

List of necessary products and equipment	_____	Basic accounting and business procedures	_____
List of approved suppliers	_____	Visits to Franchised Location	_____
Updates to Manuals	_____	Written reports regarding Franchisee's performance and conformity within the business system	_____
Other (describe below)	_____		_____

78. Will the Franchisor provide additional assistance to the Franchisee on a consulting basis for a fee? Yes ___ No ___

If yes, amount of fee: \$_____ per _____

STANDARDS

79. Does the Franchisee need to obtain pre-approval for all of its advertising? Yes ___ No ___

80. Will the Franchisee be limited to whom it may offer its services? Yes ___ No ___

If yes, please describe limitations: _____

81. What written materials will the Franchisor provide to the Franchisee to define quality control, uniformity and standards? _____

82. Is the Franchisee required to purchase any products or services from sources designated by the Franchisor?..... Yes ___ No ___

If yes, please complete Items A-B:

A.	<u>Description of Product or Service</u>	<u>Name of Manufacturer/Vendor/Supplier</u>
	_____	_____
	_____	_____
	_____	_____

B. Will the Franchisor derive any income from the designated manufacturer, vendor or supplier (the "Vendor")? Yes ___ No ___

If yes, please state the name of the Vendor and source of the income (e.g. marketing rebate, volume discount, advertising rebate): _____

83. Has the Franchisor developed any proprietary software specifically for use in operating the Franchisee's business?..... Yes ___ No ___

If yes, please answer Items A-B below:

A. Will the Franchisee be required to enter into a Software License Agreement? If yes, will Franchisor sign the Software License Agreement with Franchisor ___ Third Party ___

B. Will the Franchisee be required to pay a Software License Fee to the Franchisor or a third party? Yes ___ No ___

If yes, amount: \$_____ Payable to: _____ Date payable _____

C. Does Franchisor own the software?.....Yes ___ No ___

84. Will the Franchisee's employees be required to wear uniforms? Yes ___ No ___

85. Will the Franchisee's employees be required to sign confidentiality agreements?..... Yes ___ No ___

86. Will the Franchisee be required to obtain the Franchisor's approval before any jukeboxes, video games, vending machines, gambling devices, lottery tickets, pull tabs or other similar devices are used or sold at or near the Franchised Location?..... Yes ___ No ___

87. Will the Franchisee's employees be prohibited from smoking and drinking alcohol at or near the Franchised Location?..... Yes ___ No ___

88. Will alcoholic beverages be served on the premises of the Franchised Location? Yes ___ No ___
89. Will the Franchisee be allowed to sell promotional or other items which display the licensed Marks? Yes ___ No ___
- If yes, list the types of items that the Franchisee will be allowed to sell (e.g., t-shirts, mugs, etc.): _____
- _____
- _____
90. Will the Franchisee be required to obtain a security system for its Business? Yes ___ No ___
91. Will the Franchisee be allowed to play only approved music selections at its Business?..... Yes ___ No ___
92. When the Franchisee's Business is not open for business, will the Franchisee be required to utilize an answering service or an answering machine? Yes ___ No ___
93. Will the Franchisee be required to obtain cable, internet or other such equipment for the reception of certain programming at the Franchised Location?
94. Will the Franchisee be required to have access to cable or satellite television at the Franchised Location? Yes ___ No ___
95. What business hours will the Franchisee be required to recognize? _____
- _____
96. Will the Franchisor reserve the right to inspect the Franchisee's premises? Yes ___ No ___
- A. If yes, will Franchisor give Franchisee a notice period?.....Yes ___ No ___
- B. If yes, how long is the notice period? _____ days

97. What special equipment will the Franchisor require?

Computer	_____	800 telephone lines	_____
Software	_____	Fax machines	_____
Dedicated telephone lines	_____	ISDN/cable lines	_____
Other technology (describe below)	_____		_____

98. Are there any other uniformity requirements? _____

SPECIAL LICENSES

99. Do any special licensing requirements have to be met by the Franchisee? Yes ___ No ___

Insurance licenses	_____
Real estate licenses	_____
Environmental licenses	_____
Liquor licenses	_____
Other licenses (describe)	_____

INSURANCE

100. Which of the following insurance requirements will apply to the Franchisee?

A. General Liability Insurance in the amount of _____

B. Automobile Insurance in the amount of _____

- C. Errors and Omissions Insurance in the amount of _____
- D. Property Insurance in the amount of _____
- E. Business Interruption Insurance in the amount of _____
- F. Theft Insurance in the amount of _____
- G. Building Insurance in the amount of _____
- H. Umbrella Liability Insurance in the amount of _____
- I. Other (describe): _____

LEASE

- 101. Will the Franchisor approve the Lease for the Franchised Location? Yes ___ No ___
- 102. Will the Franchisor retain the right to assume the Lease if, prior to expiration of the Lease, the Franchisee is evicted or the Franchise Agreement expires or is terminated? Yes ___ No ___
- 103. Will the Lease for the franchised location be pledged as security for the Franchise Agreement? Yes ___ No ___

FINANCIAL STATEMENTS

- 104. Will the Franchisee be required to provide the Franchisor with financial statements for the Franchisee's Business? Yes ___ No ___
 If yes, please answer Items A-D below:
 - A. How often? _____
 - B. Describe information that must be contained in the financial statements: _____

 - C. Will the financial statements provided by the Franchisee need to be certified by an independent CPA? Yes ___ No ___
 - D. Due date of financial statements: _____
- 105. Will the Franchisee be required to provide the Franchisor with copies of the Franchisee's income tax returns, sales tax returns and/or payroll tax returns? Yes ___ No ___

- 106. Will the payment of fees by pre-authorized bank transfers be provided for in the Franchise Agreement? Yes ___ No ___
- 107. If an audit by the Franchisor reveals that the Franchisee has understated its Gross Revenues by more than ___% or \$_____ in a _____ month period, then the Franchisee must reimburse the Franchisor for all costs incurred by the Franchisor as a result of the audit.

FRANCHISOR’S RIGHT OF FIRST REFUSAL

- 108. Prior to the sale of the Business to a third party, will the Franchisor reserve the right of first refusal to purchase the Franchisee’s Business? . Yes ___ No ___
- 109. If the Franchisee ceases to operate the Business, will the Franchisor have a right of first refusal to purchase the assets of the franchised business? Yes ___ No ___

Comments _____

ASSIGNMENT

- 110. Will the Franchisee be required to pay a transfer fee to the Franchisor upon assignment of the Franchise Agreement? Yes ___ No ___
 If yes, indicate amount: \$_____
- Does this amount include training?..... Yes ___ No ___
- Is training mandatory?..... Yes ___ No ___
- 111. Will Franchisor have the option to require the assignee-franchisee to sign a new franchise agreement? Yes ___ No ___
- 112. Upon the death or disability of the Franchisee, will Franchisor have the right to manage the Business until the Franchise Agreement is assigned?Yes ___ No ___
- 113. Will Franchisor have a right of first refusal if Franchisee sells the Business? Yes ___ No ___

TERMINATION BY FRANCHISOR

114. List any grounds for termination that are unique to the franchised business? _____

115. What is the length of time that the Franchisee will be allowed to cure most breaches?
_____ days
116. What is the length of time that the Franchisee will be allowed to cure for failure to pay fees?
_____ days
117. Will the Franchise Agreement be subject to immediate termination by the Franchisor if not precluded by applicable law? Yes ___ No ___
-
-

TERMINATION BY FRANCHISEE

118. Will the Franchisee have the right to terminate the Franchise Agreement?
..... Yes ___ No ___
- If yes, please answer Items A-B below:
- A. Under what circumstances? _____

- B. What is the length of time that the Franchisor will be allowed to cure for breaches?
_____ days
-
-

FRANCHISEE'S OBLIGATIONS UPON TERMINATION

119. Upon termination of the Franchise Agreement, the Franchisee must pay all fees due to the Franchisor within _____ days.

120. Describe required modifications to the Franchised Location upon termination of the Franchise Agreement:
-
-
121. Will Franchisor own the customer data during the term of the Franchise Agreement? Yes ___ No ___
122. Will the Franchisee be required to transfer to the Franchisor (or its assignee) the customer lists of the Business? Yes ___ No ___
123. Will the Franchisee be required to transfer to the Franchisor (or its assignee) the telephone numbers and directory listings of the Business? Yes ___ No ___
-
-

COVENANTS NOT TO COMPETE

124. During the term of the Franchise Agreement, will the Franchisee be prohibited from engaging in any business similar to the Franchised Business? Yes ___ No ___
125. After termination or expiration of the Franchise Agreement, will the Franchisee be prohibited from engaging in any business similar to the Franchised Business?..... Yes ___ No ___

If yes, please answer Items A-B below:

- A. During what period of time will the Franchisee be restricted? _____
-
- B. What reasonable mile radius from an existing franchised business will the Franchisee be restricted? _____ miles

126. Will Franchisor prohibit Franchisee from employing or seeking to employ any person employed by us or any other franchisee ? Yes ___ No ___
- If yes, during what period of time?
-

DISPUTE RESOLUTION

127. All litigation will be venued in which County and State: _____

128. The terms of the Franchise Agreement will be governed by the laws of the State of:

129. Will the Franchise Agreement contain a nonbinding mediation provision? Yes ___ No ___

130. Will the Franchise Agreement contain an arbitration provision? Yes ___ No ___

If yes, please answer Items A-C below:

A. In which city and state will the arbitration take place? _____

B. Which disputes would not be subject to arbitration? _____

C. Will the Arbitration provisions prohibit the Franchisee from participating in any class action against the Franchisor? Yes ___ No ___

DEFINITIONS

131. Define Gross Revenues: _____

132. Define any terms addressed in the Franchise Agreement that are unique to the franchised business:

A. _____

B. _____

C. _____

D. _____

Franchise Development Team

(include key company personnel, accountants, lawyers, consultants, etc.):

Name/Title

Name/Title

Company

Company

Address

Address

City State Zip

City State Zip

Telephone No. Fax No.

Telephone No. Fax No.

Name/Title

Name/Title

Company

Company

Address

Address

City State Zip

City State Zip

Telephone No. Fax No.

Telephone No. Fax No.

Name/Title

Name/Title

Company

Company

Address

Address

City State Zip

City State Zip

Telephone No. Fax No.

Telephone No. Fax No.

I confirm that the information in this questionnaire is correct to the best of my knowledge.

[NAME OF FRANCHISOR]

Signature

Printed Name

Title
[OFFICER OR DIRECTOR OF FRANCHISOR]

Date

APPENDIX B

Franchisee Application / Questionnaire¹

**Request for Information From
Potential Franchise Candidate**

XYZ FRANCHISE, INC.

Contact Information:

Joe Franchisor
(888) XXX-XXX
franchise@xxxxx.com.

¹ Based on document provided by Jim Meaney. As with all form documents, you are cautioned to review and analyze applicable law (particularly those relating to privacy, data collection, security and credit reporting, which are ever-changing) to ensure that the document your client is using is in compliance.

FRANCHISE EVALUATION PROCEDURE

XYZ FRANCHISE, INC. (“we”) would like to thank you for your interest in becoming a franchise candidate. Please remember as you review this material that this is merely an application for evaluation and determination of approval by our executive staff. This Request for Information (“Request”) is one step in this multi-phase procedure.

Because the development of one of our XYZ franchises is a large undertaking, requiring significant capital on your part and a significant time investment on our part, it is very important for us to qualify your ability to own and operate our system. If we did not undertake this review at this time, proceeding further could waste your time as well as ours. Thus, we thank you in advance for your cooperation and understanding in completing this application.

Important: *Do not incur any expenses relative to the operation of a XYZ franchise as this is merely an evaluation process and is not a guarantee of awarding a XYZ franchise. Any expenses that are incurred prior to the formal issuance of a XYZ franchise agreement will be at your risk.*

APPLICATION

The following data is submitted in connection with this Request to provide us with such pertinent information as is deemed essential to appraise your financial capabilities, business and operational experience and to evaluate your potential for developing a XYZ franchise.

Please type or print all information using black or blue ink.

If a partnership, corporation, limited liability company or other entity, all partners, directors, managers, officers and principal owners should complete an application form.

PERSONAL INFORMATION

(To be completed by each principal or majority shareholder)

APPLICANT A		
FULL LEGAL NAME		
SOCIAL SEC. #	DATE OF BIRTH	PLACE OF BIRTH:
DRIVER'S LIC #	OTHER NAMES USED	
SPOUSE NAME		
SPOUSE SOC SEC #	SPOUSE DATE OF BIRTH	SPOUSE DRIVER'S LIC #
ADDRESS		
CITY	STATE	ZIP
E-MAIL	PHONE	CELL
BUSINESS EXPERIENCE		
EDUCATION:		

APPLICANT A		
DESCRIPTION OF EXISTING BUSINESS		
CURRENT OCCUPATION:		
BUSINESS NAME		
BUSINESS ADDRESS		
BUS. PHONE #		BUS. FAX #:
NO. OF EMPLOYEES	IN BUSINESS SINCE	TYPE OF BUSINESS
BANK REFERENCES		
NAME OF BANK		NAME OF BANK
OFFICER NAME:		OFFICER NAME:
ADDRESS		ADDRESS
ACCT NOS.		ACCOUNT NOS.
PHONE		PHONE
PREVIOUS ADDRESSES WITHIN THE PAST SEVEN YEARS		
ADDRESS, CITY, STATE, ZIP	FROM (DATE)	TO (DATE)

APPLICANT B		
FULL LEGAL NAME		
SOCIAL SEC. #	DATE OF BIRTH	PLACE OF BIRTH:
DRIVER'S LIC #	OTHER NAMES USED	
SPOUSE NAME		
SPOUSE SOC SEC #	SPOUSE DATE OF BIRTH	SPOUSES DRIVER'S LIC #
ADDRESS		
CITY	STATE	ZIP
E-MAIL	PHONE	CELL
BUSINESS EXPERIENCE		
EDUCATION:		

APPLICANT B		
DESCRIPTION OF EXISTING BUSINESS		
CURRENT OCCUPATION:		
BUSINESS NAME		
BUSINESS ADDRESS		
BUS. PHONE #		BUS. FAX #:
NO. OF EMPLOYEES	IN BUSINESS SINCE	TYPE OF BUSINESS
BANK REFERENCES		
NAME OF BANK		NAME OF BANK
OFFICER NAME:		OFFICER NAME:
ADDRESS		ADDRESS
ACCT NOS.		ACCOUNT NOS.
PHONE		PHONE
PREVIOUS ADDRESSES WITHIN THE PAST SEVEN YEARS		
ADDRESS, CITY, STATE, ZIP	FROM (DATE)	TO (DATE)

Personal Background

1. Are all applicants identified above citizens of the United States? _____
 If you answered "NO", which applicant(s) is/are not? _____
 What is the country of citizenship? _____

2. My preferred franchise location/territory is _____

3. What percentage of time do you plan to devote to the XYZ business _____%

4. Will this business be your primary source of income? **Yes [] No []**

5. Briefly summarize your employment and business experience and please attach a current resume as supporting documentation: _____

6. Please describe briefly the principal positions (and nature of duties) you have held during the past five years or, if graduated less than five years ago, since graduation from college. Specific employers must be identified. Also list any professional

licenses or registrations, including bar admissions, accounting certificates, and SEC or state broker-dealer registrations you hold. What is sought is a sufficient description to enable us to determine the extent of your experience in financial and business matters generally, and the business specifically: _____

7. List any franchise operations in which the applicant or any of the persons listed above are presently, or have in the past been associated either through employment or through ownership or holdings: _____

8. Does the activity in item 6 above subject the applicant to any restrictive covenant?
Yes [] No []

9. If any such associations listed in item 6 above have been terminated, state the date of termination, and reason for termination.: _____

10. Please list the names and addresses of your attorney and accountant below:

Name	Address	Phone
_____	_____	_____
_____	_____	_____

11. Names of personnel who will participate in the management of the proposed franchise on a full-time and continuing basis, and will successfully complete all phases of the Training Program prior to the opening.

Operating Owner: _____

General Manager: _____

*Please attach a résumé or detailed work history

12. If proposed franchisee is an entity, and not an individual or individuals:

- a. Please indicate type of entity and percentage of personal ownership:

() Corporation _____% () Limited Partnership _____%
() Limited Liability Company _____% () Other – Specify: _____
() General Partnership _____%

- b. Date of incorporation or organization: _____

17. Are you (or any Entity in which you are or were a partner, director, manager, officer or owner) subject to any currently effective injunctive or restrictive order or decree relating to franchises, or under any federal, state or Canadian franchise, securities, antitrust, trade regulation or trade practice law, as a result of a concluded or pending action or proceeding brought by a public agency? **Yes [] No []**

18. During the past 15 years, have you been adjudged bankrupt or reorganized due to insolvency, filed a petition in bankruptcy or had a petition in bankruptcy filed against you? **Yes [] No []**

19. During the past 15 years, were you a partner, director, manager, or officer of an Entity at a time when, or within one year of the time when, such Entity was adjudged bankrupt or reorganized due to insolvency or had a petition in bankruptcy filed against it?
Yes [] No []

20. During the previous 10 years, have you received any medical or psychological treatment as a result of, or related to, the above of or dependence on drugs, alcohol, or controlled substances? **Yes [] No []**

21. Have you ever been arrested or had criminal charges filed against you?
Yes [] No []

22. Have you ever used or been known by another name? **Yes [] No []**

23. Please indicate any additional information which you think may be helpful in enabling us to determine that your knowledge and experience in financial and business matters are sufficient to enable you to successfully operate a XYZ business:

**FINANCIAL INFORMATION
SOURCE OF EQUITY**

Please attach a signed current financial statement (balance sheet and income statement), and bank statements or other documentation supporting your liquidity position, and copies of federal income tax returns for the last five years.

1. Do you have any contingent liabilities which you reasonably anticipate could cause the need for sudden cash requirements in excess of cash readily available to you?
Yes [] No []

2. Do you have any reason to anticipate any significant decline in income or net worth in the next three years? **Yes [] No []**

3. During the previous 10 years, have you (or any Entity of which you are or were a partner, director, manager, officer, or owner) defaulted in the repayment of any loan?
Yes [] No []
4. During the previous 10 years, have you (or any Entity of which you are or were a partner, director, manager, officer or owner) made an assignment for the benefit of creditors, has a receiver appointed for any of your property, been declared insolvent, or otherwise been the subject of any proceedings under any state or federal law relating to debtors and creditors?
Yes [] No []
5. During the previous 10 years, have you (or any Entity of which you are or were a partner, director, manager, officer or owner) been sued for collection of any debt or been sued for the foreclosure of any collateral securing any debt? **Yes [] No []**
6. During the previous 10 years, have you (or any Entity of which you are or were a partner, director, manager, officer) been the subject of any "work out" arrangements with any lender as a result of failure to timely repay any loan in accordance with its original terms?
Yes [] No []
7. During the previous 10 years, have you (or any Entity of which you are or were a partner, director, manager, officer, or owner) given a deed in lieu of foreclosure to any lender, or otherwise transferred property to a lender to avoid foreclosure or collection action?
Yes [] No []
8. If any part of the funds are to be borrowed, please identify the lender, amount of loan and repayment terms: _____

The source and amount of equity to be utilized in the development of a new franchise project is an important consideration. We have established a minimum equity amount that may be greater depending on individual lender requirements, etc. Typically, ___% to ___% of the total project cost will be required as an equity investment in each project. With project costs ranging from \$_____-\$_____ this estimate roughly amounts to \$_____-\$_____ (___%) to \$_____-\$_____ (___%) per franchise. If you are not in the financial position to pursue this business venture solely, please provide any relevant information concerning the addition of an "equity partner" or realistic funding source:

Use the following chart to identify the sources of funds and the taxes, expenses, cost, penalties, etc. to be deducted to arrive at the net equity amount. The source and gross amount information should match the financial statement submitted with this Request. If additional space is required, please use a separate sheet of paper.

SOURCE	Gross Amount	Taxes or Other Expenses Payable	Net Equity Amount
Cash:			
Securities:			
Retirement Accounts*			
Other:			
Other:			
TOTAL EQUITY			

*Retirement accounts must be discounted at a rate of ___% for use with XYZ projects.

I/we certify that the above represents the source(s) and amount(s) of funds to be used for the equity portion of this new franchise project.

_____	_____
Date	Corporate/Partnership Name
_____	_____
Signature of Applicant or Person Authorized to Sign on Behalf of Applicant	Signature of Applicant Person Authorized to Sign on Behalf of Applicant
_____	_____
Signature of Applicant or Person Authorized to Sign on Behalf of Applicant	Signature of Applicant or Person Authorized to Sign on Behalf of Applicant

MANAGEMENT & OPERATING PLAN

We recognize the significance of the role of management to the successful operation of a XYZ business. As part of the approval procedure and to assist us in determining who will be responsible for the operations, please indicate your intentions by checking the appropriate box. We will require one of the following:

- A. The candidate will be an “owner/operator” of the franchise and will remain active on a day-by-day basis as a “general manager,” successfully completing the Training Program prior to the opening of the location
- B. The candidate will be an “investor” and not active on a day-to-day basis

If you have marked "B" please provide us with the following information and note the following requirements:

- Who will be the Operating Owner/General Manager?
▪ _____

- A written compensation program for the General Manager for the operation of the franchise, to be developed by you, must be submitted to us for our approval and be in effect on the day the franchise opens. The development and implementation of a qualified compensation program in and of itself is not a guarantee of a successful operation. The day-to-day activities and performance of management will, in most situations, dictate the potential success of that operation.
- The Operating Owner/General Manager must attend and successfully complete the Manager in Training Program prior to the opening of the franchise.

BUSINESS ENTITY OVERVIEW

Please be particularly careful that information given is accurate and that the individual(s) or Entity making the application is designated correctly.

The Partnership Agreements or Articles of Incorporation/Organization should be completed at the time of application. If they are not, the franchise agreement must be issued to the principles as sole proprietors. Upon completion of the Partnership Agreement or Articles of Incorporation/Organization, an assignment from the sole proprietorship to the respective Entity may be accomplished under the terms of our then-current "Assignment & Consent to Assignment Agreement."

All owners of an Entity franchise must be bound by a buy-out agreement with respect to their interest in the franchise.

The use of the name XYZ any derivation thereof or any corresponding trademarks within the Entity name is strictly prohibited.

Please complete one of the following categories:

INDIVIDUAL

A)

Name	Business Address	State
------	------------------	-------

B)

Name	Business Address	State
------	------------------	-------

PARTNERSHIP

*Please complete supplemental worksheet for partnerships

_____, "a Partnership"
Name of Partnership Business Address, State

CORPORATION

_____, a _____ Corporation
Name of Corporation State in Business Address
which incorporated

LIMITED LIABILITY COMPANY

_____, a _____ Limited Liability Company
Name of Limited Liability State in Business Address
Company which organized

OTHER TYPE OF ENTITY

Name of Entity Type of Entity Business Address, State

NOTE: Regardless of the type of entity you form, you will be required to provide applicable organizational documents to us prior to the execution of the franchise agreement.

SUPPLEMENTAL ENTITY WORKSHEET

ENTITY

Name

Business Address, State

PARTNER, SHAREHOLDER OR MEMBER INFORMATION
--

Name	Phone	% Ownership
Address:		

Name	Phone	% Ownership
Address:		

Name	Phone	% Ownership
Address:		

Name	Phone	% Ownership
Address:		

FINANCIAL NOTE: If the candidate is an Entity, a separate Request must be completed by all persons listed above. If the proposed franchisee is an Entity, please attach signed copies of the Entity's current financial statements (balance sheets and income statements) and bank statements or other documentation supporting the liquidity position of the Entity.

FRANCHISOR DISCLOSURE

We do not disclose certain information (average sales volumes, average return on investment, variable expense percentage, etc) to prospective Franchise applicants other than information included in our Franchise Disclosure Document (FDD). If required in your state or country and if you further qualify for a XYZ franchise, you will be provided with a FDD before you sign a franchise agreement.

Applicant acknowledges that we do not warrant or guarantee the accuracy or validity of information obtained from franchised contacts. Applicant further acknowledges that, other than information published in the FDD, neither we nor our representatives have stated or suggested (orally, in writing or visually) a specific level or range of potential or actual sales, income, gross or net profits or variable expense data in connection with the making of this application. Furthermore, this application or any other document or verbal advice is not to be construed in any way as a franchise agreement or the granting thereof.

REPRESENTATION WARRANTIES

Applicant acknowledges and agrees that all information contained in this Request is complete, true and accurate. The information included in this Request is for use by us in determining approval of a franchise. I authorize XYZ Franchise, Inc. to utilize other investigative sources that it considers necessary in making this determination, including credit and criminal reporting agencies. Further, I hereby authorize the banks listed in this Request to release the information necessary to assist XYZ Franchise, Inc. in its review.

Entity Name

A) _____
Signature

B) _____
Signature

Printed Name

Printed Name

Date

Date

ATTACHMENTS

Must be submitted with this completed application.

Please attach:

_____ Financial Statements

_____ Résumé or Detailed Work History

APPENDIX C

Due Diligence Questionnaire¹
(For Entire Franchise Team)

IMPORTANT DISCLOSURE INFORMATION

Confirmation of corporate organization of _____, the Franchisor entity ("Franchisor"), for purposes of disclosure under federal and state franchise laws.

The general partners, members of the board of directors, managing members, and trustees of Franchisor, according to the Franchisor's records are as follows:

Name	Title
_____	_____
_____	_____
_____	_____

The officers of the Franchisor, according to the Franchisor's records are as follows:

Name	Title
_____	_____
_____	_____
_____	_____

The persons (other than those listed above) who will have management responsibility relating to the sale or operation of franchises are as follows:

Name	Title
_____	_____
_____	_____
_____	_____

The "franchise sellers" of Franchisor (both internal and external) are as follows:

Name	Title
_____	_____
_____	_____
_____	_____

¹ Based on a document provided by Jim Meaney.

I confirm that the foregoing information is complete and correct according to the Franchisor's records and my knowledge.

[NAME OF FRANCHISOR]

Signature

Printed Name

Title

Date

[NOTE: THIS QUESTIONNAIRE SHOULD BE SIGNED BY AN EXECUTIVE OFFICER OF FRANCHISOR, PREFERABLY THE CEO OR PRESIDENT.]

APPENDIX D

Due Diligence Questionnaire¹
(For Individual Franchise Team Members)

For Use By

("Franchisor")

THIS QUESTIONNAIRE IS TO BE COMPLETED BY ALL DIRECTORS, TRUSTEES, GENERAL PARTNERS, AND OFFICERS OF THE FRANCHISOR, AND ANY OTHER INDIVIDUALS WHO WILL HAVE MANAGEMENT RESPONSIBILITY RELATING TO THE SALE OR OPERATION OF FRANCHISES.

I. GENERAL INFORMATION

1. Name: _____
2. Business Address: _____
3. Business Telephone Number: (____) _____
4. You are completing this questionnaire as (check all that apply):
 - _____ the Franchisor.
 - _____ a director, trustee or general partner of the Franchisor (or a manager of the Franchisor, if the Franchisor is an LLC).
 - _____ an officer of the Franchisor.
 - _____ an individual with management responsibility relating to the sale or operation of franchises.
 - _____ a salesperson employed by the Franchisor.
 - _____ a franchise broker of the Franchisor.
 - _____ a salesperson employed by the franchise broker.
5. Please provide the following information:
 - a. Current principal occupation or employment by title and description:

 - b. Current Employer: _____
 - c. Beginning date (by month and year) of your current position or employment:
_____, _____
 - d. Current Employer's address: _____

¹ Based on a document provided by Max Schott, II and Gray Plant Mooty.

- e. Will you engage in franchise sales for the Franchisor? Yes ___ No ___
- f. If the answer to 5(e) is "Yes," will you engage in franchise sales in all states? Yes ___ No ___
- g. If the answer to 5(e) is "No," please list the states in which you will engage in franchise sales for the Franchisor:

6. If a corporation or other entity will serve as a franchise broker, then each officer and director of that corporation or other entity must complete this questionnaire. In addition, please provide the following for the corporation or other entity:

- a. State of incorporation/formation: _____
- b. Date of incorporation/formation: _____

7. Please provide the following information for the employment or position which you held immediately preceding your current principal occupation:

- a. Employer: _____
 - (1) Principal occupation or employment by title or description:

 - (2) Beginning and ending dates by month and year) of this position or employment:
_____, _____ to _____, _____
 - (3) Previous employer's address:

8. Please provide the following information for each principal occupation which you have held during the preceding five full years, in chronological order:

- a. Employer: _____
 - (1) Principal occupation or employment by title or description:

 - (2) Beginning and ending dates by month and year) of this position or employment:
_____, _____ to _____, _____
 - (3) Previous employer's address:

- b. Employer: _____
 - (1) Principal occupation or employment by title or description:

(2) Beginning and ending dates by month and year) of this position or employment:

_____, _____ to _____, _____

(3) Previous employer's address:

c. Employer: _____

(1) Principal occupation or employment by title or description:

(2) Beginning and ending dates by month and year) of this position or employment:

_____, _____ to _____, _____

(3) Previous employer's address:

d. Employer: _____

(1) Principal occupation or employment by title or description:

(2) Beginning and ending dates by month and year) of this position or employment:

_____, _____ to _____, _____

(3) Previous employer's address:

II. LITIGATION HISTORY

1. Pending Litigation

a. Are you, at the present time, a defendant in a pending criminal action? Yes ___ No ___

b. Are you, at the present time, a defendant, or defendant to a counterclaim, in any pending civil matter? Yes ___ No ___

c. Are you, at the present time, a party to a pending administrative action? .. Yes ___ No ___

2. Do any of the above (under Section II.1) allege a violation of:

a. Any franchise law? Yes ___ No ___

b. Any antitrust law? Yes ___ No ___

c. Any securities law? Yes ___ No ___

- d. Unfair or deceptive practices?..... Yes ___ No ___
- e. Fraud? Yes ___ No ___
- f. Comparable allegations? Yes ___ No ___

3. Concluded Litigation

- a. Have you ever been convicted of a felony? Yes ___ No ___
- b. Have you ever pleaded nolo contendere to a felony? Yes ___ No ___
- c. Within the preceding 10 years, have you:
 - (1) Been convicted of a misdemeanor?..... Yes ___ No ___
 - (2) Pleaded nolo contendere to a misdemeanor? Yes ___ No ___
 - (3) Been held liable in a civil action by a final judgment?..... Yes ___ No ___
 - (4) Been the named party or the subject of a complaint? Yes ___ No ___
 - (5) Been the subject of other legal proceedings?..... Yes ___ No ___
- d. Did any of the above (under Section II.3.) involve a violation of:
 - (1) Any franchise law? Yes ___ No ___
 - (2) Any antitrust law? Yes ___ No ___
 - (3) Any securities law? Yes ___ No ___
 - (4) Fraud? Yes ___ No ___
 - (5) Unfair or deceptive practices?..... Yes ___ No ___
 - (6) Comparable allegations? Yes ___ No ___

If the answer to any of the questions in 1, 2, or 3 above is "Yes," please provide the following information:

- a. Court or arbitration office in which action filed:

- b. Date of filing: _____
- c. Docket number: _____
- d. General nature of claims asserted: _____

e. Relationship to defendant or party bringing the action (e.g., former franchisee, supplier, etc.):

f. For pending actions, describe current status: _____

g. For actions no longer pending, please provide the disposition of the case, including the terms of settlement.

Note: You may be asked to provide copies of the pleadings.

h. Please provide the following information regarding arbitration proceedings which are either pending or have been concluded within the past 10 years:

(1) The number of such pending and/or concluded arbitration proceedings: _____

(2) The number of arbitration proceedings initiated by the franchisor: _____

(3) The number of arbitration proceedings initiated by franchisees: _____

4. Currently Effective Administrative Orders

a. Are you, at the present time:

(1) Subject to any currently effective injunctive or restrictive order or decree relating to franchises? Yes ___ No ___

(2) Subject to any currently effective injunctive or restrictive order or decree under any federal, state or Canadian franchise, securities, antitrust, trade regulation or trade practice law as a result of a concluded or pending action or proceeding brought by a public agency? Yes ___ No ___

(3) Subject to any currently effective order of any national securities association or national securities exchange (as defined in the Securities and Exchange Act of 1934) suspending or expelling you from membership in such association or exchange? Yes ___ No ___

b. If the answer to any question in Section II.4.a. is "Yes," please provide us with the following

(1) The public agency or court:

(2) A summary of the allegations or facts found by the court or agency:

(3) The date of the order or decree: _____

(4) Nature, terms and conditions of the order or decree:

III. BANKRUPTCY HISTORY

1. Within the past 10 years, were you:

a. Adjudged bankrupt? Yes ___ No ___

b. Reorganized due to insolvency? Yes ___ No ___

c. A principal officer of any company or a general partner in any partnership which was adjudged bankrupt or reorganized due to insolvency during or within one year before or after you held such position? Yes ___ No ___

2. Are you presently subject to any pending bankruptcy or reorganization proceedings? Yes ___ No ___

3. If the answer to III.1. or 2. is "Yes," please provide the following information:

a. The name of the proceeding: _____

b. Date of filing (if pending): _____

c. Date of judgment (if discharged): _____

d. Court: _____

e. Docket or case number: _____

f. Any other material facts or circumstances: _____

IV. SUPPLIER INTERESTS

1. If you are an officer of the Franchisor, do you own an interest in any of the Franchisor's approved suppliers? (See attached list of approved suppliers) Yes ___ No ___

If yes, please describe: <u>Name of Supplier</u>	<u>Type of Interest Held</u>

V. OTHER MATERIAL MATTERS

1. Are you aware of any other matters relating to you, the Franchisor or the franchise system, which are not already included in the Franchisor's Franchise Disclosure Document (FDD), but may be material to a prospective franchisee? Yes ___ No ___

2. If the answer to question 1 above is "Yes," please describe below the other material matters:

I confirm that the information in this questionnaire is complete and correct to the best of my knowledge.

Signature

Title

Date

Upon completion, please return this questionnaire to: _____

JAMES A. MEANEY

James A. Meaney, a frequent presenter on franchise topics, is a franchise attorney who has practiced in the area for nearly 25 years and is currently Of Counsel to the law firm of Zaino & Humphrey in Dublin, Ohio. During his career, Mr. Meaney has held the following positions: General Counsel and Vice President of Franchise Development for Damon's Grill®, General Counsel of the Ohio Petroleum Retailers and Repair Association, Section Chief of the Ohio Attorney General's Consumer Protection Section (responsible for enforcement of Ohio's Business Opportunity Law), Chairman of the Columbus Bar Association's Franchise and Distribution Law Committee, and a member of the Board of Governors, Columbus Bar Association. He has also contributed numerous articles and presentations to various franchising publications, and is the author of *How to Buy a Franchise*. Mr. Meaney has been a member of The American Bar Association's Forum on Franchising since 1989 and has had the honor presenting at a number of Annual Forums. Mr. Meaney is licensed to practice law in Ohio and the U.S. Virgin Islands. In addition to the practice of law, he serves as a consultant to Train-Ease, Inc., an e-learning company that develops online training for franchise systems and other businesses.

MAX J. SCHOTT, II

Max J. Schott, II, is a shareholder in the Minneapolis office of Gray Plant Mooty and practices primarily in the area of franchise and distribution law, assisting and counseling franchisors in structuring domestic and international franchise programs. Max also advises clients on issues of disclosure and registration, relationship matters, supply chain maintenance, advertising, licensing, and acquisitions. Max works with start-ups, as well as with nationally-recognized franchisors with multiple brands.

Max frequently writes and speaks on franchise-related topics, both locally and nationally. Max assumed the role of Editor-in-Chief of the ABA Forum on Franchising's *The Franchise Lawyer* in August 2010, after serving as an Associate Editor for that publication during the previous two years. Max also was a member of the IFA Legal Symposium Task Force during 2008 and 2009. Max was named by *Franchise Times* as one of its "Legal Eagles" in each of the last four years. In addition, Max has been a long-time volunteer with The Advocates For Human Rights and currently serves on its Board of Directors.