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NAVIGATING THE NEW NORMAL WITH FINANCIAL PERFORMANCE REPRESENTATIONS

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Introduction

On May 8, 2017, the North American Securities Administrators Association ("NASAA") adopted the NASAA Franchise Commentary on Financial Performance Representations (the "FPR Commentary")[1]. The effective date of the FPR Commentary was the later of 180 days after the date of adoption by NASAA (May 8, 2017) or 120 days after a franchisor's next fiscal year end following adoption. While some franchisors chose to follow the FPR Commentary in their 2017 franchise disclosure documents ("FDDs") and regulatory filings even before NASAA required, it is clear that it is now time for franchisors to pay close attention to, and if necessary revise their financial performance representations ("FPRs") to address, the questions and answers found in the FPR Commentary. This is true even if a franchisor has included an FPR in its FDD for many years and it had previously been approved for use in the registration states without addressing any changes that may be required under the FPR Commentary.

Why was the FPR Commentary adopted, and was it necessary? Let's begin with a brief refresher on what an FPR is and how a franchisor may provide an FPR to prospective franchisees. Item 19 of the FTC Rule[2] states that a franchisor may provide information about the actual or potential financial performance of its franchised and/or company owned outlets to prospective franchisees, if there is a reasonable basis for the information and if the information is included in the FDD.[3] While inclusion of an FPR in a franchisor's FDD is not mandated by state or federal law, many franchisors, and likely a majority, choose to do so. A report prepared by FRANdata for the International Franchise Association Franchise Education and Research Foundation shows that in 2016, two-thirds of franchisors included an FPR in Item 19 of their FDDs (up from 52% in 2014).[4]

Unlike other disclosure Items in an FDD, a franchisor is free to craft the structure, content and information disclosed in an Item 19 FPR; again, so long as there is a reasonable basis for the structure, content and information. Much has been debated and written about what constitutes a "reasonable basis," and while the FTC Rule itself, as well as the NASAA Guidelines,[5] FTC Rule Compliance Guide,[6] and FTC Statement of Basis and Purpose[7] provide some clarification, FPRs have become increasingly complex and often difficult to understand, particularly for a prospective franchisee with little or no financial background or experience. In addition, the format of FPRs differ widely, making it difficult for prospects to do any meaningful comparison of FPRs between franchisors and franchise systems. The FTC Rule Compliance Guide states

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[1] NASAA Franchise Commentary Financial Performance Representations (May 8, 2017)
[2] 16 C.F.R. §436.5(s) (2007)
[3] *Id*.
[4] Anya Nowakowski, **Financial Performance Representation: Market Demand Pushing Higher Levels of Transparency** 8 (2017)
[5] NASAA, 2008 Franchise Registration and Disclosure Guidelines (July 1, 2008)
[6] FTC Franchise Rule Compliance Guide (May 2008)
[7] 16 C.F.R. §436, 437 (2007) Statement of Basis and Purpose

that "factual information must be the sort of information upon which a prudent business person would rely in making an investment decision."[8] While few would disagree with this statement, it does not provide much of a roadmap for a franchisor seeking to document financial performance in compliance with the FTC Rule.

While some attorneys and state regulators have felt comfortable questioning franchisors about the information contained in FPRs, in many cases the information disclosed by franchisors is approved by states without question or comment unless there was something obviously or egregiously wrong with the disclosure. The rationale may be that it is enough if a franchisor is comfortable producing an FPR and can "substantiate" the information if requested. If an FPR would turn out to be deceptive or misleading, an aggrieved franchisee could assert claims against the franchisor alleging, among other things, fraud, deceptive practices, and violation of state franchise laws. However, there has been little case law regarding successful actions (or, in reality, any actions) brought by franchisees against franchisors alleging violations of franchise laws stemming from an Item 19 FPR contained in an FDD.[9]

NASAA, through the Franchise and Business Opportunity Project Group, sought to use the FPR Commentary to reinforce what constitutes a "reasonable basis" and to provide certain clarifications to help guide appropriate disclosures in FPRs. The FPR Commentary was prepared and sent out for public comment on two occasions, with some changes made based on those comments, before NASAA's adoption of the FPR Commentary.

In the recent wake of the FPR Commentary, the franchising community is in the process of learning how state franchise regulators will interpret the FPR Commentary items to apply them to FPRs. By the time of the 2018 IFA Legal Symposium, most franchisors will have updated their FDDs since the adoption of the FPR Commentary (and mandatory phase-in of its requirements) and will have submitted registration applications and renewals to the franchise registration states for review and approval. State franchise regulators are likely to more closely scrutinize FPRs this year and perhaps for the foreseeable future. In the end, the goal of the FPR Commentary is to encourage franchisors to prepare better and more uniformly-structured FPRs to give prospective franchisees more useful information so that they can make better franchise purchasing decisions.

Many of the provisions in the FPR Commentary are relatively straight forward and are not, at least in most cases, open to interpretation or debate. But some of the issues addressed in the FPR Commentary still do not close the door on questions surrounding those issues and the need to further interpret in order to translate the requirements of the FPR Commentary to the specifics of an FPR. The FPR Commentary has provided clarity on some FPR issues, but it raises additional questions in others. While we will examine each of the items in the FPR Commentary, we will also

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[8] FTC Rule Compliance Guide, Item 19, page 135.

[9] See, e.g., *FTC v. Minuteman Press*, 53 F.Supp.2d (S.D.N.Y. 1998).

point out and focus on some of the issues which are most likely to cause debate and situations where, notwithstanding the language of the FPR Commentary, reasonable opinions may differ.

A. Definitions and Disclosures of FPRs Generally

Perhaps because of the flexibility afforded to franchisors in preparing FPRs, and the fact that different terms, used in different contexts, mean different things to different prospective franchisees, the FPR Commentary adds guardrails to certain terms, and the use of those terms, that are common to FPRs. This is done through the addition of definitions in the lead-in to the new FPR Commentary as well as four new questions addressing FPR disclosures generally.[10]

The eight definitions added at the beginning of the FPR Commentary are ostensibly included in order to establish a common understanding of how those terms are used within the Commentary.[11] But that is not the case for all of the terms as, in practice, the definitions in the FPR Commentary fall into three different categories: (1) terms that are universally defined and generally understood regardless of context (the terms, "average" and "median," which are discussed under the heading "Averages and Medians" below), (2) terms that are defined for purposes of interpreting and understanding the FPR Commentary, but may be modified by a franchisor based upon the terminology used by the franchisor in its franchise documents (the terms "gross sales,"[12] "gross profit,"[13] and "net profit."[14]), and (3) terms that would be expected to have the same meaning both in the FPR Commentary and if and as used in an FPR, and should not be varied by the franchisor (the terms "company-owned outlet," "operational franchise outlet," and "managed outlet.")[15]

The last category of terms, defining company-owned, franchised and managed outlets, is perhaps the most interesting, in part because they are expected to flow through to the use of those terms in an FPR (not necessarily just the FPR Commentary), and also because they introduce some additional new parameters to how those outlets are referenced in an FPR. For example, company-owned outlets include outlets owned indirectly by a person that is in, or is required to be in, Item 2 of the FDD, and also joint venture outlets, owned in part, and also managed, by the franchisor or an affiliate. In addition, to be an "operational" franchise outlet, the outlet must have been in operation for at least one full year (or a full season, for businesses that operate seasonally). A definition for "managed outlet" is also introduced, which is a term

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[10] FPR Commentary at 19.4 – 19.7.

[11] The preamble to the FPR Commentary's definitions states, "When used in this FPR Commentary, the following terms have the meanings indicated:"

[12] *Id*. "Gross Sales" is defined in the FPR Commentary as the "total revenue derived from the sale of goods or services less sales tax, discounts, allowances, and returns."

[13] *Id*. "Gross Profit" is defined in the FPR Commentary as "gross sales minus cost of goods sold, or minus the cost of providing services for a franchise system that offers services."

[14] *Id*. "Net Profit" is defined in the FPR Commentary as "gross profit minus all ordinary and recurring operating expenses, interest, income taxes, depreciation and amortization."

[15] *Id*.

commonly used in the hospitality industry, but not commonly used or understand outside of this industry.

Because of the importance of these terms to FPRs, their complete definitions are as follows:[16]

> **Company-owned outlet** "means an outlet owned either directly or indirectly by a franchisor, by an affiliate of the franchisor, or by any person required to be identified in Item 2 of the franchisor's Franchise Disclosure Document, which operates a substantially similar business under the same brand as the business the franchisor offers to franchisees. It also includes any such outlet that: (i) is operated as a joint venture owned in part by a franchisor, by an affiliate of the franchisor, or by a person required to be identified in Item 2; and (ii) is managed by the franchisor, an affiliate of the franchisor, or by a person required to be identified in Item 2 [of the FDD]."
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> **Operational franchise outlet** "means an outlet operated under a franchise agreement that: (i) is not a company-owned outlet; and (ii) has been fully operational for one full year or, in the case of franchise systems that operate seasonally, for at least one full season. It also includes any such outlet that: (i) is owned by a franchisee; and (ii) is managed by the franchisor, an affiliate of the franchisor, or a person required to be identified in Item 2 [of the FDD]."
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> **Managed outlet** "means any outlet that: (i) is owned by a person that is not a franchisee, the franchisor, an affiliate of the franchisor, or a person required to be identified in Item 2; and (ii) is managed by the franchisor, an affiliate of the franchisor, or by a person required to be identified in Item 2 [of the FDD]."

Addressing the fact that franchisors have flexibility in their definitions for at least some of the terms noted above, 19.4 and 19.5 of the FPR Commentary relate to the disclosure of gross sales and net profit in an FPR. Specifically, these items require a franchisor using either of these terms in an FPR to define how they are calculated,[17] but -- important to note – the Commentary does not state how they *must* be calculated.

Item 19.6 of the FPR Commentary requires a franchisor to identify the sources of data it uses to make an FPR.[18] If an FPR includes results or data from both franchised outlets and company-owned outlets, the FPR must clearly identify the results or data

[16] FPR Commentary, Definitions.
[17] FPR Commentary, at 19.4 and 19.5. To use the term "gross sales," a franchisor must define the items, if any, it is deducting from total revenue, including sales tax, discounts, allowances, and returns; and to use the term "net profit," a franchisor must define the items it is deducting from gross profit, including ordinary and recurring operating expenses, interest, income taxes, depreciation, and amortization.
[18] FPR Commentary, at 19.6.

from the two different types of outlets.[19] 19.6 also provides that "if a franchisor is adjusting or supplementing actual cost data in an FPR, the franchisor must clearly identify which data are actual costs, which data are adjusted or supplemental costs, and the method and rationale for determining the adjusted or supplemental costs."[20]

Lastly regarding the disclosure of FPRs generally, the FPR Commentary clarifies how "managed outlets" may be included in a financial performance representation.[21] The FPR Commentary notes that if an FPR includes data from managed outlets, this fact must be disclosed along with an explanation of how they are characterized.[22] If those results are not materially different from the results of other outlets, the managed outlets can be characterized as either a company-owned outlet, franchised outlet, or separately as a "managed outlet."[23] Results from managed outlets cannot be included in an FPR if their results are materially different from those of other outlets in the FPR.[24]

B. Use of Data from Company Owned Outlets

An important but previously unaddressed issue in preparing FPRs is the degree to which FPR disclosures can be based on company-owned outlet performance, and the circumstances in which that performance must be differentiated from the performance of franchised outlets. Questions 19.8 – 19.11 of the FPR Commentary address these issues.

1. Gross Sales FPR Based on Company-Owned Data Alone

Question 19.8 of the FPR Commentary makes clear that if a franchisor has operational franchise outlets, it cannot make a gross sales FPR based on company-owned data alone. Preliminarily, it should be pointed out that if a franchisor is providing a gross sales FPR, the franchisor must be sure that the term "gross sales" or whatever other term is used, is properly defined in the manner noted above. The question here is whether a franchisor can create a gross sales FPR based solely on company-owned outlets when the franchise system has both company-owned and franchise locations. The simple answer under Section 19.8 is no, but the answer in reality requires further analysis.

The theory behind Question 19.8 is that if a franchisor has both franchised and company-owned outlets that are operational, the franchisor has no "reasonable basis" for making a gross sales FPR based on company-owned data alone. In short, the concern is that for a prospective franchisee, gross sales of company-owned locations alone could be misleading based on the assumption that a new franchisee does not have the experience and resources that a franchisor may have in running company-

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[19] *Id.*
[20] *Id.*
[21] FPR Commentary, at 19.7.
[22] *Id.*
[23] *Id.*
[24] *Id.*

owned businesses and may not be able to streamline its initial operations in the same way a franchisor can when opening a company-owned location. There may or may not be truth to this assumption. However, if the franchisor has gross sales data for operational franchise outlets yet decides not to disclose this information in the FPR, a concern may be that the franchisor is omitting potentially less favorable data of franchised locations. In an effort to provide prospective franchisees with all possible information to make an informed decision, it would appear that this information would be useful – and most relevant to prospective franchisees – assuming the franchisor is able to obtain such gross sales information from its franchisees.

2. <u>What if Franchisee Data is Unavailable?</u>

There may be situations however where this information may not be available to the franchisor. If the royalty fee paid by franchisees to the franchisor is based on a percentage of sales, it would be relatively easy for the franchisor to obtain this information (as it is generally provided in conjunction with the payment of a royalty fee), but if the royalty payment is a flat fee or based on other non-sales related metrics, a franchisor may not be able to obtain sales information unless required by the franchise agreement. In such instances, where franchisees are not contractually obligated or otherwise willing to provide this information to the franchisor and franchised locations exist, the franchisor will be unable to provide a gross sales FPR based solely on company-owned locations alone. In at least one example identified, a franchisor provided a gross sales FPR based on a single company-owned outlet that had been in operation for more than eight (8) years. However, the franchisor also had seventeen (17) franchised outlets which were operational for more than a year. The franchisor excluded the franchised locations from the FPR on the basis that the franchisees were not required to report sales. In this instance, does a reasonable basis exist for the franchisor to make the FPR? This type of FPR seems to clearly run afoul of the guidance provided by Question 19.8.

What if the company-owned data is based on assumptions that are different from what a franchisee will experience? Consider the following example: A franchisor provides a gross sales FPR based on the sales of an affiliate-owned outlet. In the FPR narrative, the franchisor provides the following information: "The affiliate operates in a territory with a population of approximately 2,225,000 people." However, Item 12 of the franchisor's FDD discloses that: "A typical basic or optimal franchise territory consists of approximately 55,000 to 100,000 people. A typical metro franchise territory consists of approximately 200,000 to 300,000 people." The question is whether the franchisor may use affiliate-owned outlet sales data in an FPR when the territory in which the affiliate operates is more than seven times greater than the territory granted to a franchisee. In this case, regulators would likely request an explanation as to why the sales information presented is equivalent to the sales generated in a territory with a fraction of this population. In other words, is there a reasonable basis for making this FPR? What if the franchisor added a statement acknowledging the differential in territory size and that a franchisee, with a smaller territory, was not likely to realize these gross sales?

3. <u>Operational Franchise Outlets</u>

Consider, for example, a franchisor with several company-owned locations that have been operating for more than three years, and who began franchising about 18 months ago and has two franchised locations, both of which have been operating for less than a year. Further assume that the franchisor collects a percentage royalty based on franchisee gross sales. Under Question 19.8 of the FPR Commentary, could that franchisor make a gross sales FPR based on company-owned data alone?

While an initial reaction might be "no," because the franchisor appears to have operational franchise outlets, it is important to consider the definition (noted above) of an "operational franchise outlet." If the franchised outlets have not been open for one full year (unless a seasonal business), these outlets are not considered "operational franchise outlets" for purposes of the FPR Commentary. Accordingly, that franchisor would be able to provide gross sales information in its FPR based on company-owned sales alone only if the franchise locations were not operational for at least a full year. If a franchisor uses only company-owned outlet information in an FPR despite the fact that Item 20 of the FDD reflects the existence of franchised locations in the system, it may be helpful – in order to avoid state regulator comments or resistance - to explain in a registration application cover letter (or in the FPR itself) why franchised locations were not included in the FPR.

Below are some examples of FPRs where franchisors used data from franchised outlets that were open for less than a year.

Ex. 1: <u>Note 1</u>: On average [Acme] Express Outlets have six months and [Acme] Full Outlets have 11 months of data. Annualized Revenue and EBITDA are based on Outlets open at least two full months. One Outlet converted from a Full Outlet to an Express Outlet in July 2017 and is included as a Full Outlet through June 2017 and as an Express Outlet from August 2017 and after. Eight Outlets are not represented in this financial performance representation because Franchisor did not receive their financial information or the Outlet was not open for at least two full months.

Ex. 2: The following chart was compiled from unaudited financial reports (using the accrual basis) submitted to us from 66 franchise units which operated in the United States during the period of November 1, 2016 through October 31, 2017. 104 stores were in operation during that period – 22 of which were in France, Italy and Canada and are not included in this report. Of the remaining stores, we received adequate reports from 66. *Of those 66, 57 were in operation for 12 months and 9 were in operation for an average of 7 months.* Monthly income and expense averages have been annualized and are based on a twelve month period from November 1, 2016 through October 31, 2017. We believe that the information submitted to us is correct but cannot verify its accuracy. (emphasis added)

While in the past, FPRs based on data from such outlets might have been permitted, unless the businesses are "seasonal businesses," these examples would seemingly not be allowed under the guidance of the FPR Commentary.

Question 19.9 of the FPR Commentary addresses the converse of Question 19.8, and provides that a franchisor *may* make a gross sales FPR based on company-owned outlet data alone if that franchisor has no operational franchise outlets. Certainly the theory here is that some information is better than no information at all. The stipulation to allowing this is that, as always, the franchisor must have a reasonable basis for the FPR, and must also disclose the material financial and operational characteristics of the company-owned outlets used in the FPR that are reasonably anticipated to differ materially from future operational franchise outlets.

4. Segregation of Company-Owned and Franchised Data

If an FPR includes data from both company-owned and franchised outlets, Question 19.11 of the FPR Commentary generally requires the data from each of those types of outlets to be presented separately.[25] But, as long as that data is presented separately, the franchisor may also provide the information in a combined format.[26] The only exception to this requirement is if a franchisor has such a small number of franchises (less than ten) that the identity of the franchises whose data is being reported is discernible, and the gross sales between franchised and company-owned locations are not materially different, the franchisor may merge the data (but must include a separate representation that there are no material differences in the gross sales information).[27]

The following is an example of improperly combined FPR data among company-owned and franchised outlets:

Historical Outlet Gross Sales For 2017 Fiscal Year (ended December 31, 2017)			
	Average Outlet Gross Sales	Median Outlet Gross Sales	Number of outlets meeting or exceeding the average
37 Outlets (32 franchised and 5 affiliate-owned)	$384,590	$334,275	21

The above example would be permissible under the FPR Commentary if the franchisor had provided a separate break-out of franchised and company-owned data, as in the following example:

[25] FPR Commentary, at 19.11.
[26] *Id.*
[27] *Id.*

Historical Outlet Gross Sales For 2017 Fiscal Year (ended December 31, 2017)					
	Average Outlet Gross Sales	Median Outlet Gross Sales	Number of outlets meeting or exceeding the average	Highest Outlet Gross Sales	Lowest Outlet Gross Sales
37 Total Outlets (32 franchised and 5 affiliate-owned)	$384,590	$334,275	21	$892,457	$189,452
32 Franchised Outlets	$367,998	$317,385	18	$724,906	$189,452
5 Affiliate-Owned Outlets	$411,721	$368,243	3	$892,457	$321,011

5. Gross or Net Profit FPRs

Question 19.10 of the FPR Commentary addresses whether a franchisor may make an FPR disclosing gross profit or net profit FPR based on company-owned outlets alone.[28] A franchisor may do so if it includes (a) gross sales data from operational franchise outlets, (b) actual costs incurred by company-owned outlets; and (c) supplemental disclosure or adjustments to reflect all actual and reasonably expected material financial and operational differences between company-owned outlets and operational franchise outlets.[29]

On its face, this point seems in contrast with the outcome of Questions 19.8 and 19.9. If a franchisor can't provide gross sales information from company-owned outlets alone if it has franchised locations, why would the answer be any different for cost or expense data? The reasoning here is based on the financial information that franchisees routinely provide to franchisors and the manner, form and content of the information that is provided. It is also dependent on the financial information the franchisee is required to provide to the franchisor under the franchise agreement.

As previously mentioned, if the royalty paid by the franchisees to the franchisor is based on a percentage of franchisee sales, franchisees will be required to provide their sales information to the franchisor to substantiate the amount of royalty fees paid. However, some franchisees may not be required to provide cost and expense information to the franchisor.

In addition, while many franchise agreements require franchisees to provide periodic cost and expense information, the format and content in which this information is provided may vary significantly from franchisee to franchisee unless it is otherwise prescribed by the franchisor. Many franchisors do not require their franchisees to use an accountant to prepare financial statements (although it is most certainly

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[28] FPR Commentary, at 19.10.
[29] *Id*.

recommended), or a common chart of accounts. This can raise significant concern regarding the accounting methods used and the reliability of the information presented.

Finally, cost and expense information varies widely between similarly situated franchisees. Both the terms "gross profit" and "net profit" are defined as part of the FPR Commentary, but some of the components of those definitions leave room for interpretation or manipulation. For example, "the cost of providing services for a franchise system" in calculating gross profit, or "ordinary and recurring operating expenses" in calculating net profit, may vary widely depending upon how a particular business operates. One franchisee may work full-time at the franchised business and may take a minimal salary, relying instead on year-end profits; whereas another franchisee may have full-time managers and therefore a significantly higher payroll expense.

6. Costs and Expenses Outside of the FPR

If a franchisor only provides gross sales information of either franchised and/or company-owned outlets, another question is whether that franchisor can generally discuss cost and expense information found in the FDD with the prospective franchisee? This question needs to be read in conjunction with the Franchise Rule Compliance Guide (the "Compliance Guide"), page 131[30] and Footnote 8 of the FPR Commentary. The Compliance Guide states that the presentation of cost or expense data alone is not an FPR.[31] Accordingly, referring a prospective franchisee to costs and expenses, for example those disclosed in Items 5 through 7 of the FDD, alone does not constitute an FPR. However, the Compliance Guide and Footnote 8 of the FPR Commentary go on to state that when a franchisor makes an FPR disclosing only gross sales, it may not separately provide cost or expense data outside of the FPR from which a prospective franchisee can readily calculate average net profits. Under these circumstances, the presentation of this cost information in this format would constitute an FPR.[32]

This is an example of the importance of careful instruction and monitoring of franchise sales personnel. It is easy to think of a situation where a salesperson, armed with FPR gross sales information, as well as costs and expenses information found elsewhere in the FDD, will use this combined information to help a prospective franchisee construct a profit and loss statement. Here lies the problem. The salesperson can discuss the sales information contained in the FPR with the prospect, and also direct the prospect to the information in Items 5, 6 and 7 of the FDD to identify costs and expenses that he/she will incur in starting up and operating the franchised business, but it is the combination of this information in a way to produce a profit and loss analysis that is prohibited. Care must be taken in this area to avoid creating an unlawful FPR out of what would otherwise be the lawful disclosure of information.

[30] FTC Franchise Compliance Guide (May 2008).
[31] *Id*. at Item 7, footnote 13.
[32] *Id*.

7. Differences in Fees/Expenses of Company-Owned Outlets

Finally, if cost information is provided in an FPR based on the costs and expenses incurred by company-owned locations alone, the franchisor must provide supplemental disclosure or adjustments to reflect the differences between fees and expenditures incurred by company-owned and franchised locations. For example, if company-owned locations do not make royalty payments, or if insurance costs are higher (or lower) for corporate locations, those differences must be added to the FPR. This leads to another question: when a franchisor discloses gross profit or net profit-based on company-owned outlets alone, how should adjustments be disclosed to reflect all actual and reasonably expected material financial and operational differences between company-owned and franchised outlets?

Before the FPR Commentary was adopted, many FPRs that disclosed gross profit or net profit based on company-owned locations may have included a footnote to generally describe the categories of expenses which those locations did not incur.

This is no longer permitted under the FPR Commentary under the rationale that prospective franchisees tend to look solely at the numbers and may disregard information in the footnotes, which could have a significant impact on financial performance.

Company-owned locations may not incur certain expenses that franchised locations have, and vice versa. Therefore, what expenses/costs must be included or adjusted in an FPR and how should those costs/expenses be expressed? Certainly if the company-owned locations do not pay royalties or advertising fees, the percentages or amounts that franchisees are required to pay under the terms of the franchise agreement must be included because, while these are not actual expenses of the company-owned units, the omission of these expenses would clearly not be representative of all of the costs and expenses that a franchisee will incur.

More difficult to reflect in an FPR are the expenses, such as management fees or supervisory costs, which may vary dramatically depending on the circumstances. If a company-owned location has a manager overseeing the outlet (thus incurring management costs) but a franchised location is managed by the owner/operator (who does not take a salary), should managerial costs be excluded from the company-owned information? Probably not. Those additional costs could be noted to indicate that if a franchisee is managing the location and does not draw a salary, the management costs may not be incurred. But eliminating those costs from the FPR data would be tampering with actual historical results, which may transform the FPR to more of a projection rather than a presentation of historical numbers.

Consider other variable expenses that may be higher or lower for franchised locations. For example, some company-owned location expenses may be lower due to certain economies of scale (such as shared office space and administrative functions, lower food costs due to high volume of purchases, etc.). On the other hand, some company-owned location expenses may be higher due to the more established nature

of the operations (such as higher wages for employees, higher insurance costs based on loss history, etc.). When considering the adjustments or supplemental information that may be necessary in an FPR that includes more variable expenses in calculating gross profit or net profit of company-owned locations alone, it may be best to take a conservative approach. Where a judgment must be made, this means adjusting costs upward if the franchisor has reason to believe that a franchisee's costs in a certain category could be higher, and not adjusting costs downward where the franchisee's costs could be lower. This is obviously a less attractive approach from a sales perspective, but it can help insulate a franchisor from franchisee claims resulting from unreasonable financial performance expectations.

There has historically been wide disparity on how company-owned location costs or expenses are documented in FPRs. In some, the information was footnoted and generally described in narrative form, if at all. The FPR Commentary makes it clear that this information must be included in the results and "clearly presented and in the same format as the rest of the FPR."[33] For example, if the FPR data is presented in tabular form, the adjustments must be included within or added to the end of the table.

The following is a relatively well crafted example of an FPR for company-owned outlets that includes supplemented costs and expenses for a franchised outlet. In the example, company (affiliate) data is presented in the table through the "EBITDA" disclosure, and franchise outlet information is supplemented after that:

	Year 1	Year 2	Year 3	Year 4
Total # of [redacted] Gyms	39	34	23	9
Year-End Membership	4,593	5,224	5,208	5,333
Gross Sales	$1,189,440	$1,460,797	$1,584,819	$1,456,203
Personnel Costs	$264,673	$265,975	$287,121	$279,570
Supplies & Maintenance	$34,513	$33,734	$35,199	$31,873
Utilities	$81,022	$79,051	$70,797	$84,609
Product Cost of Goods Sold	$14,890	$19,265	$16,896	$13,849
Other Club Expenses	$91,394	$106,295	$113,360	$134,511
EBITDAR	$702,947	$956,478	$1,061,446	$911,792
Rent & Occupancy	$374,544	$557,801	$527,338	$515,691

[33] FPR Commentary, at 19.10.

EBITDA	$328,403	$398,677	$534,109	$396,102
Annual Franchise Expense Not Encompassed in Table Above (assuming median annual Gross Sales) (See Note A below)				
Royalties (5%)	$59,472	$73,040	$79,241	$72,810
Technology and Support Services Fees ($600 monthly)	$7,200	$7,200	$7,200	$7,200
Brand Fund (2%)	$23,789	$29,216	$31,696	$29,124
Local Marketing (5%)	$59,472	$73,040	$79,241	$72,810

But if actual gross profit or net profit information is adjusted to reflect additional expenses that a franchisee may incur, it can be argued that the information is no longer the actual historical performance of the company-owned locations, but is based on company-owned historical costs and projected franchised costs. To avoid converting a historical FPR into a projection, gross profit or net profit information should be provided in a format which makes clear the actual historical expenses that have been incurred by company-owned locations. Adjustments to be made for expected material financial differences can be segregated, but in the same format, so as to make clear that the adjustments do not alter the historical information. These adjustments can be accompanied by footnotes or a narrative below to describe any assumptions made by the franchisor.

8. Consistency Between Item 19 and Item 20 Outlet Information

One point worth mentioning in the context of the outlets that can or must be used in FPR results, and although not addressed in the FPR Commentary, is the connection between Item 19 FPR data and Item 20 outlet data. While it may seem obvious that both Items should have consistent information, it is often different individuals at a franchisor who are gathering the relevant information. They may not be coordinating with each other. Reviewers of the FDD, including franchise counsel, may miss inconsistencies between the two Items disparately prepared. The following is an example showing how these two Items can be inconsistent:

Item 19 FPR disclosure:

The following data represents results from our two franchisee-owned Stores (one opened on 2/27/15 and one of 5/15/15) that were open for 12 months or more as of our 2016 fiscal year end. Data for 2015 is partial year data based on opening date. The data in the table below represents the actual Gross Revenue achieved (excluding operating expenses):

Item 20 Table 1:

Outlet Type	Year	Outlets at the Start of Year	Outlets at the End of the Year	Net Change
Franchised	2015	0	3	+3
	2016	3	3	0
	2017	3	6	+3

The two disclosures are inconsistent because Item 19 provides results for two units (noting that both were opened in 2015) and Item 20 indicates that there are three franchised units, each of which opened in 2015. Although this is only a difference of a single unit, the impact upon the FPR could be material considering the small number of outlets in the system.

C. Use of Subsets

The FTC Rule and the Compliance Guide have always permitted the use of subsets in an Item 19 earnings claim or FPR. The FTC Rule itself states that the franchisor must disclose … "[w]hether the representation relates to the performance of all of the particular set of characteristics …"[34] Furthermore, the FTC Rule Compliance Guide states that [a] franchisor that makes an historic financial performance representation, in Item 19 must state whether the representation relates to the performance of all existing outlets or only a subset of them sharing some characteristic (e.g., all in the same geographic region or locale, all occupying free standing premises as opposed to premises in a shopping center, or all in operation for at least three years)."[35] The FPR Commentary provides further clarification to previous language and instructions.

First, the FPR Commentary confirms that franchisors can use subsets assuming there is a reasonable basis for the subset, it is accurate, and it is not misleading.[36] The FPR Commentary also makes clear that geographic subsets are specifically permitted as long as the franchisor describes why that geographic subset was selected,[37] and it is not misleading. For example, if a franchisor offers and sells ice cream shop franchises and it decides to focus its franchise sales activities solely in the Midwestern United States where consumer demand for ice cream shop products is likely lower in the winter months than in the summer months, providing an FPR based on a subset of locations in Florida may not be justifiable and could be misleading. However, providing subsets of rural and urban unit locations would likely be different and, if presented properly, these subsets of information could be useful to a prospective franchisee seeking an urban or rural location, respectively.

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[34] FTC Rule, 16 C.F.R. § 436.5(s)
[35] FTC Franchise Compliance Guide (May 2008), Item 19.
[36] FPR Commentary, at 19.12.
[37] FPR Commentary, at 19.15.

The FPR Commentary goes further to describe what is not acceptable as a subset in an FPR. Question 19.13 addresses whether a franchisor can make an FPR based solely on the performance of a subset of its best performing outlets[38] The answer is a qualified no, on the basis that, like the example noted above of Florida ice cream shop performance being provided to a prospective Midwestern franchisee, providing a subset based solely on high performance is inherently misleading and lacks a reasonable basis. However, rather than stating that such a subset is entirely impermissible, the FPR Commentary states that such a subset is permitted as long as a corresponding subset of the lowest performing outlets is provided. For example, if a franchisor provides a subset of the highest grossing 10% of its outlets, it must also provide the same information for the lowest grossing 10% of outlets in the system. Some franchise practitioners may believe that providing a subset of top performing outlets is always unreasonable and misleading as they will argue that aggressive franchisor salespersons will "steer" prospective franchisees to these subsets of information. However, under the FPR Commentary, this information can be provided as long as it is accompanied by corresponding lowest performers.

Finally, the FPR Commentary provides certainty around the use of subsets for franchisors that have a small number of units (company-owned or franchised) upon which to base an FPR. Question 19.14 of the FPR Commentary provides that a franchisor cannot create a subset with less than ten outlets. The FPR Commentary confirms that an FPR can be created based on the data of less than ten units if the franchisor has a reasonable basis for doing so, but it cannot create a subset of this information.

D. <u>Averages and Medians</u>

When crafting an FPR, many franchisors choose to include an average expression of quantity as a part or all of that FPR, such as average outlet revenue or items sold. Historically, the "mean" average is the most popular and well known measure of expressing an estimate of centralized trend. The FPR Commentary defines a mean average as "the sum of all data points in a set, divided by the number of data points in that set."[39] So, if a franchisor is expressing in an FPR the mean average revenue of 100 outlets, this is calculated by adding together the total the revenue of each of those outlets and dividing by 100.

Using a mean average can have some advantages. Because it includes every point in a sample as part of the calculation, it can reduce inaccuracies in forecasting any one value in that sample. It also statistically represents the value that is most common in a sample even though it is often not one of the values in that sample.

An important disadvantage of using the mean average to express a trend is that it is susceptible to the presence of outliers. Outliers are values that can skew an

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[38] FPR Commentary, at 19.13

[39] *Id*., at 19.4.

average because they are very different from (much higher or lower than) most of the other points used to determine the average.

Take, for example, the following sample of revenues from outlets in a system:

Outlet	1	2	3	4	5	6	7	8	9	10
Revenue in Thousands $	170	185	190	205	220	245	255	305	875	940

The mean average revenue for these outlets is $359,000. However, looking at the revenue from those outlets, the mean may not be the most accurate way in an FPR to express the typical revenue of the outlets, because most of the outlets tend to have revenues in the $190,000 to $250,000 range. The reason the mean is higher than that range is because of two outlets included in the data set with much higher revenues than the others.

Historically, one way in which the FTC and NASAA sought to address the outlier issue with respect to mean averages in an earnings claim or FPR was the requirement that franchisors disclose in an earnings claim or FPR the number and percent of the outlets whose data were used in arriving at the representation that actually attained or surpassed the stated results.[40] In this way, a prospective franchisee might be able to glean how outliers may or may not contribute to the calculation of the average. For example, if within a given mean average there is a relatively low percentage (for example, 5% to 25%) or high percentage (for example, 75% to 95%) of the outlets used in the calculation that meet or exceed that average, a prospect would know that there may be some outliers pulling the average up or down. Conversely, if the number of outlets that meet or exceed an average skews closer to the middle (for example, 40% to 60%), then a franchisee may have greater confidence that the average is representative of how a majority of the outlets have performed.

1. <u>Highest and Lowest Gross Sales</u>

The requirement in Question 19.16 of the FPR Commentary seeks to add to this measure by requiring the inclusion of the median average in the FPR if a mean average is also included[41] (and vice versa). A median average represents the middle number in a sequence of numbers.[42] If the sequence is odd, then the median is the middle value. If the sequence is even, then you add the two middle values and divide by two

[40] *See* 16 C.F.R. § 436.5(s)(3)(ii)(E); NASAA, Uniform Franchise Offering Circular Guidelines – 1993, Item 19 – Earnings Claims, reprinted in Bus. Franchise Guide (CCH) ¶ 5771 (adopted April 25, 1993); NASAA, 2008 Franchise Registration and Disclosure Guidelines, (s)(3)(ii)(E) Item 19: Financial Performance Representations, reprinted in Bus. Franchise Guide (CCH) ¶ 5705 (adopted June 8, 2008).

[41] FPR Commentary, at 19.16.

[42] The FPR Commentary defines the "median" as "the data point that is in the center of all data points used. That number is found by examining the total number of data points and finding the middle number in that set. In the event the number of data points is an odd number, the median will be the center number. If the dataset contains an even number of data points, the median is reached by taking the two numbers in the middle, adding them together, and dividing by two."

(essentially, taking the mean average of the two middle values). In the example noted above regarding the ten outlets whose mean average was $359,000, the median is $232,500. In that case, the median average is a closer representation of the performance of the majority of the outlets because of the presence of outliers. A point of clarification here is that disclosure of highest and lowest numbers in the range must be provided whenever the franchisor discloses the mean average (or median) of gross sales. These numbers need not be provided for expenses or gross or net profit.[43]

2. Outlets Closed During Time Period

Questions 19.16 and 19.17 of the FPR Commentary also require that the franchisor disclose the highest and lowest numbers in the range whenever a franchisor discloses a mean or median average of gross sales.[44] That, along with the requirement in Question 19.16 to add a median average when using a mean average, is intended to provide prospective franchisees with additional information that may point to outliers in an average.

Regarding averages, the FPR Commentary clarifies that franchisors may exclude from an FPR that expresses a mean or median average outlets that closed during the time period covered by the average calculation.[45] This can be done as long as "the franchisor discloses in the FPR: (i) the number of company-owned outlets that closed during the time period, if the FPR includes company-owned outlets; (ii) the number of franchise outlets that closed during the time period, if the FPR includes franchised outlets; and (iii) the number of excluded outlets that closed during the same time period after being open less than 12 months."[46] That requirement applies to each year or period of time included in the FPR.

An average calculation in an FPR is most effective if the values used in the data set have the same underlying assumptions and parameters – similar operations, open for the same period of time, etc. So for obvious reasons, franchisors may not wish to include outlets in an average calculation that are not open and operational for the entire period of time covered by that calculation. If included, outlets that did not perform for the same period of time as the other outlets in the calculation could artificially lower the average in a way that does not represent outlet performance. When excluding certain closed outlets from an average calculation in an FPR, many franchisors already disclose, or at least should know to disclose, the number of outlets that closed during the time period(s) in question. What 19.18 of the FPR Commentary adds to this is an additional requirement to identify how many of the excluded outlets closed within their

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[43] FPR Commentary, at 19.16.

[44] Note, in both 19.16 and 19.17, the FPR Commentary specifically refers to an average of "gross sales," which therefore begs the question, if an average of some other metric (for example, number of items in outlets sold) is used, must the FPR include the high and low number of that average as well? Considering that it is in both the best interest of a franchisor and prospective franchisee to have such information, the broader interpretation of this language would seem not only the safest but the best course of action.

[45] FPR Commentary, at 19.18.

[46] *Id.*

first 12 months of operation. This suggests a desire by NASAA for franchisors to additionally identify the attrition rate of nascent outlets in a system.

The following is an example of an FPR prepared in the past to include mean average sales that did not also include a median average.

Annual Average Unit Volume for 2015 Calendar Year

	Top 10%	Top 25%	Top 50%	Top 75%	Total (All)
Number of Outlets	11	28	55	82	109
Average Unit Volume (AUV)	$544,383	$470,611	$416,233	$375,902	$335,837
Number and Percent that Met or Exceeded the AUV	5 45%	11 39%	21 38%	34 41%	51 47%

art I Explanatory Notes

1) Each column identified as "Top 10%", "Top 25%", "Top 50%" and "Top 75%" refer to the respective percentage of outlets ranked by their Gross Sales in descending order.

2) The "Number of Outlets" refers to the number of outlets within the respective category.

3) "Average Unit Volume" refers to the average Gross Sales of all outlets within the category.

Under the FPR Commentary, the above example would need to be supplemented to include median average volume for each of the tiers of outlets noted in the table.

E. Forecasts and Projections.

Franchisors are permitted, under the FTC Rule and the NASAA Guidelines, to prepare FPRs that, instead of disclosing historical outlet performance, include a forecast of future financial performance.[47] To do so, the FTC Rule merely requires a franchisor to state the material bases and assumptions upon which the forecast is based, including "significant factors upon which a franchisee's future results are expected to depend."[48] This leaves open many possible bases and sources of information, some of which may be speculative in nature, for the preparation of a forecast or projection in an FPR. The FPR Commentary now reduces the scope of information upon which a forecast or projection can be made.

Consider the following FPR prepared as a projection:

[47] 16 C.F.R. § 436.5(s)(3)(iii).
[48] *Id.*

Gross Revenue and Gross Profit Projections:

We estimate that on average, new [redacted] clinics will achieve the following Gross Revenue and Gross Profit results in their first two years of operation:

	Year 1 [4]	Year 2 [5]
Gross Revenues [1]	$837,000	$1,488,000
Cost of Goods Sold [2]	$208,250	$372,000
Gross Profit (Gross Revenues minus Cost of Goods Sold) [3]	$628,750	$1,116,000

Our predecessor [redacted] and our existing Franchisees do not have significant history using our current "brick and mortar" Franchise model. Our only Franchisee that has more than 3 months of operations using the local office model is our Phoenix, Arizona clinic, which opened in January 2017 and became a Franchisee in May 2017. Operating in conjunction with [redacted] the Phoenix clinic acquired 39 new patients in February-April 2017, for an average of 13 new patients per month.

Absent additional information, the above example likely does not satisfy the FPR Commentary's requirements. Because of its limited franchised operations, the franchisor does not have adequate historical information upon which to be able to project future revenues, cost of goods sold, and gross profit through two succeeding years. In addition, in the note that follows the table, the background information regarding new patients is not an adequate basis and assumption for the information projected in the table.

Although there are likely few FPRs that are prepared on such a basis, the FPR Commentary states in Question 19.19 that projections cannot be based on mere hypothetical situations or expectations.[49] Instead, projections must be based on historical data from outlets substantially similar to the type of outlet offered in the FDD.[50] The FPR Commentary does, however, allow a franchisor to adjust or supplement historical results in order to reflect changes in the market that may have taken place since the period of time reflected by the historical results.

Adding to that, Question 19.20 of the FPR Commentary further narrows the scope of acceptable sources for a forecast or projection by requiring a projection to be based on historical data (a) from the brand being offered, and (b) from outlets substantially similar to the type of outlet offered in the FDD. [51] Some franchisors may in the past may have chosen to use historical information from other brands in an effort to draw a parallel to expected results for their own brand. The FPR Commentary now strictly forbids such practices by stating that a projection "may not be based on the

[49] FPR Commentary, at 19.19.
[50] *Id.*
[51] *Id.*, at 19.20.

results of other brands operated or licensed by the franchisor or its affiliates, or on the results of similar or competitive brands operated by others, or on industry reports."[52]

Although not a forecast or projection, the following is an example of an FPR note explaining that the information in the FPR is for an outlet that recently converted to the franchisor's brand:

> Note 1: The historical sales and cost information presented in the above table for the 2016 calendar year is for one franchisee that converted its "[Acme Competitor]" award-winning business to an Acme Outlet on January 5, 2018. This franchisee has operated in St. Louis, Missouri for over five years as a fitness and health facility that is substantially similar to the Franchised Business offered in this Disclosure Document.

If the above example were a projection or forecast of instead of the presentation of historical results, the FPR Commentary is clear that such an FPR would no longer be permitted. However, in light of the FPR Commentary's prohibition on use of historical data from competitive brands for the preparation of a projection, does this suggest that the FPR Commentary also prohibits the presentation of historical competitive brand information in general? The answer lies in whether there is a reasonable basis for the presentation of such information. It is likely that in most circumstances, an FPR prepared solely with historical competitive brand information would not be sufficiently relevant or meaningful to a franchisor's prospective franchisees, unless the franchisor could substantiate that the brand change would not substantially impact the information provided. If that were truly the case, why convert to this brand?

F. Disclaimers

FPRs are the means by which franchisors may offer insight to prospective franchisees as to selected financial prospects of a franchise offering. One of the pitfalls of crafting an FPR is the possibility that the information disclosed could mislead a prospective franchisee as to those financial prospects. Perhaps in an attempt to guard against such pitfalls, some franchisors want to include language in an FPR that in some manner qualifies the information disclosed, or the expectations that the prospect should have.

The FTC Rule prohibits franchisors from disclaiming or requiring "a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments."[53] The FTC explains that "this prohibition is intended to prevent fraud by preserving the completeness and accuracy of information contained in disclosure documents."[54] The FTC is concerned about franchisors who might attempt to insulate themselves from false or deceptive statements made in an FDD, particularly with respect to portions of the FDD pertaining to matters other than the terms of the

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[52] *Id.*
[53] 16 C.F.R. § 436.9(h).
[54] 16 C.F.R. § 436 (2007) Statement of Basis and Purpose, reprinted in Bus. Franchise Guide (CCH) ¶ 6066.

franchise agreement that cannot be negotiated, such as a financial performance representation.[55] For that reason, the FTC prohibits franchisors from making statements that contradict those in their FDD, because to permit otherwise would undermine the FTC Rule's very purpose by signaling to prospective franchisees that they cannot trust or rely upon the disclosure document.[56]

1. Required Disclaimer

Before addressing prohibited disclosures, it is important to note that the FPR Commentary leaves unchanged the FTC Rule requirement that a disclaimer must be placed in an Item 19 FPR, in the form of a "clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation."[57] There is no additional guidance in the FTC Rule as to the form that the clear and conspicuous admonition should take. When NASAA issued its 2008 Commentary, it specifically provided that language, which is to appear in a separate paragraph:[58]

> For historical representations, the admonition should be: "Some [outlets] have [sold] [earned] this amount. Your individual results may differ. There is no assurance that you'll [sell] [earn] as much."
>
> For projections, the admonition should be: "These figures are only estimates of what we think you may [sell] [earn]. Your individual results may differ. There is no assurance that you'll [sell] [earn] as much."

In the FPR Commentary, NASAA revisited this issue, as since the 2008 Commentary was issued regulators presumably have received and taken issue with admonition language in FDDs that differed from the prescribed language and felt the need to clarify how that language is to be expressed and the circumstances in which it may vary. In Question 19.21, the FPR Commentary makes clear that a franchisor may not vary the required admonition language unless the franchisor makes a type of FPR that does not fit the situation for the language provided.[59] The prescribed language for both types of admonition applies to an FPR based on sales or earnings; thus, a franchisor that makes an FPR based on outlet sales or earnings must use the applicable language, without any variation, and without adding any additional disclaimer language.[60] However, if an FPR is based on the measure of something that is not outlet sales or earnings (for example, number of haircuts given, or hotel occupancy rates), a

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[55] *Id.*
[56] *Id.*
[57] 16 C.F.R. § 436.5(s)(3)(iv).
[58] NASAA, Commentary on 2008 Franchise Registration and Disclosure Guidelines, reprinted in Bus. Franchise Guide (CCH) ¶ 5706 at 19.03.
[59] FPR Commentary, at 19.21.
[60] *Id.*

franchisor may change the admonition language, but only to the extent necessary to fit the FPR.[61]

Question 19.22 of the FPR Commentary clarifies that the "clear and conspicuous" requirement means that the admonition must be easily noticeable and easily understandable by a prospective franchisee, so for example, it must be in a separate paragraph from the rest of the FPR and in bold type.[62] It may not be in capital letters, underlined, or in larger type than the rest of the FPR.[63]

2. Prohibited Disclaimers

The most interesting -- and perhaps debatable -- development in the FPR Commentary regarding the standard admonition language is the requirement in Question 19.23, which mandates that a franchisor may not include any disclaimers in an Item 19 FPR that are in addition to the admonition language mandated by FPR Commentary Question 19.3.[64] NASAA explains this requirement:

> The admonition required . . . is not intended to allow a franchisor to disclaim responsibility for the FPR or advise a franchisee that it may not rely on the FPR. Under the FTC Franchise Rule, a franchisor is prohibited from disclaiming or requiring a prospective franchisee to waive reliance on any representation made in the Franchise Disclosure Document. A franchisor, therefore, may not include in Item 19 or elsewhere in a Franchise Disclosure Document any disclaimers that contradict, mitigate, or are inconsistent with the admonition prescribed . . .[65]

So while the FPR Commentary is clear that additional disclaimers are not permitted, what may not be as clear is what specifically constitutes "disclaimer" language. The explanations and notes that are included in an FPR are important to add context and meaning to the financial performance results disclosed. But some disclosures in an FPR that are at least intended to be explanations can be viewed by regulators to be disclaimer language because in their opinion its intent is more exculpatory rather than explanatory. Statements in an FPR that include language such as "we make no representations," "we cannot guarantee," and "you may not rely upon," are now often called out by regulators as impermissible disclaimers.

The following is an example of language that was recently deemed by a state franchise regulator to be disclaimer language and, as a result, to be removed from an FPR:

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[61] *Id*.
[62] FPR Commentary, at 19.22.
[63] *Id*.
[64] FPR Commentary, at 19.23.
[65] *Id*.

> These results are averages of specific [ACME franchisor] programs and should not be considered as the actual or probable results that you will realize. The information presented does not indicate whether these programs operated profitably. We make no representations about the programs not included above. As each program serves a different age, economic, business or social segment of the population, you should not rely on any information provided in this Item 19 as basis for determining the financial performance of another program not included.

Taking a closer look at this prohibited language, one could conclude that its purpose is to explain rather than to disclaim. Yes, the first sentence is similar in meaning to part of the required admonition language, but the remainder of the language at least arguably clarifies to the prospective franchisee what the stated results do not provide. Note, for example, that the third sentence (beginning with "we make no representations about") does not disclaim any information that *was* included in the FPR but rather only information that is *not* included in the FPR. Different readers may not view this language the same way. The conclusion is that there is no bright line standard as to what language rises to the level of a "disclaimer" in an FPR, and that in the absence of further guidance from the FTC or NASAA on that point, it is up to regulators themselves to establish that standard.

Some additional examples from actual FDDs that have not been permitted by one or more state examiners include the following:

> "We do not represent that any franchisee can expect to attain these results."
>
> "should not be considered as the actual or probable results that will be realized by you…"
>
> "results are determined by the quality of management….energy and dedication of the franchisees…."
>
> "You are likely to achieve results that are different, possibly significant and adversely, from the results shown above."
>
> "The average franchised business included in the above calculations is a mature business; accordingly, a new franchisee's individual Gross Sales and financial results are likely to differ from the results stated above."
>
> "Your Gross Sales and financial results will depend upon, among other things, factors such as local and national economic conditions; how much you follow our methods and procedures; your sales skills; your management skills; experience and business acumen; whether you personally manage your Franchised Business or hire a manager; the region in which your Franchised Business is located; the competition in your local market; the prevailing wage rate; and the sales level reached during the initial period."

> "THE FRANCHISOR MAKES NO REPRESENTATIONS, GUARANTIES, OR WARRANTIES, EXPRESS OR IMPLIED, WITH RESPECT TO THE ACTUAL VOLUME. ACTUAL RESULTS MAY VARY SUBSTANTIALLY."

The question to consider is whether any of these statements are inappropriate "disclaimers" under the FPR Commentary, or rather explanations of fact to assist a prospective franchisee in understanding an FPR and its risks.

Conclusion

Once the 2018 renewal season is concluded, practitioners and regulators alike should have a better sense of the FPR Commentary's impact upon FPRs and the registration and disclosure process. The FPR Commentary is likely to lead to a more thorough examination of FPRs by state regulators with the addition of new and more specific "guideposts" for FPR preparation. If the result of this scrutiny leads to better FPRs that are more universally comparable among franchise systems, the FPR Commentary should be considered a success. However, if this is not the case, and instead the FPR Commentary merely generates additional comments and resistance from regulators – especially on issues that are open to interpretation and nuance – this could lead to decisions by some franchisors to eliminate their FPR entirely in order to register in some jurisdictions. That result would be detrimental to prospective franchisees and a potential disservice to franchising in general. The hope is that the FPR Commentary provides reasonable parameters for franchisors preparing FPRs, and lends regulatory sanction for examiners to enforce consistency among FPRs and to eliminate or correct deficiencies.