

**NOTICE OF REQUEST FOR PUBLIC COMMENTS REGARDING PROPOSED NEW  
STATE COVER SHEETS TO FRANCHISE DISCLOSURE DOCUMENTS**

**June 12, 2018**

The Corporation Finance Section of the North American Securities Administrators Association, Inc. (“NASAA”) is seeking public comments on a proposal to revise the instructions in the NASAA Franchise Registration and Disclosure Guidelines for filing the state cover page to Franchise Disclosure Documents (the “Proposal”).

Comments on the proposal are due by **July 13, 2018**. To facilitate consideration of comments, please send comments to Dale Cantone ([dcantone@oag.state.md.us](mailto:dcantone@oag.state.md.us)), Chair of the Franchise and Business Opportunities Project Group; Bill Beatty ([bill.beatty@dfi.wa.gov](mailto:bill.beatty@dfi.wa.gov)), Chair of the Corporation Finance Section Committee; Chris Staley ([nasaacomment@nasaa.org](mailto:nasaacomment@nasaa.org)), Assistant General Counsel; and Mark Stewart ([nasaacomment@nasaa.org](mailto:nasaacomment@nasaa.org)), Counsel at the NASAA Corporate Office. We encourage, but do not require, comments to be submitted by e-mail. Hard copy comments may be submitted at the address below.

NASAA Legal Department  
Mark Stewart, Counsel  
NASAA  
750 First Street, NE, Suite 1140  
Washington, DC 20002

**Note:** After the comment period has closed, NASAA will post to its website the comments it receives as submitted by the authors. Parties should therefore only submit information that they wish to make publicly available. Further, the following notice will appear on NASAA’s website where comments are posted: NASAA, its agents, and employees accept no responsibility for the content of the comments posted on this Web page. The views, expressions, and opinions expressed in the comments are solely those of the author(s).

## **Background on Franchise State Cover Page**

The NASAA 2008 Franchise Registration and Disclosure Guidelines<sup>1</sup> (“Franchise Guidelines”) require franchisors to include a “State Cover Page” to a Franchise Disclosure Document.<sup>2</sup> The State Cover Page includes several standard risk factors and certain cautionary information about franchising. In addition, the Franchise Guideline instructions allow state examiners, in their discretion, to require that franchisors disclose additional risk factors specific to a franchise offering.

It has been ten years since NASAA adopted the Franchise Guidelines.<sup>3</sup> The Franchise Project Group within the Corporation Finance Section has concluded that the State Cover Page section should be updated and improved. This Proposal seeks to amend Part III, Section B of the Franchise Guidelines.

## **Discussion and Analysis of the Three State Cover Sheets**

The Proposal requires the addition of a new page, titled “How to Use this Franchise Disclosure Document.” The Franchise Project Group is aware that many prospective franchisees find the Franchise Disclosure Document overwhelming.<sup>4</sup> As a result, some prospective franchisees never review the document in its entirety, and others do not review it at all. This new page gives prospective franchisees clear and readable directions about how to use a Franchise Disclosure Document to find answers to common franchise questions.

The Proposal also requires a second page titled “What You Need to Know About Franchising, *Generally*.” This page includes general information about franchising that many prospective franchisees do not appreciate until after they have entered a franchise relationship. This information updates and supplements the cautionary information included on the current State Cover Page.

The Proposal includes new instructions for a third page titled “Special Risks to Consider about *This Franchise*.” This page replaces the current State Cover Page. The new title of this page is more descriptive than “Risk Factors.” This page requires one standard risk factor if a franchisor requires that franchisees resolve disputes outside of the franchisee’s home state. The instructions to this page continue to allow states to require additional risk factors specific to a franchise offering.

The Proposal changes the format of the information presented in the State Cover Sheets. Among other things, the Proposal requires all risk factors and cautionary information to be written in

---

<sup>1</sup> The Franchise Guidelines are available via the NASAA website. See <http://www.nasaa.org/industry-resources/corporation-finance/franchise-resources/>

<sup>2</sup> The requirement is located within Part III, Section B.

<sup>3</sup> The 2008 Franchise Guidelines became effective July 1, 2008.

<sup>4</sup> See E. Karp and A. Stern, A Proposal for a Mandatory Summary Franchise Disclosure Document, *Franchise Law Journal*, Vol. 35, No. 4 (Spring 2016) p. 543 (“[T]he franchise disclosure document has, in recent times, grown greatly in length and complexity for the benefit of franchisors. . . . It is now not unusual for the entire franchise disclosure document, including all related attachments, to exceed 300 pages. In fact, it is not unheard of for a franchise disclosure document to exceed 500 pages, or 7.5 pounds, of material”).

lower case text, not capital letters, as is required under the Franchise Guidelines. Many sources agree that typeface written in all capital letters makes text difficult to read.<sup>5</sup> In addition, the cautionary information includes explanatory captions, also to improve readability.

Finally, the Proposal includes new instructions and procedures for requiring risk factors. The new instructions promote uniformity and reduce repetition in the presentation of risk factors. Under current practice, some state cover pages include state specific risk factors that may not apply in all states. Other state cover pages include multiple risk factors on the same subject with slightly different wording. The instructions specifically allow states to include non-uniform risk factors on a state specific addenda to a Franchise Disclosure Document if the risk factor is state-specific, if it is required by only a single state, or if different states insist on different wording for substantially the same risk factor.

The proposed New State Cover Sheets to Franchise Disclosure Documents is attached as Exhibit A.

---

<sup>5</sup> See A Plain English Handbook: How to create clear SEC disclosure documents, Office of Investor Education and Assistance, US Securities and Exchange Commission (August 1998), p. 43, quoting Josef Albers, Interaction of Color (“...words consisting of only capital letters present the most difficult reading—because of their equal height, equal volume and, with most, their equal width.”) <https://www.sec.gov/pdf/handbook.pdf>.

# **Exhibit A**

### III. The Franchise Disclosure Document

#### B. *State Cover Sheets and State Effective Dates Page*

1. The Franchise Disclosure Document must include the following State Cover Sheets prepared according to the Instructions following Form G:
  - a. “**How to Use This Franchise Disclosure Document.**”
  - b. “**What You Need to Know About Franchising *Generally*.**”
  - c. “**Special Risk(s) to Consider About *This Franchise*.**”
2. The Franchise Disclosure Document also must include a page titled “**State Effective Dates**” with the following information prepared according to the Instructions following Form G:

#### **State Effective Dates**

The following states require that the Franchise Disclosure Document be registered or filed with the states, or be exempt from registration: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

This document is effective and may be used in the following states, where the document is filed, registered, or exempt from registration, as of the Effective Date stated below:

| <b>State</b> | <b>Effective Date</b> |
|--------------|-----------------------|
| [State]      | [Date or pending]     |
| [State]      | [Date or pending]     |

3. A sample of an FTC Cover Page, State Cover Sheets, and State Effective Date Page is attached as Form G showing where the pages are to appear in a Franchise Disclosure Document.

## Form G

[Sample]

### FRANCHISE DISCLOSURE DOCUMENT



SUN VISION FRANCHISING, LLC  
2018 Mercury Avenue, Suite 1600  
Venus, Texas 77666  
(214) 777-2222  
harry.earth@sunvision.com  
www.sun.com

As a SUN VISION® franchisee, you will sell solar power-related equipment, training and supplies primarily to small and medium-sized businesses.

The initial investment necessary to begin operation of a SUN VISION franchised business ranges from \$145,000 to \$350,000. This includes \$35,000 to \$100,000 that must be paid to the franchisor or its affiliates.

This disclosure document summarizes certain provisions of your franchise agreement and other information in plain English. Read this disclosure document and all accompanying agreements carefully. You must receive this disclosure document at least 14 calendar days before you sign a binding agreement with, or make any payment to, franchisor or an affiliate in connection with the proposed franchise sale. **Note, however, that no government agency has verified the information contained in this document.**

You may wish to receive your disclosure document in another format that is more convenient to you. To discuss the availability of disclosures in different formats, contact Harry Earth at 2018 Mercury Avenue, Suite 1600, Venus, Texas 77666, (214) 777-2222, [harry.earth@sunvision.com](mailto:harry.earth@sunvision.com).

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

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

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

Issuance Date: August 1, 2018

## How to Use This Franchise Disclosure Document

Here are some questions you may be asking about buying a franchise and tips on how to find more information:

| QUESTION  | WHERE TO FIND INFORMATION  |
|---|--|
| <b>How much will I earn?</b>  | Item 19 may give you information about outlet sales, costs, profits or losses. You should also try to obtain this information from others, like current and former franchisees. You can find their names and contact information in Item 20 and Exhibit [ ]. |
| <b>How much will I need to invest?</b>  | Items 5 and 6 list fees you will be paying to the franchisor and at the franchisor's direction; Item 7 lists the initial investment to open, and Item 8 describes the suppliers you must use.  |
| <b>Does the franchisor have the financial ability to support my business?</b> | Item 21 and Exhibit [ ] include financial statements. Review these statements carefully.   |
| <b>Is the franchise system stable and growing or shrinking?</b>               | Item 20 summarizes the 3-year history of the number of company-owned and franchised outlets.   |
| <b>Will my business be the only [XYZ] business in my market?</b>              | Item 12 and the "territory" provisions in the franchise agreement describe whether the franchisor and other franchisees can compete with you.  |
| <b>Does the franchisor have a troubled legal history?</b>                     | Items 3 and 4 tell you whether the franchisor or its management have been involved in material litigation or bankruptcy proceedings  |
| <b>What's it like to be [an XYZ] franchisee?</b>                              | Item 20 and Exhibit [ ] list current and former franchisees. You can contact them to ask about their experiences.  |
| <b>What else should I know?</b>   | These questions are only a few things you should look for. Review all 23 Items and all Exhibits in this disclosure document to better understand this franchise opportunity. See the table of contents.  |

## What You Need To Know About Franchising *Generally*

Consider these facts about franchising before investing in any franchise:

1. **Losses and personal liability.** You may have to pay royalties and other fees even if your franchise is losing money.
2. **Additional investment.** The franchise agreement may allow the franchisor to change its manuals and business model without your consent. These changes may require you to make additional investments in your franchised business or may adversely impact the operation of your franchised business.
3. **Operating restrictions.** The franchise agreement may prohibit you from operating a similar business both during the term of the franchise and after the franchise ends. If so, you would be unable to operate a similar business after the franchise ends even if you still have obligations to your landlord or other creditors.
4. **When your franchise ends.** Your franchise agreement may not permit you to renew. Even if it does, most franchise agreements do not allow you to renew on the same terms and conditions. You may have to sign a new agreement with different terms and conditions in order to continue to operate your franchised business.
5. **Supplier Restrictions.** You may have to buy or lease items from the franchisor or a limited group of suppliers the franchisor designates. These items may be more expensive than similar items you could buy on your own.

### Some States Require Registration

Your state may have a franchise law that requires franchisors to register before offering or selling franchises in the state. Registration does not mean that the state recommends the franchise or has verified the information in this document. To find out if your state has a registration requirement, or to contact your state, use the agency information in Exhibit [ ].

Your state also may have laws that require special disclosures or amendments be made to your franchise agreement. If so, you should check the State Specific Addenda. See the Table of Contents for the location of the State Specific Addenda.



## Special Risks to Consider About *This Franchise*

Certain states require that the following risk(s) be highlighted:

1. **Out-of-State Dispute Resolution.** The franchise agreement requires you to resolve disputes with the franchisor by mediation and arbitration only in [State]. Out-of-state mediation and arbitration may force you to accept a less favorable settlement for disputes. It may also cost more to mediate or arbitrate with the franchisor in [State] than in your own state.

[If applicable] Certain states may require other risks to be highlighted. If so check the “State Specific Addenda” pages for your state.

Body of Franchise Disclosure Document  
Items 1-22

DRAFT

## State Effective Dates

The following states require that the Franchise Disclosure Document be registered or filed with the state, or be exempt from registration: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

This document is effective and may be used in the following states, where the document is filed, registered or exempt from registration, as of the Effective Date stated below:

| <b>State</b> | <b>Effective Date</b> |
|--------------|-----------------------|
| California   | Pending               |
| Hawaii       | May 17, 2018          |
| Illinois     | Pending               |
| Indiana      | May 20, 2018          |
| Maryland     | Pending               |
| Michigan     | May 10, 2018          |
| Minnesota    | May 23, 2018          |
| New York     | June 15, 2018         |
| North Dakota | May 10, 2018          |
| Rhode Island | May 11, 2018          |
| South Dakota | May 10, 2018          |
| Virginia     | May 31, 2018          |
| Washington   | Pending               |
| Wisconsin    | May 9, 2018           |

**Instructions for Preparing  
State Cover Sheets and State Effective Date Page**

1. Insert the State Cover sheets immediately following the FTC required Cover Page described in Part VII.
2. Include the page titled “**How to Use This Franchise Disclosure Document**” as illustrated in the Sample in Form G.
  - a. Format the information on a single page, in at least 13 point type.
  - b. Use bold text only as illustrated in the Sample.
  - c. Do not add, modify, or delete any of the information in the Sample page, except as described below.
  - d. Insert the name of the franchise business where indicated in the first column, and the appropriate Exhibit letters or numbers from the franchisor’s Franchise Disclosure Document where indicated in the second column.
3. On the page immediately following “How to Use this Franchise Disclosure Document,” include the page titled “**What You Need to Know About Franchising Generally**” as illustrated in the Sample in Form G.
  - a. Format the information on a single page, in at least 13 point type.
  - b. Use bold and underlined text only as illustrated in the Sample.
  - c. Do not add, modify, or delete any of the information in the Sample, except as described below.
  - d. Insert the appropriate Exhibit letter or number from the franchisor’s Franchise Disclosure Document where indicated in the second to last paragraph.
4. On the page immediately following “What You Need to Know About Franchising Generally” include the page titled “**Special Risk(s) to Consider About This Franchise**” as illustrated in the Sample in Form G.
  - a. Unless otherwise directed to do so by a state, include this information on a single page, in at least 13 point type.
  - b. If a franchisor requires any dispute resolution outside of a franchisee’s home state, include the risk factor captioned Out-of-State Dispute Resolution, conforming the disclosure to the franchisor’s requirements and inserting the applicable state or jurisdiction.
  - c. Include additional risk factors if required by a state.
  - d. Do not add, modify, or delete any risk factor unless specifically directed to do so by a state.

- e. Number all risk factors if more than one risk factor is required.
  - f. Disclose any other risk factor or factors required by a State on the same page, unless the state allows the risk factor or factors to appear on a separate State Addendum under a heading captioned “Special Risk(s) to Consider About This Franchise.”
  - g. A risk factor may be allowed to appear on a State Addendum if it is state-specific, if it required by only a single state, or if different states insist on different wording for substantially the same risk factor.
  - h. A state required risk factor may include a short caption with the subject of the risk. If so, follow the format illustrated in the Sample, using bold and underlining for the caption only.
  - i. Do not use uppercase, multiple fonts, bold face, or underlining of the text of a risk factor, unless specifically directed to do so by a state.
  - j. If any risk factors appear in a State Addendum, include the following statement at the end of the page titled Special Risk(s) to Consider About This Franchise: Certain states may require other risks to be highlighted. If so, check the “State Specific Addenda” pages for your state.
5. Insert a page titled **State Effective Dates** immediately before the acknowledgement of receipt pages required under Item 23 of Part VII.
- a. Use the format illustrated in the Sample in Form G.
  - b. If a franchisor is filing for registration in only one state, the franchisor may insert the state effective date information on the same page as the Special Risks to Consider About This Franchise page, if the information will fit on a single page with text not less than 13 point type.
  - c. List an effective date or pending only for those states where a franchise registration, filing, or exemption application has been made or is pending.
  - d. Regional franchisors may add a statement to the State Effective Date page that their territory is limited to a specific state or states.
  - e. As registrations are ordered and made effective, the State Effective Date page can be modified by the franchisor without any refiling or amendment applications with the states.