



OFFICE OF THE ATTORNEY GENERAL  
STATE OF ILLINOIS

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ATTORNEY GENERAL

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From 1994 through 1999, the franchise registration process changed due to: amending the Uniform Franchise Offering Circular (UFOC), as adopted by the North American Securities Administrators Association (NASAA); amendments to the Illinois Franchise Disclosure Act (Act); and Rules under the Act. The Franchise Bureau believes it may be helpful to franchisors if we advise you of our current review process and some of the most common problems we encounter. It is our hope that this information will assist in your filing preparations.

Some franchisors are unaware of the fact that the Act was amended in 1987 to permit a registered franchise to continue sales efforts without interruption, even though its annual report or amendment review has not been completed. Some franchisors choose to wait for the review process to be completed to avoid the possibility of a material omission or conflict with the UFOC Guidelines that would require revising the circular. In a few instances, franchisors have been required to offer rescission to a new franchisee in addition to revising their UFOC.

Just as a franchisor must file Annual Reports to maintain registration, the franchisor must file timely amendments even if the franchisor is not currently offering or selling franchises in Illinois.

We intend to make the review process as quick and painless as possible because we recognize your need to do business with as few delays as possible. The diligent preparation and maintenance of your UFOC is appreciated, but you may not be aware of the fact that the Franchise Bureau continues to encounter circulars from some franchisors that are missing or incorrectly stating material information. Incomplete circulars require more processing time for the franchisor and our staff, which then delays other reviews.

The review of original registration applications for compliance with the Act and UFOC Guidelines is performed within the 21-day period allowed by the Act. This review is also intended to assist first time franchisors and make the filing of Annual Reports easier.

Annual Reports and Amendments are processed with a reduced scope of review based upon a cursory check to ascertain whether or not the Circular is complete, coupled with an examination of the more material aspects of the disclosure document, including litigation, bankruptcy, franchisee lists and financial data. Previously required corrections to material disclosures will be checked to ensure critical information is still being made available to prospective franchisees. This reduced review should allow us to reach our goal of reviewing annual reports within 30 days, with the exception of March through May, which as you well know, is the heaviest filing period.

In an effort to reduce the number of UFOC Guideline compliance problems and facilitate the review process, we have outlined some of the most frequent problems our examiners have encountered. The identification of such common problems will hopefully assist you in the preparation of the application documents, which will then reduce the registration processing periods. By carefully reading the UFOC Guidelines and reviewing the enclosed list of frequent problems, you should become registered in Illinois in a shorter period of time, and be less likely to have compliance problems with Annual Reports.

We intend to update this list whenever necessary. Your comments or sharing of UFOC preparation tips that might make this letter more helpful will be greatly appreciated.

Sincerely,

Robert Tingler  
Franchise Bureau Chief

RT/bjm  
Enc.

## **COMMON CONFLICTS WITH UFOC GUIDELINES**

The UFOC Guidelines are designed to inform prospective franchisees of information vital in making an informed buying decision. If the person preparing the UFOC follows the UFOC Guidelines and writes the circular with the prospects' needs in mind, few problems should arise.

The following list represents the most common compliance problems found in franchisors' UFOC disclosure documents:

### **Item 1 - Franchisor/Predecessors/Affiliates**

Too often the franchisor does not advise the UFOC preparer that corporate changes have occurred affecting (1) who the franchisor is; (2) who runs the franchise, and (3) whether predecessors or affiliates resulted from the changes. **NOTE: Changes in Items 1 and 2 can trigger required changes in Items 3, 4 and 21.**

### **Item 2 - Business Experience**

Changes in who operates the company and which brokers represent the company are too often omitted. If a broker is a corporation, the officers and directors need to be identified too.

### **Item 3 - Litigation**

Include for each matter: (1) case title; (2) court, case number, filing date; (3) key allegations (even if you believe they will later be dismissed); (4) types and amounts of damages or other relief sought; (5) current status; and (6) date and terms of settlement or judgment (even if a "gag clause" was agreed to by the parties).

Changes in litigation status require amendments (such as new litigation, settlement, judgment...) if the case is material to the prospects' buying decision. If in doubt, disclose or call your franchise examiner.

**(NOTE: Settlement results dated after April 25, 1993, must be disclosed regardless of any contrary provision in the settlement agreement. UFOC Guidelines were changed as of this date to require disclosure of confidential settlement terms.)**

## Items 5 and 7 - **Initial Franchise Fee/Initial Investment**

When a franchisor changes its fees or the estimated franchisee investment costs need to be adjusted, the changes must be made in Items 5, 7 and the Cover Page.

## Item 8 - **Restrictions on Sources**

**Item 8 D and Instruction iii** require various figures pertaining to franchisor and affiliate revenue from purchases required of franchisees. Too often the franchisor omits some or all of this information.

## Item 11 - **Franchisor's Obligations**

**Item 11 B ii.g.** Advertising fund information is often omitted or is very incomplete. In many systems, this is one of the highest costs a franchisee may encounter and is important in making a buying decision.

## Item 13 - **Trademarks**

Trademarks can represent the very heart of the franchised business and yet many franchisors do not provide the required information that would let the buyer know exactly what rights the franchisor owns and what the franchisee can rely upon.

## Item 17 - **Renewal, Termination, Transfer & Disputes**

**Item 17 v. & w.** requires disclosure of where litigation is to take place and what state's law will apply. The Illinois Franchise Disclosure Act, §4 Jurisdiction and Venue, and §41 Waivers Void, supplements Item 17 with the requirement that Illinois venue and law apply.

Illinois does not require a statement in Item 17 and the contract that repeats the Illinois requirements. However, another state's law or venue cannot be identified as controlling. If a statement is made in Item 17 and/or in the contract, Illinois jurisdiction and venue must be indicated in plain English.

## Item 20 - **List of Outlets**

Disclosure information must be current within 120 days of the franchisor's anniversary date (this date can be changed by a timely request to the Attorney General). Many franchisors do not provide current franchisee information, or if information is current, they do not indicate when the list was prepared.

The item 20 chart information can be made current within 120 days by attaching franchisee lists to the Annual Report, with the preparation date indicated.

Some franchisors overlook the Item 20E requirement that former franchisees' **home** address and phone be provided. The former franchisee usually abandons its business address and phone, so the prospect must have the home information if the prospect hopes to ask questions of the former franchisees.

Another overlooked provision in item 20 E is the failure to treat franchisees who have not communicated with the franchisor within 10 weeks of the filing date, as former franchisees. To save everyone's time, the preparer should state in Item 20 that the former franchisee list includes any franchisee that failed to communicate with the franchisor within 10 weeks or that there are no such franchisees.

#### Item 21 - **Financial Statements**

The most common problems in Item 21 are failing to provide three fiscal years of externally prepared financial statements and making sure that they conform to Generally Accepted Accounting Practices (GAAP).

**(Please review UFOC Item 21 and its instructions together with Rule 200.600(c) for specific variations of this requirement.)**

Interim statements, current within 120 days may be internally prepared, but must also be consistent with fiscal year end statements. Interim financial statements are required if your statements are not current within 120 days of your anniversary date. An inconsistency in interim statements may sometimes be explained by a footnote or a reconciliation.

GAAP must be according to U.S. GAAP, not foreign GAAP. Keeping up with frequent GAAP changes in various nations is impossible and franchise prospects need to be able to make meaningful comparisons among prospective franchisors.

#### Item 22 - **Contracts**

As mentioned in the Item 17 notes, the contract must either clearly state that litigation is to be in Illinois and is subject to Illinois law, or the contract can be silent as to this matter. It cannot designate another state's law and venue as to Illinois franchisees.

## Item 23 - **Receipt Page**

The circular is to have two copies of the receipt so that both the franchisor and franchisee have a copy once it is signed. Failing to send two copies to the Attorney General would not by itself hold up a new registration, but it usually shows an inattention to the Guidelines that is repeated with other items.

### **OTHER FILING CONCERNS**

1. Amendments are to be filed with the Attorney General within 90 days of the occurrence of any material change (See §11 of the Act and Rule §200.604). If an amendment cannot be timely filed, the franchisor must suspend its sales activity and submit an affidavit indicating the cessation of sales, reasons for the amendment delay and tentative date of filing.
2. The information in the initial UFOC and subsequent annual reports is all to be current within 120 days of the anniversary date. A few of the items franchisors most frequently forget to update are: Items 1, 2, 3, 20 and 21.
3. Amendments, whether separately filed during the year or changes made in the Annual Report, must be redlined or otherwise highlighted. Failure to do this makes review much slower and may force examiners to either read sections that might otherwise have been skipped or the document will be returned to the franchisor to make clear where amendments were made.
4. When financials indicate negative stockholder's equity, financial assurance will be required (See §15 of Act and Rules 500, 502-508 as to choices of financial assurance).
5. Preparers must be careful not to use old computer files to generate Annual Reports that previously had deficiencies, or that drop entire sections of data.
6. When exhibits are added or deleted, these changes should be reflected in the Table of Contents and on the Receipt Page. When appropriate, exhibits should be re-labeled to reflect new titles and the proper sequence.

**Please visit our Web site to obtain a copy of the Illinois Franchise Disclosure Act and Rules, which includes the UFOC Guidelines: [www.ag.state.il.us](http://www.ag.state.il.us) and click on "Publications."**