STRATEGIES FOR LEVERAGING INTELLECTUAL PROPERTY THROUGH LICENSING, JOINT VENTURES, ALLIANCES AND FRANCHISING

Netpreneur Distinguished Author Series
The Morino Institute
Reston, VA

June 5, 2001

Presented by
Andrew J. Sherman, Esq.

McDermott, Will & Emery
600 Thirteenth Street, N.W.
Washington, D.C. 20007
Tel: 202-756-8610
Fax: 202-756-8087
ajsherman@mwe.com

A. KEY TRENDS AND DEVELOPMENTS AFFECTING THE PROTECTION AND LEVERAGING OF INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS

- Emerging growth companies and netpreneurs must protect what they have and use these intangible assets to penetrate new domestic markets or be the fuel for international expansion. The key challenge is how to keep growing in a slowing economy.

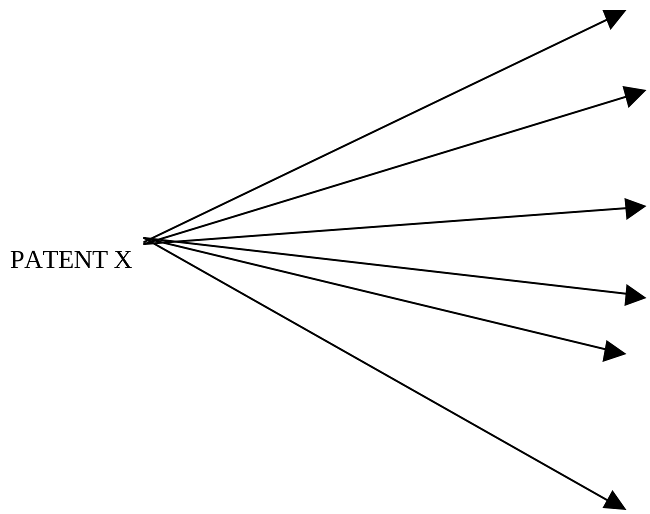
- **Capital-efficient** growth is the mandate of many CEO's and CFO's during these turbulent financial markets.

- Companies of all sizes and in all industries are under pressure to create new opportunities and new revenue streams from existing assets (technologies, systems, brands, relationships, know-how, etc.). The results of this type of analysis may also identify a need or an opportunity to restructure the company around the portfolio of intellectual property assets or create subsidiaries or spin-out companies based on IP leveraging opportunities.

- Today's businesses need to periodically re-evaluate whether current teaming agreements, alliances, distribution channels and market-partners are really working effectively to generate the highest and best shareholder value and income streams/profits (e.g. is this the highest and best strategy available to meet our objectives? What is origin of these relationships? What politics or red tape will we face if these agreements and relationships are re-evaluated? Should there be restructuring around a real or perceived imbalance in the economics of any existing relationships?) Wall Street and venture capitalists do not reward companies who make their licensees and market partners wealthy at the company's expense. It is critical to focus on the periodic need to repair channels and relationships which are broken, ineffective or where greater controls over the channels would yield better results.

- With high levels of employee turnover and competition for a qualified work force, it is more important than ever that employees are educated on their obligations to protect the company's intellectual property both while they are employed and thereafter.

- From an licensing out perspective, many growing companies may be sitting on a portfolio of patents, technologies and brands that can be licensed in non-competing ways to augment existing initiatives and core businesses. See the chart below.



#1 Direct Use and Application in Company's Core Business

#2 Licensed For A Parallel, Non-Competitive Use to Third Party (Limited Use)

#3 Licensed To A Competitor Abroad (Limited Geographic Area)

#4 Consortium (nonexclusive)

#5 Research and Development (To User Who Hopes To Find Other Applications Within Non-Competing Industries/Option to License)

#6 Licensed to Aftermarket Service Provider (Service, Maintenance, Parts, etc.)

Multiple Applications/Multiple Revenue Streams

- Even from a <u>licensing in</u> perspective, companies of all sizes may not have the resources to conduct research and development at the same levels and may need or want to explore access to technologies and brands which are <u>already</u> established or readily-available on an off-the-shelf basis and coupled with training support and valued-added services <u>or</u> where Goliaths will partner with Davids to get access to resources and technology.

- There may also be licensing, <u>in</u> opportunities, which when paired with the company's current technology portfolio, can create new products, services and market opportunities.

- Technology licensing, brand-extension licensing, joint ventures and strategic alliances, business format franchising, outsourcing are <u>all</u> intellectual property leveraging strategies which are being regularly discussed and adopted inside today's corporate boardrooms, and need to be coupled with an effective intellectual property portfolio analysis to be effective.

- Various intellectual property leveraging strategies are often precursors to capital formation transactions, such as venture investments and acquisitions, especially in David/Goliath transactions as well as peer-to-peer transactions.

- In today's merger and acquisition frenzy, a strategic and legal review of your intangible assets may be an excellent way to prepare for a buyer or a merger partner's due diligence process in order to ensure that gaps in the chain of title are filled or any potential disputes over ownership are resolved. The results of the analysis may also be necessary to support the company's proposed valuation if and when it is a target in an M&A transaction.

B. BRIEF OVERVIEW OF VARIOUS TYPES OF IP LEVERAGING STRATEGIES

- What technologies have non-competing applications that could be licensed to others?
- What brands offer value in a brand-extension licensing or co-branding relationship?
- What distribution channels or partnering opportunities can be strengthened if the client had greater control?
- What growth and expansion strategies are being used by our client's competitors? Why? How are their circumstances different, it at all?
- Where are the strategic/financial holes in current licensing and alliance relationships?
- What is the company's on-line and e-commerce strategy? How could it be strengthened or improved?

1. Technology and Merchandise Licensing

Established companies should consider various types of technology and brand licensing as the centerpiece of their intellectual property leveraging and external growth strategies. Licensing is a contractual method of developing and exploiting intellectual property by transferring rights of use to third parties *without* the transfer of ownership. From a legal perspective, licensing involves complex issues of contract, tax, antitrust, international, tort, and intellectual property law. From a business perspective, licensing involves a weighing of the advantages of licensing against the disadvantages in comparison to alternative types of vertical distribution systems.

The two principal types of licensing occur at two different levels in the marketplace: (1) technology licensing, where the strategy is to find a licensee for exploitation of industrial and technological developments; and (2) merchandise and character licensing, where the strategy is to license a recognized trademark or copyright to a manufacturer of consumer goods in markets not currently served by the licensor.

Many of the benefits of licensing include:

- Spreading the risk and cost of development and distribution

- Achieving more rapid market penetration
- Earning initial license fees and ongoing royalty income
- Enhancing consumer loyalty and goodwill
- Preserving the capital that would otherwise be required for internal growth and expansion
- Testing new applications for existing and proven technology
- Avoiding or settling litigation regarding a dispute over ownership of the technology

The disadvantages of licensing may be:

- A somewhat diminished ability to enforce quality control standards and specifications
- A greater risk of another party infringing upon the licensor's intellectual property
- A dependence on the skills, abilities, and resources of the licensee as a source of revenue
- Difficulty in recruiting, motivating, and retaining qualified and competent licensees
- The risk that the licensor's entire reputation and goodwill may be damaged or destroyed by the act or omission of a single licensee
- The administrative burden of monitoring and supporting the operations of the network of licensees

Failure to consider all of the costs and benefits of licensing could easily result in a regretful strategic decision or the terms of an unprofitable license agreement due to either an underestimation of the licensee's need for technical assistance and support or an overestimation of the market demand for the licensor's products and services. In order to avoid such problems, a certain amount of due diligence should be conducted by the licensor prior to any serious negotiations with a prospective licensee. This preliminary investigation generally includes market research, legal steps to fully protect intellectual property, and an internal financial analysis of the technology with respect to pricing, profit margins, and costs of production and distribution. It will also include a more specific analysis of the prospective licensee with respect to its financial strength, research and manufacturing capabilities, and reputation in the industry.

2. Business Format Franchising

There are a wide variety of reasons cited by successful franchisors as to why franchising has been selected as a method of growth and distribution. Through franchising, they are able to:

- Obtain operating efficiencies and economies of scale
- Increase market share and build brand equity
- Use the power of franchising as a system to get and keep more and more customers -- building customer loyalty
- Achieve more rapid market penetration at a lower capital cost
- Reach the targeted consumer more effectively through cooperative advertising and promotion
- Sell products and services to a dedicated distributor network
- Replace the need for internal personnel with motivated owner/operators
- Shift the primary responsibility for site selection, employee training and personnel management, local advertising, and other administrative concerns to the franchisee, licensee, or joint venture partner with the guidance or assistance of the franchisor

In the typical franchising relationship, the franchisee shares the risk of expanding the market share of the franchisor by committing its capital and resources to the development of satellite locations modeled after the proprietary business format of the franchisor. The risk of business failure of the franchisor is further reduced by the improvement in competitive position, reduced vulnerability to cyclical fluctuations, the existence of a captive market for the franchisor's proprietary products and services (due to the network of franchisees), and the reduced administrative and overhead costs enjoyed by a franchisor.

a. The Foundation for Franchising

Responsible franchising is the *only* way that franchisors and franchisees will be able to harmoniously co-exist in the twenty-first century. Responsible franchising requires a secure foundation from which the franchising program is launched. Any company considering franchising as a method of growth and distribution or any individual considering franchising as a method of getting into business must understand the key components of this foundation:

- A *proven prototype* location (or chain of stores) that will serve as a basis for the franchising program. The store or stores must have been tested, refined, and operated successfully and be consistently profitable. The success of the prototype should not be too dependent on the physical presence or specific expertise of the founders of the system.

- A *strong management team* made up of internal officers and directors (as well as qualified consultants) who understand both the particular industry in which the company operates and the legal and business aspects of franchising as a method of expansion.

- *Sufficient capitalization* to launch and sustain the franchising program to ensure that capital is available for the franchisor to provide both initial as well as ongoing support and assistance to franchisees (a lack of well-written business plan and adequate capital structure is often the principal cause of demise of many franchisors).

- A *distinctive and protected trade identity* that includes federal and state registered trademarks as well as a uniform trade appearance, signage, slogans, trade dress, and overall image.

- *Proprietary and proven methods of operation and management* that can be reduced to writing in a comprehensive operations manual, not be too easily duplicated by competitors, maintain their value to the franchisees over an extended period of time, and be enforced through clearly drafted and objective quality control standards.

- *Comprehensive training programs for franchisees* which integrates all of the latest education and training technologies and which takes place both at the company's headquarters and on-site at the franchisee's proposed location at the outset of the relationship and on an ongoing basis.

- *Field support staff* who are skilled trainers and communicators and must be available to visit and periodically assist franchisees as well as monitor quality control standards.

- *A set of comprehensive legal documents* that reflect the company's business strategies and operating policies Offering documents must be prepared in accordance with applicable federal and state disclosure laws, and franchise agreements should strike a delicate balance between the rights and obligations of franchisor and franchisee.

- A *demonstrated market demand* for the products and services developed by the franchisor which will be distributed through the franchisees. The franchisor's products and services should meet certain minimum quality standards, not be subject to rapid shifts in consumer preferences (e.g., fads), and be proprietary in nature. Market research and analysis should be sensitive to trends in the economy and specific industry, the plans of direct and indirect competitors, and shifts in consumer preferences. It is also important to understand what business you are *really* in. For example, many of the major oil company franchisors *thought* that they were in the gasoline business until they realized that they were in the *convenience* business and quickly jumped into mini-marts, fast-food and quick-service restaurants either directly or via co-branding.

- *A set of carefully developed uniform site selection criteria and architectural standards* that can be readily and affordably secured in today's competitive real estate market.

- *A genuine understanding of the competition* (both direct and indirect) that the franchisor will face in marketing and selling franchises to prospective franchises as well as the competition the franchisee will face when marketing products and services.

- *Relationships* with suppliers, lenders, real estate developers, and related key resources as part of the operations manual and system.

- *A franchisee profile and screening system* in order to identify the minimum financial qualifications, business acumen, and understanding of the industry that will be required by a successful franchisee.

- *An effective system of reporting and record keeping* to maintain the performance of the franchisees and ensure that royalties are reported accurately and paid promptly.

- *Research and development capabilities* for the introduction of new products and services on an ongoing basis to consumers through the franchised network.

- *A* communication *system* that facilitates a continuing and open dialogue with the franchisees and as a result reduces the chances for conflict and litigation within the franchise network.

- *National, regional, and local advertising, marketing, and public relations programs* designed to recruit prospective franchisees as well as consumers to the sites operated by franchisees.

3. Joint Ventures

Another key external growth strategy which should be considered by established and emerging growth companies is the establishing of partnering relationships whereby two or more companies work together to achieve a specific purpose or towards the attainment of common business objectives. Joint Ventures, Strategic Partnering, Cross-Licensing, Co-Branding and Technology Transfer Agreements are all strategies designed to obtain one or more of the following: (1) direct capital infusion in exchange for equity and/or intellectual property or distribution rights; (2) a "capital substitute" where the resources which would otherwise be obtained with the capital are obtained through joint venturing; or (3) a shift of the burden and cost of development (through licensing) in exchange for a potentially more limited upside.

These various types of partnering arrangements have been used for a wide variety of business purposes, including: joint research and co-promotion; distribution and commercialization and cross-licensing and sub-licensing of new technologies. The participants to these agreements could be at various points in the value chain or distribution channel – from agreements by and among direct or potential competitor (e.g. cooperate rather than compete as a precursor to a merger and/or to join forces to fend off an even larger competitor) to agreements by and among parallel producers (e.g. to widen or integrate product lines) to parties linked at different points in the vertical distribution channel (e.g. to achieve distribution efficiencies).

One of the key factors to analyze when structuring these relationships is the respective ***positions*** of each party that will influence structure, economies and key objectives. These include:

GOLIATH/GOLIATH	David/David
David/ GOLIATH	Value Webs/Federations

In **Goliath/Goliath** partnering transactions, two very large companies are getting together to co-market or cross-promote each other's brands either to capture more customers or to achieve certain efficiencies. An easy-to-understand example would be two major airlines serving different primary geographic routes honoring each other's frequent flyer programs or McDonald's promoting a new Disney film by offering licensed toys when a consumer buys a kid's meal. These arrangements are negotiated with parallel leverage and are not the focus of this presentation.

In **David/David** partnering relationships, two smaller companies, both with limited resources, are coming together to leverage off each other's strengths on a peer-to-peer basis in order to achieve a defined business purpose or set of objectives. The key to peer-to-peer partnering relationships is the avoidance of greed. To work well, <u>both</u> party's objectives must be met and the sharing of the rewards must be parallel with the level of effort and sharing of the risks.

In **David/Goliath** partnering relationships, the smaller company is partnering with a much larger strategic ally, which may be a large domestic corporation, a foreign conglomerate or even a university or government agency looking to commercialize a given technology. **This presentation has been written to focus on these situations where the rapidly-growing company, as David, needs to work closely with their lawyers to make sure that their rights are protected and that the strategic objectives that are motivating the transaction are met on an initial and continual basis.** In fact, the mindset of the typical entrepreneur has shifted dramatically in the last few years from being fearful of partnering with much larger companies due to a fear of losing control to being afraid if they ***don't*** have at least one or more alliances in place with the big guys due to a fear of not having the credibility and market leverage that a larger player is likely to bring to the table. One common mistake to avoid is merely "running around and collecting cool logo's to include in your PowerPoint presentation. In other words, these relationships must be more than just piggy-backing on a more established brand and reputation, they must eventually lead to new technologies, new customers, increases in market share, revenues, profits and increases in shareholder value. There must be benchmarks established that can measure the success of the alliance.

In **Value Webs/Federations**, there are multiple participants to the joint venture or strategic alliance, each maintaining their operational and ownership autonomy but coming together to share resources, distribution channels or costs in some way to increase revenues or reduce expenses. The alignment of shared interests may be very broad or may be more limited – such as cooperative advertising or a shared Web site or toll-free phone number to generate new business. In emerging technology industries, value webs may be created by five or six companies who are each bringing a technical component or solution to the table to meet a customer's (or series of customers) real or perceived needs.

With technology developing rapidly, competition becoming more intense, business operations becoming more global in nature and industry convergence taking place on a number of different fronts, the number and the pace of deal-making in the joint venture and strategic alliances areas is very liken to quicken and increase over the next few years. The need to combine and share core competencies and resource capabilities but in a manner and within a structure where autonomy can be preserved must be a key component in any fast-growing company's business strategy.

Joint Ventures are typically structured as a partnership or as a newly-formed and co-owned corporation where two or more parties are brought together to achieve a series of strategic and financial objectives on a short-term or a long-term basis. Companies considering a joint venture as a growth strategy should give careful thought to the type of partner they are looking for and what resources each party will be contributing to the newly formed entity. Like the raising of a child, each parent will be making their respective contribution of skills, abilities and resources.

4. Strategic Alliances and Partnering

Established companies should also consider strategic alliance and partnering relationships as a method of leveraging the company's intellectual property. Strategic Alliances refers to any number of collaborative working relationships where no formal joint venture entity is formed but where two independent companies become interdependent by entering into a formal or informal agreement which is built on a platform of: (a) mutual objectives; (b) mutual strategy; (c) mutual risk; and (d) mutual reward. The relationships are commonly referred to as: (i) teaming; (ii) strategic partnering; (iii) alliances; (iv) cross-licensing; and (v) co-branding. Regardless of the specific structure, the underlying industry or even the actual purpose of the strategic relationship, all successful joint venture and strategic alliance relationships share a common set of essential success factors. These critical success factors include:

- a complementary unified force or purpose which bonds the two or more companies together;
- a management team committed at levels to the success of the venture, free from politics or personal agendas;
- a genuine strategy synergy where the "sum of the whole truly exceeds its individual parts" (e.g., 2+2+2=7);
- a cooperative culture and spirit among the strategic partners which lends to trust, resource-sharing and a friendly chemistry among the parties;
- a degree of flexibility in the objectives of the joint venture to allow for changes in the marketplace and an evolution of technology;

- an actual alignment of management styles and operational methods at least to the extent that it affects the underlying project (as in the case of a strategic alliance) or the management of the new company created (as in the case of a formal joint venture); and

- the general levels of focus and leadership from all key parties that are necessary to the success of any new venture or business enterprise.

The strategic benefits of these relationships include:

- Develop a new market (domestic/international);

- Develop a new product (research and development);

- Develop/share technology

- Combine complementary technology;

- Pool resources to develop a production/distribution facility;

- Acquire capital;

- Execute a government contract; and

Access to a new distribution channel or network or sales/marketing capability.

	Joint Ventures	Strategic Alliances
Term	Usually Medium to Long-Term	Short-Term
Strategic Objective	Often serves as to Precursor to a Merger	More Flexible and Non-Committal
Legal Agreements and Structure	Actual legal entity formed	Contractual-Driven
Extent of Commitment	Shared Equity	Shared Objectives
Capital Resources	Each party makes a capital contribution of cash or intangible assets	No specific capital contributions (may be shared budgeting or even cross-investment)
Tax Ramifications	Be on the lookout for double taxation unless pass-through entities utilized	No direct tax ramifications

C. KEY LEGAL AND STRATEGIC ISSUES IN FRANCHISING

Over the last three decades, franchising has emerged as a popular expansion strategy for a variety of product and service companies. Recent International Franchise Association ("IFA") statistics demonstrate that retail sales from franchised outlets comprise nearly 50 percent of all retail sales in the United States, estimated at over $900 billion and employing some ten million people in 2000. Over one hundred (100) different industries now use some form of franchising as a business growth and brand development strategy – from financial services to healthcare to industrial applications in order to strengthen and improve distribution and retail channels.

Responsible franchising starts with an understanding of the strategic essence of the business structure. There are three critical components of the franchise system -- the brand, the operating system and the ongoing support provided by the franchisor to the franchisee. The brand creates the demand, allowing the franchisee to initially obtain customers. The brand includes the franchisor's trademarks and service marks, its trade dress and decor and all of the intangible factors which create customer loyalty and builds brand equity. The operating system essentially "delivers the promise," thereby allowing the franchisee to maintain customer relationships and build loyalty. The ongoing support and training provide the impetus for growth, providing the franchisee with the tools and tips to expand its customer base and build its market share.

The responsibly-built franchise system is one which provides value to its franchisees by teaching them how to get and keep as many customers as possible, who consume as many products and services as possible, as often as possible. In fact, most litigation in franchising revolves around the gap between the actual needs of the franchisees to remain competitive in the marketplace and the reality of what support the franchisor is capable of providing. The genesis of the disappointment begins during the recruitment phase of the relationship and continues beyond the start-up as the franchisee struggles to remain competitive unless the franchisor delivers on its promises and is committed to providing excellent initial and ongoing training and support.

Strategic Prerequisites to Launching a Franchising Program

The most important strategic prerequisite for the success of any business format franchising system is the operation and management of a successful prototype. This prototype location is where virtually all operating problems are to be resolved, recipes and new products tested, equipment and design decisions made, management and marketing techniques tested, a trade identity and goodwill established, and financial viability proven. The franchisor is offering a tried and tested package to a franchisee, and the contents of that package must be clearly identified prior to sale. It is irresponsible and potentially in violation of the law to ask someone to part with their life savings to invest in a system which is not ready for replication, unless it is disclosed as such.

The concept of a system or prescribed business format that is operated according to a uniform and consistent trade identity and image is at the heart of a successful franchising program. Therefore, a prospective franchisor must be able to reduce all aspects of running the business to be franchised into an operations and training manual for use by franchisees in the day-to-day operation of their business. These systems must be adequately and clearly communicated in the initial and ongoing training program. If a company offers services that are highly personalized or a product that is difficult to reproduce, then franchising may not be the most viable alternative for growth because of the difficulty in replicating these systems or products in the operator's manual or in the training program. Similarly, if all the "kinks" in the system have not yet been worked out, it is probably premature to consider franchising.

There are a number of other important business and strategic factors that must be considered before franchising. First, franchising should not be viewed as a solution to undercapitalization or as a "get rich quick" scheme. While it is true that franchising is less capital-intensive than is construction of additional company-owned sites, the initial start-up costs for legal, accounting, and consulting fees can be extensive. Second, franchisors must view franchising as the establishment of a series of long-term relationship and the ongoing success of the company as a franchisor will depend on the harmony of these relationships. A field support staff must be built to provide ongoing services to the existing franchisees, as well as to maintain quality control and uniformity throughout the system. New products and services must be developed so that the franchisee can continue to compete with others in its local market. Innovative sales and marketing strategies must be continually developed to attract new customers and retain existing patrons of the franchised outlet. If the franchisor expects the franchisee to continue to make its royalty payment on gross sales each week, then an array of valuable support services must be provided on an ongoing basis to meet the franchisee's changing needs.

Franchising As A Strategic Relationship

Prospective and current franchisors must always bear in mind that first and foremost, franchising is about *relationships*. **The franchisor and franchisee knowingly and voluntarily enter into a long-term interdependent relationship, each depending on the other for its success.** The exact nature of the franchisor-franchisee relationship has been compared to many others. There are parallels to the relationship between parent and child, between a football coach and his team, between a conductor and his orchestra, and between a landlord and his tenants. The award of the franchise has been compared to the state which grants a driver's license -- you may use and renew the privilege of driving but subject to the rules of the road and the payment of ongoing fees. Like the relationship between franchisor and franchisee, you have the freedom to drive but not necessarily however or wherever you want. There has been much emphasis in recent years to avoid the "Them vs. Us" mentality and organizational culture with a refocus on the "We" as well as the "And. " The focus has been on how can *we* work together for each other's benefit, where the enemy is not each other but rather the competition.

A recent survey seems to indicate that this new focus on the strategic aspects of the relationship seems to be working. While over one-half of our nation's marriages wind-up in divorce, nearly 92 percent of the nation's franchisees said they would get married to their franchisor again. In a recent survey conducted by the Gallup Organization and published by the International Franchise Association (IFA) Educational Foundation in March of 1998, more than nine of 10 (92 percent) of the franchise owners surveyed said they were either very or somewhat successful. Of those who had been in business 11 years or more, 96 percent indicated they were very or somewhat successful. Gallup surveyed 1,001 U.S. franchisees, nearly eight out of 10 of whom own only one franchised small business. Women accounted for 28 percent and nearly half of those who responded had a professional or managerial position before purchasing a franchise, while nearly two of 10 were involved in either services/labor or retail sales. Given the high satisfaction ratings, it is not surprising that nearly two-thirds (65 percent) of the franchise owners said they would purchase the same franchise again if given the opportunity. Of those who wouldn't buy the same franchise again, nearly half (43 percent) said they would consider buying a different one. Nearly two-thirds (64 percent) said they would be less successful if they had tried to open the same type of business on their own and not as part of a franchise system. On average, franchise owners reported annual gross incomes of $91,630. Nearly one of four (24 percent) earned $100,000 or more during the past year.

The franchisor who wants its system and franchisee satisfaction ratings to meet or exceed these levels of success must build a culture of honesty, trust, passion and genuine commitment to long-term success. This often begins in the recruitment process by carefully screening and educating qualified candidates to ensure that your long-term objectives are truly shared and best interests truly aligned. This type of strategy will lead to mutually-beneficial relationships and significantly decrease the chances of litigation. Some degree of franchisee failure will be inevitable and there are typically two factors at play -- one that you can control and one that you often can't. You can control the quality of your systems, training and support tools and innovation of your marketing to help increase the chances of success. Other than through careful screening and continuous monitoring, you <u>cannot</u> typically control local market conditions or changes in the franchisee's personal life which may also affect their performance.

Understanding the Needs of the Modern-Day Franchisee

One way to avoid failure is to understand the profile of today's prospective franchisee. A wide variety of marketing, planning, operational, and strategic decisions can be made by the growing franchisor once certain basic premises are understood. As a general rule, franchisees in today's competitive markets are getting smarter, *not* dumber. The better educated, better capitalized franchisee is here to stay. As franchising has matured, prospective franchisees have more resources (seminars, media articles, trade shows, International Franchise Association programs, etc.) than ever before to turn to for information and due diligence. These new, sophisticated franchisees are very different from their "mom and pop" predecessors of the 1970s and 1980s. This prospect is better trained to ask "all the right questions" and hire "the right advisors" in t investigation and franchise agreement negotiation process. These new franchises are also better heeled and more likely to organize themselves into associations and take action if they are not receiving the required levels of support and assistance. Franchisors who fail to mold their sales and support systems around the characteristics of these new franchisees and continue to conduct business "the old-fashioned way" are headed on the road to disaster and litigation.

A Commitment to Being (and Staying) Creative and Competitive

Today's franchisor must have an initial and ongoing commitment to being creative and competitive. Market conditions and technology which affects franchising is changing constantly and the franchisee of the next millennium expects you to change at the same pace. For example, the ability to adopt your franchising system to allow for growth and market penetration into alternative and non-traditional venues is critical. The more creative and aggressive franchisors in the retail and hospitality industries are always searching for new locations where captives markets may be present, such as airports, hotels, hospitals, highway roadside travel plazas, universities, sports arenas, or military bases where trends towards outsourcing, the demand for branded products and services and the desire to enhance the captive customer's experience have all opened up new doors and opportunities for franchising. Franchisors such as TCBY, based in Little Rock, Arkansas, have nearly 50 percent of their 3,000 frozen yogurt stores worldwide in these alternative venues. In other cases, franchisors have pursued co-branding strategies to penetrate these new markets, again taking advantage of the trend towards convenience stores, grocery store chains and gas stations all wanting to provide their patrons with an enhanced customer experience and offer a more comprehensive and integrated solution to their consuming needs. And again, a trend towards branding and the ability to share costs, positioning toward differentiation, and penetrate new market segments at a relative low cost has opened up many doors for the creative and aggressive franchisor who is committed to capturing more market share and serving more and more customers.

D. LEGAL AND REGULATORY ISSUES IN FRANCHISING

The offer and sale of a franchise is regulated at both the federal and state level. At the federal level, the Federal Trade Commission (FTC) in 1979 adopted its trade regulation rule 436 (the "FTC Rule" which specifies the minimum amount of disclosure that must be made to a prospective franchisee in any of the fifty states. In addition to the FTC Rule, over a dozen states have adopted their own rules and regulations for the offer and sale of franchises within their borders. Known as the registration states, they include most of the nation's largest commercial marketplaces, such as California, New York, and Illinois. These states generally follow a more detailed disclosure format, known as the Uniform Franchise Offering Circular (the UFOC).

The UFOC was originally developed by the Midwest Securities Commissioners Association in 1975. The monitoring of and revisions to the UFOC are now under the authority of the North American Securities Administrators Association (NASAA). Each of the registration states has developed and adopted its own statutory version of the UFOC. The differences among the states should be checked carefully by both current and prospective franchisors and their counsel, as well as individuals considering the purchase of a franchise opportunity.

A new version of the UFOC was adopted by NASAA in April of 1993 and approved by the FTC in December of 1993. As of January 1, 1995, the registration states had approved the new UFOC and mandated its use for filings in their states. The new UFOC Guidelines ("Guidelines") require that the offering circular be written in plain English. Disclosures must be made "clearly, concisely and in a narrative form that is understandable by a person unfamiliar with the franchise business" and should not contain technical language, repetitive phrases or "legal antiques. "

Brief History of Franchise Regulation

The laws governing the offer and sale of franchises began in 1970, when the state of California adopted its Franchise Investment Law. Shortly thereafter, the FTC commenced its hearings to begin the development of the federal law governing franchising. After seven years of public comment and debate, the FTC adopted its trade regulation rule that is formally titled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Venture" on December 21, 1978, to be effective October 21, 1979. Many states followed the lead of California, and there are now fifteen states that regulate franchise offers and sales.

The states that require full registration of a franchise offering prior to the "offering" or selling of a franchise are *California*, *Illinois*, *Indiana*, *Maryland*, *Minnesota*, *New York*, *North Dakota*, *Rhode Island*, *South Dakota*, *Virginia*, and *Washington*.

Other states that regulate franchise offers include *Hawaii*, which requires filing of an offering circular with the state authorities and delivery of an offering circular to prospective franchisees; *Michigan and Wisconsin*, which require filing of a "Notice of Intent to Offer and Sell Franchises;"

Oregon, which requires only that pre-sale disclosure be delivered to prospective investors; and *Texas*, which requires the filing of a notice of exemption with the appropriate state authorities under the Texas Business Opportunity Act.

Among other things, the FTC Rule requires that every franchisor offering franchises in the United States deliver an offering circular (containing certain specified disclosure items) to all prospective franchisees (within certain specified time requirements). The FTC has adopted and enforced its rule pursuant to its power and authority to regulate unfair and deceptive trade practices. The FTC Rule sets forth the minimum level of protection that shall be afforded to prospective franchisees. To the extent that a "registration state" offers its citizens a greater level of protection, the FTC Rule will not preempt state law. There is no private right of action under the FTC Rule; however, the FTC itself may bring an enforcement action against a franchisor that does not meet its requirements. Penalties for noncompliance have included asset impoundments, cease and desist orders, injunctions, consent orders, mandated rescission or restitution for injured franchisees, and civil fines of up to $10,000 per violation.

The FTC Rule regulates two types of offerings: (1) <u>package and product franchises</u> and (2) <u>business opportunity ventures</u>. The first type involves three characteristics: (i) the franchisee sells goods or services that meet the franchisor's quality standards (in cases where the franchisee operates under the franchisor's trademark, service mark, trade name, advertising, or other commercial symbol designating the franchisor ("Mark")) that are identified by the franchisor's Mark, (ii) the franchisor exercises significant assistance in the franchisee's method of operation, and (iii) the franchisee is required to make payment of $500 or more to the franchisor or a person affiliated with the franchisor at any time before to within six months after the business opens.

Business Opportunity Ventures also involve three characteristics: (i) the franchisee sells goods or services that are supplied by the franchisor or a person affiliated with the franchisor; (ii) the franchisor assists the franchisee in any way with respect to securing accounts for the franchisee, or securing locations or sites for vending machines or rack displays, or providing the services of a person able to do either; and (iii) the franchisee is required to make payment of $500 or more to the franchisor or a person affiliated with the franchisor at any time before to within six months after the business opens.

Relationships covered by the FTC Rule include those within the definition of a "franchise" and those represented as being within the definition when the relationship is entered into, regardless of whether, in fact, they are within the definition. The FTC Rule exempts 1) fractional franchises, 2) leased department arrangements, and 3) purely verbal agreements. The FTC Rule excludes 1) relationships between employer/employees and among general business partners, 2) membership in retailer-owned cooperatives, 3) certification and testing services, and 4) single trademark licenses.

Among other things, the FTC Rule requires that every franchisor offering franchises in the United States deliver an offering circular (containing certain specified disclosure items) to all prospective franchisees (within certain specified time requirements). The FTC has adopted and enforced its Rule pursuant to its power and authority to regulate unfair and deceptive trade practices. The FTC Rule sets forth the *minimum* level of protection which shall be afforded to prospective franchisees. There is no private right of action under the FTC Rule, however, the FTC itself may bring an enforcement action against a franchisor which does not meet its requirements. Penalties for noncompliance have included asset impoundments, cease and desist orders, injunctions, consent orders, mandated rescission or restitution for injured franchisees and civil fines of up to $10,000 per violation.

The information must be current as of the completion of the franchisor's most recent fiscal year. In addition, a revision to the document must be promptly prepared whenever there has been a material change in the information contained in the document. The FTC Rule requires that the disclosure document must be given to a prospective franchisee at the earlier of either 1) the prospective franchisee's <u>first personal meeting</u> with the franchisor; or 2) <u>ten business days</u> prior to the execution of a contract; or 3) <u>ten business days</u> before the payment of money relating to the franchise relationship. In addition to the disclosure document, the franchisee must receive a copy of all agreements that it will be asked to sign at least <u>five business days</u> prior to the execution of the agreements. A business day is any day other than Saturday, Sunday, or the following national holidays: New Yearns Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veteran's Day, Thanksgiving, and Christmas.

The timing requirements described above apply nationwide and preempt any lesser timing requirements contained in state laws. The ten-day and five-day disclosure periods may run concurrently, and sales contacts with the prospective franchisee may continue during those periods.

It is an unfair or deceptive act or practice within the meaning of Section 5 of the FTC Act for any franchisor or franchise broker:

1. To fail to furnish prospective franchisees, within the time frame established by the Rule, with a disclosure document containing information on twenty different subjects relating to the franchisor, the franchise business, and the terms of the franchise agreement

2. To make any representations about the actual or potential sales, income, or profits of existing or prospective franchisees except in the manner set forth in the rule

3. To fail to furnish prospective franchisees, within the time frame established by the rule, with copies of the franchisor's standard form of franchise agreement and copies of the final agreements to be signed by the parties

4. To fail to return to prospective franchisees any funds or deposits (such as down payments) identified as refundable in the disclosure document

State Franchise Regulations

The goal of the FTC Rule is to create a minimum federal standard of disclosure applicable to all franchisor offerings and to permit states to provide additional protection as they see fit. Thus, while the FTC Rule has the force and effect of federal law and, like other federal substantive regulations, preempts state and local laws to the extent that these laws conflict, the FTC has determined that the rule will not preempt state or local laws and regulations that either are consistent with the rule or, even if inconsistent, would provide protection to prospective franchisees equal to or greater than that imposed by the rule.

Examples of state laws or regulations that would not be preempted by the Rule include state provisions requiring the registration of franchisors and franchise salespersons, state requirements for escrow or bonding arrangements, and state-required disclosure obligations set forth in the Rule. Moreover, the Rule does not affect state laws or regulations that regulate the franchisor/franchisee relationship, such as termination practices, contract provisions, and financing arrangements.

Definitions Under State Law

Each state franchise disclosure statute has its own definition of a "franchise," which is similar to, but not the same as, the definition set forth in the FTC Rule. If the proposed relationship meets this definition, then the franchisor must comply with the applicable registration and disclosure laws.

There are three major types of state definitions of a franchise or business opportunity. They consist of:

A. **Majority State Definition**. In the states of California, Illinois, Indiana, Maryland, Michigan, North Dakota, Oregon, Rhode Island, and Wisconsin, a franchise is defined as having three essential elements:

1. A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor.

2. The operation of the franchisee's business . . . is substantially associated with the franchisor's trademark or other commercial symbol designating the franchisor or its affiliate.

3. The franchisee is required to pay a fee.

B. **Minority State Definition**. The states of Hawaii, Minnesota, South Dakota, and Washington have adopted a somewhat broader definition of *franchise*. In these states, a franchise is defined as having the following three essential elements:

1. A franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name or other commercial symbol or related characteristics.

2. The franchisor and franchisee have a common interest in the marketing of goods or services.

3. The franchisee pays a fee.

C. New York Definition. The state of New York has a unique definition. Under its law a franchisee is defined by these guidelines:

1. The franchisor is paid a fee by the franchisee.

2. Either essentially associated with the franchisor's trademark or the franchisee operates under a marketing plan or system prescribed in substantial part by the franchisor.

D. Virginia Definition. The Commonwealth of Virginia also has its own definition of a franchise, which stipulates that:

1. A franchisee is granted the right to engage in the business of offering or distributing goods or services at retail under a marketing plan or system prescribed in substantial part by a franchisor.

2. The franchisee's business is substantially associated with the franchisor's trademark.

Virginia and New York have definitions that are broad in certain respects. Virginia does not have a "fee" element to its definition. New York requires a fee, but specifies *either* association with franchisor's trademark *or* a marketing plan prescribed by the franchisor. Therefore, in New York no trademark license is required for a franchise relationship to exist. However, the regulations in New York exclude from the definition of a franchise any relationship in which a franchisor does not provide significant assistance to or exert significant controls over a franchisee.

Guidelines for Determining What Is A Franchise: Is the Relationship Fish or Fowl?

Every year, I am asked by a few clients to advise them on how to structure a relationship which avoids the definition of a "franchise" under federal or state laws. The first question I ask is "Why?" to ensure that they seek to avoid compliance with these registration and disclosure laws for the appropriate legal or strategic reasons. Most answers fall into one of the following categories:

(a) an overseas franchisor who is uncomfortable with concepts of disclosure which may not be required in their country of origin;

(b) a mid-sized or large company who feels that (as a pioneer) their industry is not ready for or will react adversely to the kinds of controls that a franchise relationship typically implies;

(c) a company or individual officer who has an aspect of their past that they would prefer not to be disclosed (raising other legal problems);

(d) a small company concerned with the perceived costs of preparing and maintaining the legal documents;

(e) the real or perceived belief that by becoming a franchisor the company somehow increase its chances of being sued (a myth I usually try to debunk); or

(f) some other specific circumstances or myth or fear which the company's management team has towards franchising.

Before dealing with the parameters developed by the courts and regulatory authorities over the years which provides some (but not complete) insight as to which relationships will be considered a franchise and which will not, we usually try to solve their problem with creative thinking and structural alternatives. For example, under (a) above, a foreign franchisor may want to set up a new subsidiary in lieu of disclosing the parent company (usually privately-held) financial statements. If the subsidiary is properly capitalized and certain other specific conditions met, the confidentiality of the parent company's data may be preserved. Under (b) above, we have often created the "non-franchise franchisor," which is a company that has essentially agreed to prepare and provide a UFOC even though the details of their relationships are in a regulatory grey area. This way the franchisor appeases the regulators but also placates the industry participants who may be more comfortable with a "strategic partner" or "licensee" designation than a franchisor-franchise relationship.

If the company still insists on avoiding compliance with these laws, then we go through an exercise of determining from a cost-benefit analysis which leg of the "three-legged stool" they will agree to sacrifice. In today's brand-driven environment, the willingness to license the system without the brand to avoid the trademark license leg has not been very popular. Similarly, in an economy where "cash flow is king," most of these clients have not been willing to waive the initial franchise fee or wait over six months for their financial rewards. And the age-old trick of "hiding" the franchise fee in a training program or initial inventory package was figured out by the regulators a long time ago. So it is often the third leg of the stool, the one which is most difficult to interpret, where the creative structuring must take place. The courts and the federal and state regulators have not provided much clear guidance as to the <u>degrees</u> of support or the <u>degrees</u> of assistance that will meet the definition and those which will not. The mandatory use of an operating system or marketing plan will meet the third element of the test, but what if the use of the system is optional? What if the plan or system is not very detailed and provides lots of room for discretion by the franchisee without penalty for adopting the plan or system to meet local market conditions? And if you choose this path, does allowing this degree of discretion and flexibility sacrifice your ability to maintain quality control? In addition, a competitive environment where most growing companies are trying to provide more and more support and assistance (as well as exercise more controls) to their partners in the distribution channel, would providing less than the norm just to avoid the definition of a "franchise" really make sense? These legal and strategic decisions should not be made hastily without the long-term implications properly analyzed.

FTC Definitional Analysis

The term "franchise" is defined in Section 436.2(d) of the FTC Rule. There are three key components to this definition: (1) the franchisee's goods and/or services are to be offered and sold under the franchisor's trademarks; (2) the franchisee is required to make a minimum $500 payment to the franchisor; and (3) the franchisor exercises significant control of, or provides significant assistance to the franchisee's method of operation. Each of these components is outlined below.

Trademark. This element is satisfied when the franchisee is given the right to distribute goods or services under the franchisor's trademark or service mark.

Required Payment. This element is met if a franchisee is required to pay the franchisor at least $500 as a condition of obtaining the franchise or of commencing operations. Payments made at any time prior to, or within 6 months after commencing operations will be aggregated to determine if the $500 threshold is met. The payments may be required by the franchise agreement, an ancillary agreement between the parties or by practical necessity (such as required supplies that are only available from the franchisor).

Significant Control and Assistance. The key to this element is that the control or assistance must be "significant." According to the "Final Guides to the Franchising and Business Opportunities Ventures Trade Regulation Rule" (the "Final Guides"), published by the Federal Trade Commission, the term "significant" "relates to the degree to which the franchisee is dependent upon the franchisor's superior business expertise." The Final Guides state that the dependence on the business expertise of the franchisor may be conveyed by the franchisor's controls over the franchisee's methods of operation or by the franchisor furnishing assistance to the franchisee in areas related to methods of operations. The presence of ***any one*** of the following types of control or assistance may suggest the existence of "significant control or assistance" sufficient to satisfy this prong of the definition of a franchise:

Types of Control

- site approval
- site design/appearance requirements
- dictating hours of operation
- production techniques
- accounting practices
- personnel policies/practices
- required participation in, or financial contribution to promotional campaigns
- restrictions on customers
- restrictions on sales area or location

Types of Assistance

- formal sales, repair or business training
- establishing accounting systems
- furnishing management, marketing or personnel advice
- site selection assistance
- furnishing detailed operations manual

Strategic Definitional Analysis

There are a wide variety of strategic questions and structural issues to consider when conducting this analysis. Among them:

- Do we anticipate the relationship to be short-term or long-term? Are we just dating or really serious about getting married to this market or chained partner?

- Are we ready to sacrifice the ability to build brand awareness and increase the value of other intangible assets on our balance sheet in a brand-driven competitive environment?

- Are we prepared to deliver the level and the quality of training and support that is typically implied and expected in the franchisor-franchisee relationship?

- Will we be converting or keeping in place existing distributors, sales representatives or other components of the current distribution channel? How will the franchising program <u>truly</u> differ?

- In considering the operational dynamics of the proposed relationship, how interdependent do we really need or want to be? Are you truly inextricably intertwined with synergistic and shared goals or would a more casual commitment suffice? Would a joint venture or strategic partnering relationship adequately suffice? But at what strategic or operational cost?

- To what extent will training, support, marketing and other key functions truly be uniform and centralized? Or will a more flexible system suffice?

- Could you "unbundle" the license of the intellectual properly being offered, making items an optional menu of support and services rather than making them mandatory and integrated?

- If you choose to operate in the grey area and without a UFOC, how comfortable are you and your management team with living the possibility of a regulatory investigation and or a system-wide rescission offer if the relationship is subsequently deemed to be a franchise? How comfortable with this strategy are you if your company is publicly-traded?

- To what extent will market conditions dictate that you maintain **control** over the product mix, customer service standards, marketing techniques, operational methods, warranty policies, discounting policies, etc. or the need to conduct quality control audits or make pricing suggestions?

Again, you don't want to destroy key strategic financial or operational aspects of the current or proposed program merely to avoid compliance with federal and state franchise laws. Remember that the courts and the regulators are likely to examine the "totality of the relationship," with an emphasis on reality an practice, rather than the written word of the contract or offering materials. For example, if you take the position that the support services are optional but in practice, 99 percent of your franchisees have elected to use and pay for them, then the reality of the situation will probably prevail. If the marketing plan or operating system is prescribed in substantial part by you in practice, and that there will be adverse consequences to the other party if these procedures and standards are not followed, whether or not your agreement says so, then you will have difficulty supporting your position that you are not a franchise. Although a "community of interest" is not generally a term that provides much insight, here are some factors directly considered by the court in arriving at this determination:

- the franchisor's advertising claims to prospective franchisees that a successful marketing plan is available.

- the contemplation of nation-wide or area-wide distribution on an exclusive or semi-exclusive basis, possibly with multiple levels of jurisdiction (such as regional and location distributorships and arrangements) designed to establish uniformity of prices and marketing terms.

- reservation of control by the franchisor over matters such as customer terms and payments, credit practices, and warranties and representations made to customers.

- the franchisor's rendering of collateral services to the franchisee.

- any prohibition or limitation on the franchisee's sale of competitive or noncompetitive products.

- a requirement that the franchisee observe the franchisor's direction or obtain the franchisor's approval for site selection, trade names, advertising, signs, appearance of the franchisee's business premises, fixtures and equipment used in the business, employee uniforms, hours of operation, housekeeping procedures, etc.

- the franchisor's implementation of its requirements regarding the conduct of the business by inspection and reporting procedures.

- the franchisor's right to take corrective measures which may be at the franchisee's expense.

- comprehensive advertising or other promotional programs, especially if the programs identify the location of the franchisee and if the franchisee's advertising or promotional activities require the franchisor's approval.

- grant of an exclusive territory, and the sale of products or services at bona fide wholesale prices.

- percentage discounts (although insubstantial), and mutual advertising and soliciting by the franchisor and the franchisee.

- volume discounts attained by a system of distributors and subdistributors, and mutual advertising.

- use of the franchisor's confidential operating manuals or forms by the franchisee, and mutual opportunity of profit.

- grant of an exclusive patent and an exclusive territory, and a training program for which the franchisor receives payment from the franchisee.

- required purchases from the franchisor, an exclusive territory, franchisor-supplied advertising, the provision of leads to the franchisee, and prohibitions on selling competitive products.

- the franchisor's selection of locations, and required purchases through the franchisor.

- performance of services devised by the franchisor, franchisor-approved forms, mutual service of customers, franchisor approval of the franchisee's presentations, and mutual financial benefit.

- the franchisee's production of products under the franchisor's patent, technical assistance, training, the franchisee's ability to subfranchise, and required recordkeeping.

- the franchisor's selection of locations, the franchisee's purchase of product from the franchisor for regularly serviced accounts, and required recordkeeping.

Preparing the Disclosure Document Under UFOC Guidelines

The UFOC format of franchise disclosure consists of 23 categories of information that must be provided by the franchisor to the prospective franchisee at least ten business days prior to the execution of the franchise agreement. Because this format has been adopted by many states as a matter of law, franchisors may not change the order in which information is presented, nor may any of the disclosure items be omitted in the document. In addition, many sections of the UFOC must be a mirror image of the actual franchise agreement (and related documents) that the franchisee will be expected to sign. There should be no factual or legal in consistencies between the UFOC and the franchise agreement.

A description of the information required by each disclosure item of the UFOC is as follows:

Cover Page: NASAA has sought to create a generic cover page by moving state-specific information to Item 23 (Receipt) or to exhibits to the offering circular. Information moved off of the cover page includes state-mandated language regarding offering circular delivery requirements and related disclaimers, addresses of administrators and the list of registered agents, subfranchisors and franchise brokers. The Guidelines mandate disclosure of certain risk factors. A franchisor must use prescribed language to disclose as a risk that its franchise agreement includes an out-of-state form and/or choice of law provision. Additional risk factor disclosures may be required by state regulators.

Item 1: THE FRANCHISOR, ITS PREDECESSORS AND AFFILIATES. Franchisors must identify themselves by using "we," initials or two words of reference. "Franchisor" and "Franchisee" are not be used. The entities for which disclosure must be made are expanded to include franchisors affiliates. The number of years of the franchisor's predecessors is reduced from 15 to 10. Agents for service of process may be disclosed in Item 1, Item 23 (Receipt) or an exhibit to the offering circular. In addition, franchisors must disclose, in general terms, "any regulations specific to the industry in which the franchise business operates." Regulations which are applicable to businesses generally need not be disclosed.

Item 2: BUSINESS EXPERIENCE. This section requires disclosure of the identity of each director, trustee, general partner (where applicable) and officer or manager of the franchisor who will have significant responsibility in connection with the operation of the franchisor's business or in the support services to be provided to franchisees. The principal occupation of each person listed in Item 2 for the past five years must be disclosed, including dates of employment, nature of the position, and the identity of the employer. The identity and background of each franchise broker (if any) authorized to represent the franchisor must also be disclosed in this Item.

Item 3: LITIGATION. A full and frank discussion of any litigation, arbitration, or administrative hearings affecting the franchisor, its officers, directors, or sales representatives over the past ten years should be included in this section. The formal case name, location of the dispute, nature of the claim, and the current status of each action must be disclosed. Item 3 does not require disclosure of all types of litigation but rather focuses on specific allegations and proceedings that would be of particular concern to the prospective franchisee. "Ordinary routine litigation incidental to the business" is not to be considered material. Litigation is deemed "ordinary routine" if it "ordinarily results from the business and does not depart from the normal kind of actions in the business."

Item 4: BANKRUPTCY. This section requires the franchisor to disclose whether the company or any of its predecessors, officers, or general partners, have during the past ten years been adjudged bankrupt or reorganized due to insolvency. The court in which the bankruptcy or reorganization proceeding occurred, the formal case title, and any material facts and circumstances surrounding the proceeding must be disclosed.

Item 5: INITIAL FRANCHISE FEE. The initial franchise fee and related payments to the franchisor prior to opening the franchise must be disclosed in this section. The manner in which the payments are made, the use of the proceeds by the franchisor, and whether or not the fee is refundable in whole or in part must be disclosed. If the initial franchise fee is not uniform, the franchisor must disclose the formula or range of initial fees received by it in the most recent fiscal year prior to the application date.

Item 6: OTHER FEES. A tabular form of any other initial or recurring fee payable by the franchisee to the franchisor or any affiliate must be disclosed and the nature of each fee fully discussed, including but not limited to royalty payments, training fees, audit fees, public offering review fees, advertising contributions, mandatory insurance requirements, transfer fees, renewal fees, lease negotiation fees, and any consulting fees charged by the franchisor or an affiliate for special services. The amount, time of the payment, and refundability of each type of payment should be disclosed. A "remarks" column or footnotes may be used to elaborate on the information about the fees disclosed in the table. In addition, if fees are paid to a franchisee cooperative, the franchisor must disclose the voting power of its outlets in the cooperative. Further, the range of any fees imposed by that cooperative must be disclosed if the franchisor's outlets have controlling voting power.

Item 7: INITIAL INVESTMENT. Each component of the franchisee's initial investment that the franchise is required to expend in order to open the franchised business must be estimated in this section, in a prescribed tabular form, regardless of whether such payments are made directly to the franchisor. Real estate, equipment, fixtures, security deposits, inventory, construction costs, working capital, accounting and legal fees, license and permit fees, and any other costs and expenditures should be disclosed. The disclosure should include to whom such payments are made, under what general terms and conditions, and what portion, if any, is refundable. A payment must be disclosed if it is required to be paid during the "initial phase" of the business. The Guidelines instruct that "a reasonable time for the initial phase of the business is at least three months or a reasonable period for the industry." The Guidelines also require disclosure of additional funds required during the initial phase and the factors, basis and experience upon which the franchisor bases its calculation.

Item 8: RESTRICTIONS ON SERVICES OF PRODUCTS AND SERVICES Any obligation of the franchisee to purchase goods, services, supplies, fixtures, equipment, or inventory that relates to the establishment or operation of the franchised business from a source designated by the franchisor should be disclosed. The terms of the purchase or lease as well as any minimum-volume purchasing requirements must be disclosed. If the franchisor will or may derive direct or indirect income based on these purchases from required sources, then the nature and amount of such income must be fully disclosed. Remember that such obligations must be able to withstand the scrutiny of the antitrust laws. In addition to disclosing whether the franchisor or its affiliates will or may derive revenue or material consideration as a result of franchisees' required purchases or leases, the franchisor must also disclose the estimated proportion of these required purchases and leases to all purchases and leases by the franchisee of goods and services necessary to establish and operate the franchise. The franchisor must disclose whether there are any purchasing or distribution cooperatives serving its system. The franchisor must disclose, based on immediately preceding yearns financial statements, its: 1) total revenues; 2) revenues derived from required purchases and leases of products and services; and 3) the percentage of its total revenues from such required purchases and leases. If the franchisor's affiliates also sell or lease products or services to franchisees, the franchisor must also disclose the percentage of the affiliates revenues derived from these sales or leases. Any fees required for approval of a new supplier must also be disclosed. In addition, the franchisor must disclose whether it offers franchisees inducements, such as renewal or additional franchises, for purchasing goods or products from designated or approved sources.

Item 9: FRANCHISEE'S OBLIGATIONS FRANCHISEE'S OBLIGATIONS. Franchisors must set forth the franchisees' obligations in a prescribed tabular form with regard to 24 specific categories. The table must cite the relevant sections of both the franchise agreement and offering circular.

Item 10: FINANCING. In this section, the franchisor must disclose the terms and conditions of any financing arrangements offered to franchisees either by the franchisor or any of its affiliates. The exact terms of any direct or indirect debt financing, equipment or real estate leasing programs, operating lines of credit, or inventory financing must be disclosed. If any of these financing programs is offered by an affiliate, then the exact relationship between the franchisor and the affiliate must be disclosed. Terms that may be detrimental to the franchisee upon default, such as a confession of judgment, waiver of defenses, or acceleration clauses, must be disclosed in this Item of the UFOC. The terms and conditions of "indirect offers of financing" made to franchisees must be disclosed. An "indirect offer of financing" includes: 1) a written arrangement between the franchisor, or its affiliate, and a lender for the lend to offer financing to franchisees; 2) an arrangement in which the franchisor or its affiliate receives benefits from a lender for franchisee financing; and 3) the franchisor's guarantee of a note, lease or obligation of the franchisee. Franchisors are permitted, but not required, to make disclosure in tabular form. Franchisors must disclose the annual percentage rate of interest ("APR") charged for financing, computed in accordance with Sections 106-107 of the Consumer Protection Credit Act, 15 U.S.C.

(sections) 106-107. If the APR varies depending on when the financing is issued, franchisor must disclose the APR as of a disclosed recent date. Franchisor must disclose to the franchisee the consequences of any default of its obligations, including operation of any cross-default provisions, acceleration of amounts due, and payment of court costs and attorneys' fees. In addition, Franchisors must include in the offering circular specimen copies of any financing documents.

Item 11: FRANCHISOR'S OBLIGATIONS. This section is one of the most important to the prospective franchisee because it discusses the initial and ongoing support and services provided by the franchisor. Franchisors must disclose only those pre-opening obligations which they are contractually required to provide to franchisees. Pre-opening assistance that the franchisor intends to provide, but to which it is not contractually bound to provide, may not be included. Accordingly, this disclosure must begin with the following sentence: "except as listed below, (franchisor) need not provide any assistance with you." Franchisors must take comprehensive disclosures regarding advertising, including: 1) the type of media in which the advertising may be distributed; 2) whether the media coverage is local, regional or national in scope; 3) the source of the advertising (e.g., in-house or advertising agency); 4) the conditions under which franchisees are permitted to use their own advertising; and 5) if applicable, the manner in which the franchisee advertising council operates and advises the franchisor. Franchisors must make specific disclosures regarding local or regional advertising cooperatives, including: 1) how the area and/or membership of the cooperative is defined; 2) how franchisees' contributions to the cooperative are calculated; 3) who is responsible for administration of the cooperative; 4) whether cooperatives must operate from written governing documents and whether the documents are available for review by franchisees; 5) whether cooperatives must prepare annual or periodic financial statements and whether such statements are available for review by franchisees; and 6) whether the franchisor has the power to form, change, dissolve or merge cooperatives. Franchisors must disclose information about advertising funds they administer, including: 1) the basis upon which franchisor-owned outlets contribute to the fund; 2) whether franchisees contribute at a uniform rate; and 3) the percentages of the fund spent on production, media placement, administrative and other expenses. Franchisor must also disclose whether they are obligated to advertise in the area in which the franchise is to be located and the percentage of funds used for advertising that is principally a solicitation for the sale of franchises. Franchisors are required to disclose whether franchisees must buy or use electronic cash register or computer system. If there is such a requirement, the franchisor must describe in non-technical language: 1) the hardware components; 2) the software program; and 3) whether such hardware and software are proprietary property of the franchisor, an affiliate or a third party. If the hardware or software are not proprietary, the franchisor must disclose: 1) whether the franchisee has any contractual obligation to upgrade or update the equipment, and if so, any limitations on the frequency and cost of such obligation; 2) how it will be used in the franchise; and 3) whether the franchisor has any independent access to information or data in the system. The UFOC Guidelines mandate disclosure regarding site selection procedures to include the factors considered by the franchisor in site selection or approval. In addition, a copy of the table of contents of the franchise Operating Manual must be included in the offering circular unless the prospective franchisee will view the manual before purchasing the franchise.

Item 12: TERRITORY. The exact territory or exclusive area, if any, to be granted by the franchisor to the franchisee should be disclosed, as well as the right to adjust the size of this territory in the event that certain contractual conditions are not met, such as the failure to achieve certain performance quotas. The right of the franchisor to establish company-owned units or to grant franchises to others within the territory must be disclosed. A detailed description and/or map of the franchisee's territory should be included as an exhibit to the franchise agreement. In addition to disclosing whether it has established or may establish additional franchised or company-owned outlets which may compete with franchisees' outlets, the franchisor must disclose whether it has established or may establish "other channels of distribution" under its mark. The franchisor must disclose the conditions under which it will approve the relocation of a franchise or the establishment of additional franchises. In addition, a franchise must disclose whether it or an affiliate operates or has plans to operate another chain or channel of distribution under a different trademark to sell goods or services which are similar to those offered by the franchise. If the franchisor operates competing systems, it must also disclose the methods it will use to resolve conflicts between them regarding territory, customers and franchisor support. If the principal business address of the competing system is the same as franchisor's, it must also disclose whether it maintains separate offices and training facilities.

Item 13: TRADEMARKS. Franchisors need only disclose the principal trademarks, rather than all trademarks, to be licensed to the franchisee. If a principal trademark is not federally registered, franchisors must include a statement that "by not having a Principal Register federal registration for (trademark), (franchisor) does not have certain presumptive legal rights granted by a registration."

Item 14: PATENTS, COPYRIGHTS AND PROPRIETARY INFORMATION. If the franchisor claims proprietary rights in confidential information or trade secrets, it must disclose the general subject matter of its proprietary rights and the terms and conditions under which they may be used by the franchisee.

Item 15: OBLIGATION PARTICIPATE IN THE ACTUAL OPERATION OF THE FRANCHISED BUSINESS. Franchisors are required to disclose obligations arising from its practices, personal guarantees, and confidentiality or non-competition agreements.

Item 16: RESTRICTIONS ON WHAT THE FRANCHISEE MAY SELL. In this section the franchisor must disclose any special contractual provisions or other circumstances that limit either the types of products and services the franchisee may offer or the types or location of the customers to whom the products and services may be offered.

Item 17: RENEWAL, TERMINATION, TRANSFER AND DISPUTE RESOLUTION. The disclosures must be presented in a prescribed tabular form. The table must contain abbreviated summaries regarding 23 specific categories with references to relevant sections of the franchise agreement. Preceding the table, the offering circular must state: "this table lists important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this offering circular."

Item 18: PUBLIC FIGURES. Any compensation or benefit given to a public figure in return for an endorsement of the franchise and/or products and services offered by the franchisee must be disclosed. The extent to which the public figure owns or is involved in the management of the franchisor must also be disclosed. The disclosure is only required if a public figure endorses or recommends an investment in the franchise to prospective franchisees. Consequently, franchisors need not disclose franchisees' rights to use the names of public figures who are featured in consumer advertising or other promotional efforts.

Item 19: EARNINGS CLAIMS. If the franchisor is willing to provide the prospective franchisee with sample earnings claims or projections, they must be discussed in Item 19.

Item 20: LIST OF FRANCHISE OUTLETS. A full summary of the number of franchises sold, number of operational units, and number of company-owned units, including an estimate of franchise sales for the upcoming fiscal year that are broken down by state. The names, addresses, and telephone numbers of franchisees should be included in this Item. With the exception of the list of franchise names, addresses, and telephone numbers, franchisors must disclose all information required by this Item in tabular form. The franchisor must disclose the number of franchised and company-owned outlets sold, opened and closed in its system as of the close of each of its last three fiscal years. Operational outlets must be listed separately from those not opened, and disclosure must be provided on a state-by-state basis. The franchisor may limit its disclosure of the franchisees' names, addresses and telephone numbers to those franchised outlets in the state in which the franchise offering is made if there are 100 outlets in such state. If there are fewer than 100 in the state, the franchisor must disclose the names, addresses and telephone numbers of franchised outlets from contiguous states and, if necessary, the next closest states until at least 100 are listed. For the three-year period immediately before the close of its most recent fiscal year, the franchisor must disclose the number of franchised outlets which have: 1) had a change in "controlling ownership interest;" 2) been canceled or terminated; 3) not been renewed; 4) been re-acquired by the franchisor; or 5) otherwise ceased to do business in the system. The franchisor must disclose the last known home address of every franchisee who has had an outlet terminated, canceled, not renewed, or who otherwise voluntarily or involuntarily ceased to do business under the franchise agreement during the most recently completed fiscal year end or who has not communicated with the franchisor within ten weeks of the application date. In addition, the franchisor must disclose information about company-owned outlets that are substantially similar to its franchised outlets. The same table may be used for both franchised and company-owned outlets so long as the data regarding each is set out in a distinct manner.

Item 21: FINANCIAL STATEMENTS. The franchisor must include its balance sheet for the last two fiscal years. Disclosures of statements of operations, stockholder's equity and cash flow are required for the franchisor's last three fiscal years. If the most recent balance sheet and statement of operations are as of a date more than 90 days before the application date, the franchisor must also include an unaudited balance sheet and statement of operations for a period falling within 90 days of the application. If the franchisor does not have audited financial statements for its last three fiscal years, it may provide either 1) an audited financial statement for its last fiscal year and, if the audit is not within 90 days of the application date, an unaudited balance sheet and income statement for a period falling within 90 days of application; or 2) an unaudited balance sheet as of the date within 90 days of the application and an audited income statement from the start of its fiscal year through the date of the audited balance sheet.

Item 22: CONTRACTS. A copy of the franchise agreement as well as any other related documents to be signed by the franchisee in connection with the ownership and operation of the franchised business must be attached as exhibits to the UFOC.

Item 23: RECEIPT. Franchisor are required to provide two copies of the Receipt in the offering circular, one to be kept by the prospective franchisee and the other to be returned to the franchisor. The franchisor must disclose the name, principal business address and telephone number of any subfranchisor or franchise broker offering the franchise in the state. The Receipt must contain an itemized listing of all exhibits to the offering circular. If not previously disclosed in Item 1, the franchisor must disclose the name(s) and address(es) of its agent(s) authorized to receive service of process.

ANDREW J. SHERMAN, ESQ.

Biographical Overview

ANDREW J. SHERMAN is a Capital Partner in the Washington, D.C. office of **McDermott, Will & Emery,** an international commercial law firm with over nine hundred (900) attorneys worldwide. Mr. Sherman is a recognized international authority on the legal and strategic issues affecting small and growing companies and serves as **Chairman** of the firm's **Franchising, Licensing and Distribution Group**. Mr. Sherman serves as an international corporate lawyer as well as a business growth strategist, with a focus on both external growth strategies (such as franchising, licensing, joint ventures and strategic alliances) as well as internal growth strategies (such as capital formation, technology development and mergers and acquisitions).

Mr. Sherman serves as legal counsel to over two hundred (200) franchisors and emerging growth businesses in industries as diverse as high technology, specialty retailing, consumer electronics manufacturers, restaurants (including fast-food), automotive aftermarket services, Internet service providers and database management companies, financial services and venture capital, communications, manufacturing, healthcare services, recreation and entertainment, and transportation and computer services. He practices primarily in the areas of: (a) franchising, licensing, joint ventures and distribution law; (b) corporate finance, private placements and venture capital; (c) intellectual property law; and (d) business planning and general corporate law.

Mr. Sherman represents both international and domestic franchising and corporate clients. He has worked on franchising-related projects for clients which range in size from over two dozen multi-billion dollar international conglomerates such as **Texaco, Intel, America On Line (AOL) Select, Owens Corning, The Pritzker Organizations (Hyatt Hotels), Shell Oil, Revlon, TLC Beatrice Foods International, General Dynamics, Panasonic, Sanyo, Metrocall, Sears, Travel Services International, Mail Boxes, etc. (a division of U.S. Office Products), Household Finance Corporation, Bankers Trust,** and **GAF Corporation**, to a wide range of early-stage, rapidly-growing, publicly-traded, and closely-held franchisors and middle market companies. He has represented clients and served as counsel on international franchising projects, technology transfer, licensing, joint ventures, acquisitions, brand-extension licensing, co-branding and general business transactions in over thirty (30) countries and throughout the world.

As a recognized attorney, lecturer and author on business growth, licensing and franchising strategies, Mr. Sherman has been asked to serve as an expert witness on a wide variety of litigation and arbitration matters, including recent cases on behalf of **McDonald's Corporation, Subway** and **Yamaha Corporation**, as well as a complex case on behalf of a Texas-based franchisor in connection with a litigation brought against the company by the federal government. He was recently retained as a consulting expert witness in key litigation on behalf of **Hooters International** and by **Systems 4 Corporation**, both cases involving disputes over the ownership and licensing of intellectual property.

Mr. Sherman also has extensive experience in general corporate matters, complex commercial transactions and capital formation. He has worked on a wide variety of mergers and acquisitions and capital formation transactions by and among franchisors, including the acquisition of the **Bresler's** and **I Can't Believe It's Yogurt** franchise system by **Yogen Früz International**, the acquisition of **Ruth Chris Steakhouse** by Madison Dearborn Partners, the acquisition of Dahlberg (**Miracle Ear** franchise system) by **Amplifon SpA** from Bausch & Lomb, and the acquisition of **The Glass Doctor** by **The Dwyer Group of Companies**. He has served as securities counsel on a wide range of private and public offerings of securities; as transactional counsel to both buyers and sellers in mergers, acquisitions, spin-offs, leveraged buy-outs, acquisitions of Chapter 11 companies (and development of the plan of reorganization) and management buy-outs; has negotiated on behalf of borrowers in large commercial loan transactions and assisted in the preparation and review of loan proposals; has represented both investors and entrepreneurs in several dozen venture capital transactions; has assisted many companies in the preparation of business and strategic development plans; and routinely prepares and negotiates general corporate and business agreements such as shareholders agreements, extensive employment contracts, distribution and sales agency agreements, joint venture agreements, technology transfer agreements and related corporate documentation.

Mr. Sherman is one of the nation's few leading franchising and business growth attorneys who has both direct operating experience in managing a growing franchisor as well as an extensive background in strategic planning, licensing and corporate finance. Mr. Sherman's particular area of expertise is in the strategic management of business growth as well as in the design and analysis of efficient and profitable distribution channels, the structuring of interdependent and synergistic business relationships, and in the development of brand-leveraging strategies and marketing systems to meet a company's domestic and international growth objectives. His goals are to always develop pragmatic and cost-effective solutions to the challenges facing a growing company. His passion for business growth, creative problem-solving and a total commitment to his clients have been recognized by various business groups, the media and hundreds of entrepreneurs and growing companies both in the United States and abroad.

BOOKS

Mr. Sherman is the author of eleven (11) books on the legal and strategic aspects of business growth and franchising. **One Step Ahead: The Legal Aspects of Business Growth**, was published by AMACOM Books, a division of the American Management Association, in November of 1989 and **Franchising & Licensing: Two Ways to Build Your Business**, was published by AMACOM Books in April of 1991 and is now in its fourth printing and an updated second edition was published in January of 1999. These two books have enjoyed wide distribution, critical acclaim and have been featured selections of the Fortune and Newbridge Book Clubs. Mr. Sherman was the managing editor of **The Franchising Management Handbook**, which was released in January of 1993 and was endorsed by the International Franchise Association (IFA). The **Handbook** was also chosen as a featured selection of the Newbridge Book Club and is frequently referred to by industry leaders as being among the best resources on franchising which has been published in recent years. **The Consumer's Guide to Non-Franchised Business Opportunities**, published by Holt, was released in May of 1993. **Financing Your Franchise**, (co-authored with Ripley Hotch and Meg Whittemore), was published by McGraw-Hill in August of 1993 and was a featured selection of the Newbridge Book Club and has been excerpted in several top business magazines including **Success** and **Nation's Business**. **The Complete Guide to Running and Growing A Business**, was published by **Random House** in November of 1997, was selected as the recommended business book of the month by Amazon.com in March of 1998 and by Netscape's Netcenter for Small Business in May of 1998, and has also been reviewed or excerpted in Success Magazine, Library Journal, Successful Franchising Magazine, and a wide variety of local newspapers and business journals. **Mergers and Acquisitions: A Strategic and Financial Guide for Buyers and Sellers** was published by AMACOM in April of 1998 and has received a wide variety of industry praise and positive reviews. He has also been the author of the Annual Supplement to **The Franchise Advisor**, published by Shepard's/McGraw-Hill from 1992 to 1995 and by Clark Boardman

Callahan since 1996. He is the author of "Drafting and Negotiating Franchise Agreements" chapter for West's book on **Commercial Contracts** to be published in Spring of 2000 and the author of the chapter on "Business and Financial Planning in Franchising" for the AMA's **Handbook of Budgeting** (4th edition) to be published in Spring of 2000. His ninth book, entitled **Parting Company: Succession Planning, Exit Strategies and Transition Management for Closely-Held Companies**, will be published by Kiplinger's Books in October of 1999. His tenth book, **Raising Capital**, was published by Kiplinger's Books in Spring of 2000.

UNIVERSITY AFFILIATIONS

Mr. Sherman is an ***Adjunct Professor*** in the ***Masters of Business Administration (MBA)*** program at the ***University of Maryland*** where he taught a course on "**FRANCHISING, LICENSING AND BUSINESS GROWTH**" each Spring semester from 1990 to 1994. This three-credit course was the first franchising class taught at the MBA level in the Mid-Atlantic region at a nationally recognized university. In addition, he has taught a three-credit course on '**FINANCING STRATEGIES FOR START-UP AND GROWING COMPANIES**" each year since 1994. He serves as part of a team of five (5) adjunct professors who teach in the entrepreneurship program at the University of Maryland, which has been annually named among the top 25 MBA programs for entrepreneurs by **Success** magazine since 1994. Since the Spring of 1996, he has also been teaching a three-credit course in the MBA program on "**NEW VENTURE CREATION AND BUSINESS PLANNING**." In 1997 and 1999, he was voted by the students and faculty as being among the top 15% ranking of the professors in the College of Business and Management at the University of Maryland.

Mr. Sherman also serves as an ***Adjunct Professor*** in the MBA program at ***Georgetown University*** where he has taught full and half-semester courses on "**ENTREPRENEURSHIP AND BUSINESS PLANNING**" as well as '**FRANCHISING AND GROWTH STRATEGIES FOR EMERGING COMPANIES**" since 1996.

MEDIA INTERVIEWS

Mr. Sherman is regularly interviewed as an authority on legal and strategic issues affecting franchising, business growth, capital formation, mergers and acquisitions, technology development, licensing and the leveraging of intellectual property by **The Wall Street Journal**, **USA Today**, **Investor's Business Daily**, **The New York Times**, **Business Week**, **The Washington Post**, **The Chicago Tribune**, **The Chicago Sun-Times**, **The Miami Herald**, **The Orlando Sentinel, Legal Times, The San Francisco Examiner**, **The Washington Times**, **Forbes** magazine, **U.S. News & World Report**, **Money** magazine, **Inc.** magazine, **Dun & Bradstreet Reports**, **Your Company** magazine (an American Express publication), **Franchise Update**, **Boardroom Reports**, **Nation's Business**, **Kiplinger's Changing Times** magazine, **Success** magazine, **Mergers and Acquisitions Report**, **World Trade** magazine, **Franchising World**, **Independent Business** (a publication of the NFIB), **Global Franchise Alert** (CCH), **Franchise Times**, **Small Business Update** (published by Bell Atlantic), **The Sarasota Business Journal**, **Investor's Daily**, **The Journal of Small Business Management**, **Entrepreneur** magazine, **China Business Daily** (a Taiwanese newspaper), **The Calgary Herald**, **Inc.** magazine, **Millionaire** (an Italian Business Journal), **The Asian Business Journal**, **Defis** and **L'essentiel du Management**, (two leading French entrepreneurial and business publications), **Apertura** (one of Argentina's leading business publications), **Global Franchise** magazine, **Income Opportunities** magazine, **Successful Franchising** magazine, **Black Enterprise** magazine, **Minority Entrepreneur** magazine, **Travel & Trade** magazine, **Washington Business Journal**, **Baltimore**

Business Journal, as well as publications of the IFA and the Center for Entrepreneurial Management. He was profiled as an industry advisor specializing in franchising, licensing and distribution matters in the January/February 1994 issue of **M&A Today** published for merger and acquisition professionals. He was profiled as one of five Who's Who in the Franchising Community in a special edition of the **Washington Business Times** in November of 1996. He is regularly interviewed for articles on mergers and acquisitions, capital formation and related issues published in **Trendwatch**, an on-line business newsletter which is a section of the **American Management Association's** web site.

Mr. Sherman has been a guest on a variety of television and radio programs including the national cable shows, ***Power Lunch***, produced by CNBC, ***Street Sweep***, produced by the Cable News Network Financial News (CNNFN), ***The American Entrepreneur***, produced by the Financial News Network (FNN), ***Managing (with Jan Hopkins)*** produced by Cable News Network (CNN), ***For Entrepreneurs Only,*** produced by CNNFN, ***DayWatch***, produced by CNN, Bloomberg Television, ***Asian Business News*** (produced by Dow Jones and broadcast throughout Southern Asia), and has had multiple appearances on ***First Business***, a show produced by the USA cable channel and on the U.S. Chamber of Commerce's ***Nation's Business Today***. He has been interviewed on international franchising for an instructional videotape on international marketing (hosted by Professor Philip Kotler), which was published and distributed by Simon and Schuster in 1996.

He has been interviewed on national and regional radio programs, including National Public Radio's ***Talk of The Nation***, CBS News Radio, Associated Press (AP) Radio Network's ***Business Minute***, multiple appearances in various shows broadcast over The Business Radio Network (simultaneously broadcast in over 100 cities), the Financial and Business News Radio (FBNR) network, the Armed Forces Radio Network, the "Business Day" and "Working From Home Shows" on the Business News Network (BNW), the "Small Business Advocate" radio show on the Talk America Radio Network, and the Let's Talk Business Radio Network (broadcast in over 50 cities), Newsline (Singapore and the Philippines), WGN Radio Network (Chicago and affiliates), Wisconsin Public Radio, and on local television and radio stations in Los Angeles, Boston, New York, Chicago, Phoenix, Orlando, Denver, Washington, D.C., Atlanta and Lansing. He also appears regularly on the "Great Ideas" radio show which focuses on intellectual property issues for technology entrepreneurs. From 1987 to 1988, he served as the co-host of a regional cable television show for small business owners. His television and radio interviews have been re-broadcast on the special in-flight business segments for USAir and Pan Am Airlines. In February of 1996, Mr. Sherman was taped for a series of television shows which were broadcast on The Peoples Network (TPN) in Spring of 1996. The television programs were designed for entrepreneurs and growing companies and are entitled "Entrepreneurial Insights with Verne Harnish." Mr. Sherman was the host of a series of "Legal Briefs" special features which included discussions of franchising, licensing, capital formation and protection of intellectual property.

PUBLICATIONS AND EDITORIAL ADVISORY BOARDS

Mr. Sherman has written well over two hundred fifty (250) articles on legal and management issues affecting franchising and business growth which have been published in national and international magazines and journals such as **Inc.** Magazine, **Dun & Bradstreet Reports**, **Nation's Business**, **Success Magazine**, **Small Business Reports**, **Management Review**, **The International Journal of Entrepreneurship,** **Profit**, **Global Franchise** magazine, **Franchising World** (a publication of the IFA), **Franchise Times** (a publication of the Crain's group), **The Licensing Journal**, **Today's Business Owner**, **Journal of Corporate Renewal** (a publication of the Turnaround Management Association), **Inside Minority Business**, and **Business Age**, as well as in various publications of the U.S. Chamber of Commerce, National Small Business United, the American Management Association, the Young

Entrepreneurs' Organization (YEO), the IFA, the Association of Collegiate Entrepreneurs, and in the publications of a variety of regional and local business groups. He was the developer and periodic author of the "CFO" column for **Franchise Update** magazine. He writes a periodic column on the legal and strategic aspects of franchising for **Successful Franchising** magazine. He publishes a regular column on legal and strategic issues in franchising for **Exposure**, the international franchising newsletter published by The Blenheim Group. He is a frequent contributor of articles on international franchising issues for **Business Franchise**, a leading European magazine on franchising, and contributed an article to the 7th Annual **Italian Directory of Franchising** (published by Multipla Systems in Milan). He has served as a contributor to the Business Law column of **The Washington Business Journal**, and several of his articles have been consecutively reprinted in **The Washington Business Journal's "Annual Small Business Survival Guide"** since 1990. He served as the Washington Bureau Chief of **Business Age** magazine from 1986 to 1989, for which he published a monthly column entitled "Washington Watch," a survey of legal and regulatory issues and developments affecting growing companies. Many of his articles and speeches over the years have appeared or have been reprinted in several international academic business journals published by universities in Malaysia, Brazil, Canada, United States, and throughout Europe.

Mr. Sherman serves as the legal columnist and strategic resource to **CENTERCOURT.COM**, a Web site maintained by IFX International for franchisors, growing companies and entrepreneurs. He is also the author of a series of articles on capital formation and small business which appear on the **Entreworld/Kauffman Center for Entrepreneurial Leadership (EntreWorld.org)**, **Let's Talk Business Network** (**ltbn.com**) websites, both of which enjoy a very active small business electronic community.

Mr. Sherman has served on editorial advisory boards and as a contributing editor to a wide variety of magazines and journals for owners and managers of rapidly-growing businesses published by the U.S. Chamber of Commerce, the American Management Association, Dun and Bradstreet, IBM/New York Times Publishing, the University of Pennsylvania's Wharton School of Business, Franchise Update Publications, World Trade/Global Franchise Publications, Business Age Magazine, and The Blenheim Group.

Mr. Sherman served on the editorial advisory board and was a frequent contributor to **Profit**, a magazine and resource for small business owners jointly published by IBM and the New York Times from 1990 to 1994. He is currently a contributor on legal and strategic planning issues to **Catalyst**, a newsletter for emerging growth companies published by IBM. He was a frequent contributor and also served on the editorial advisory board of **Small Business Reports**, a publication of the American Management Association from 1990 to 1993. Since 1988, he has served on the Advisory Board of the **Journal of Business Venturing**, a publication of the University of Pennsylvania's Wharton School Center for Entrepreneurship. Prior to the cessation of its publication in 1994, he was a frequent contributor to **Dun & Bradstreet Reports**, served on its editorial board, and from 1990 to 1992, authored a regular column entitled "Legal Briefs."

Mr. Sherman is the author of "Understanding The Arbitration Process," which appears as a chapter in **The Franchise Relations Handbook**, published by the IFA in November of 1995. He recently published an article on the legal and strategic aspects of joint ventures between franchisors and franchisees in the **Franchise Legal Digest**, also published by the IFA. Mr. Sherman served as the legal editor and on the editorial board of the newsletter **Franchise Investor**, the first international publication which focuses exclusively on corporate finance issues in the franchising community. His first series of articles focused on the unique legal and strategic issues facing a growing franchisor in connection with an initial public offering. He is an annual contributor to **Franchise Update's "Executive's Guide to Franchise Opportunities"** and is the author of its special report entitled "Strategies for Raising Capital for the Growing Franchisor." He is the author of the Foreword to Greg Matusky's book, **The Consumer's Guide to Home-Based Franchises**, published by Doubleday in 1992. Mr. Sherman is also the author of four (4) special reports and monographs on business growth and franchising, published by the IFA and the Michael D. Dingman Center for Entrepreneurship at the University of Maryland. He is also the author of **Financial Management, Business Planning and Capital Formation Strategies for the Growing Franchisor**, a special report, published by the IFA in late 1995. He was the author of the guidebook and served as a special consultant to the video tape series entitled "**Financial and Succession Planning Strategies for Small and Growing Businesses**," published and produced by **Kiplinger's Books** in 1997.

Mr. Sherman serves on the Advisory Board of the **Inc.** magazine Business Consulting Services division, where he provides input on business planning and strategic issues. He also serves on The Board of Directors and as General Counsel to the **Masters of Business Dynamics** program, the nation's leading educational and training program for "Gazelle 10,000" companies. Mr. Sherman serves on the Advisory Board and as General Counsel to the **Collegiate Entrepreneurs Organization (CEO)** and was a featured speaker at their inaugural conference in the fall of 1998 and 1999. He also serves on the Advisory Board and Research Committee of the **Research Institute for Small and Emerging Businesses (RISEbusiness)**. He was also recently appointed to the **International Franchise Association's Educational Advisory Committee**, where his input will focus on the strategic and developmental issues facing early-stage franchisors.

Mr. Sherman was recently named as one of the **10 Best Attorneys** for entrepreneurs and growing companies in the Washington, DC-Baltimore region by the **Morino Institute's Netpreneur Program**. He is also the author of several articles on capital formation and small business management issues for the Netpreneur program's on-line newsletter, **NET-INVEST**.

Mr. Sherman has been appointed as a **Special Advisor** to the Franchising Task Force of the **International Chamber of Commerce (ICC)**, where his duties have included providing editorial direction and input to its preparation of a Model International Franchise Contract as well as to prepare the formal Commentary (including an introduction and explanatory footnotes) to the model agreement which will be published in 1999.

Mr. Sherman also served as the **Chairman** of a Special Task Force assembled by **Success** magazine in 1997 to develop a new set of criteria for selecting the annual Franchise Gold 100 awards, identify trends and issues in franchising for selecting the annual Franchise Gold 100 issue, identify trends in franchising for the next millennium and identified topics for future franchising columns in the magazine. This Special Task Force includes members representing the International Franchise Association, the International Franchise Center (formerly the FLWC), Nation's Business magazine and several leading franchisors. He was recently interviewed in a special edition of **Success Magazine** on Franchising published in March 1998 as one of seven industry experts to discuss the future of franchising and related trends.

SEMINARS AND PUBLIC SPEAKING

Mr. Sherman is a frequent national and international lecturer on legal issues affecting business growth and has been a featured speaker at **Inc.** magazine's first and second annual conferences on "Capital Formation," seven consecutive annual meetings of the IFA's **International Franchise Exhibition (IFE)** (the world's largest annual international franchising event since 1992), the **American Management Association's** "President's Council" meetings, eleven (11) consecutive annual conferences of the Young Entrepreneurs Organization, five consecutive annual and regional conferences of the Association of Collegiate Entrepreneurs from 1989 to 1993, **Microsoft's** Small Business Crossings series of seminars, the IFA/Management 2000 program on "Franchisee Recruitment and Selection Strategies," an annual meeting of the **Licensing Executive Society**, multiple conferences on capital formation, intellectual property and franchising hosted by **The Michael Dingman Center for Entrepreneurship** at the University of Maryland, the Connecticut Venture Group, the New York Venture Group, the Tennessee Venture Group, the Route 128 (Boston) Venture Group, the Virginia Governor's Conference on Small Business, the General Services Administration, the 1991 and 1992 international student conferences of Junior Achievement International, various conferences on small business development sponsored by the Metropolitan Washington Council of Governments, the Jaycees, the Sales Marketing Executives Association, the sixtieth (60th) annual conference of the National Cooperative Business Association, the Hellenic Board of Trade (Montreal), Deloitte & Touche's executive compensation and stock options seminar, the State of Maryland's Franchise Opportunity series, the small business development centers of George Mason University and Howard University, several small business and minority business development seminars sponsored by the Montgomery County (Maryland) Office of Economic Development, five consecutive annual conferences of **The Entrepreneurship Institute**, regional meetings of the Philadelphia Franchise Association and the Mid-Atlantic Franchise Association, and Franchise Forums III and IV in Chicago and Philadelphia.

Mr. Sherman is a frequent speaker for national and regional meetings of the IFA. He has spoken at three (3) annual IFA international conventions, at several national IFA financing conferences in Dallas and New Orleans, and at regional conferences in Atlanta, Boston, Chicago, Dallas, New York, Phoenix, Los Angeles, Houston, Orlando, Philadelphia, San Francisco, and Minneapolis. He was a faculty lecturer for the IFA's Certified Franchise Executive (CFE) Program on financial management, business planning and capital formation for early-stage and growing franchisors. At the IFA's 1996 through 1999 International Franchise Exhibitions, he served as the moderator and key speaker for a one-and-a-half day program entitled "**Strategies For Canadian and Overseas Franchisors To Penetrate U.S. Markets**," which focused on the legal and strategic aspects of international franchising.

Mr. Sherman has served as one of the top-rated annual speakers for nine (9) consecutive years at the "**Birthing of Giants**," an annual management leadership and strategic conference for rapidly growing companies which is co-sponsored by **Inc.** magazine, MIT Enterprise Forum and YEO, and held on the campus of MIT in Boston since 1990. He was a speaker at the **1995 KeyCorp Small Business Conference** held at the U.S. Senate's Russell Building on Capitol Hill, which featured the nation's leading policymakers on small business issues. He was a featured speaker on "Alternative Sources of Growth Financing" for small and growing companies at the **CBS/WTOP Small Business World Exposition and Conferences** in 1996, and 1997, held in Washington, D.C. and sponsored by Wells Fargo Bank, IBM, FedEx, and Bell Atlantic. He was a VIP guest speaker at NFTE's national teacher training on "Trends and Perspectives on Teaching Youth Entrepreneurship" in August of 1999.

Mr. Sherman served as a keynote speaker on "**Regulation D and Private Placement Offerings**" for the annual meeting of the **Regional Investment Bankers Association** in June of 1997 and was a key speaker on "**Capital Formation Strategies for Emerging Companies**," at **Inc**. Magazine's three (3) most recent Annual Growing Your Company Conferences in 1997 through 1999, where he has consistently been one of the conference's top-rated speakers. He has served as one of the key speakers at 9 (nine) special conferences on mergers and acquisitions for emerging growth companies sponsored by The Geneva Companies, The U.S. Chamber of Commerce, and Georgetown University, where he delivered a presentation entitled "**Key Legal and Strategic Issues In Preparing To Sell Your Business**" at various locations from 1996 to 1999. He was a speaker at the **American Management Association's** Executive Forum on Mergers and Acquisitions: Strategies for Creating Shareholder Value, where he gave a speech in June of 1997 on "**The Legal and Strategic Aspects of International Mergers and Acquisitions**." In January of 1998, he served on a special advisory task force to the **Securities and Exchange Commission (SEC)** to provide legal and strategic input on a series of proposed changes to **Regulation D** and related aspects of the Securities Act of 1933. As a follow-up to this meeting, he also served on a panel of experts which provided input on related issues to the **SEC** at a forum hosted by the **University of Southern California (USC)**. He has also attended, by invitation, several annual meetings of the SEC's **Small Business Capital Formation Forum**, where he provided input on the legal aspects of various capital formation strategies. In the Fall of 1998, he was a keynote speaker on "**Capital Formation Strategies for High-Tech and Emerging Growth Businesses,"** for the annual conference of the **Council of Growing Companies** at **IBM's** conference center and has since spoken at a variety of local and regional events for the **Council of Growing Companies.**

Mr. Sherman was a speaker at the first and second sessions of the National Restaurant Association's Corporate Legal Study Group Conference in Atlanta in November of 1997 and Washington, D.C. in June of 1998. The topic was "**Franchising Issues in the Restaurant Industry/Domestic and International Growth Opportunities"** and the audience featured the in-house general counsels of the nation's largest restaurant and food services conglomerates. He served as the keynote speaker at the 1998 Annual Conference of the **National Association of Small Business International Trade Educators (NASBITE)** where he delivered a speech on **"International Franchising and Related Strategies for Penetrating Overseas Markets."**

He has been a speaker on international franchise law at two South American franchising conferences hosted by the **Brazilian Franchise Association** in Sao Paulo and Rio de Janeiro in September of 1992 and at a European franchising conference co-hosted by the British Franchise Association and the **European Franchise Association** in England in October of 1992. He was a speaker in 1995 and 1996 at the "First Annual Pacific Rim Franchising Conference" in Sydney, Australia and at a "Far Eastern Franchising Conference" in Taipei, Taiwan in 1993. He was a co-developer and speaker at the "Expanding Your Franchising Program into the United States" seminar held in Toronto, Ontario and sponsored by the **Canadian Franchise Association (CFA)** in 1993. He served as the U.S. legal panelist on a special program for the Canadian Franchise Association on North American franchise disclosure laws in 1994 and was a featured speaker at the CFA's 1994 annual meeting. He served as a keynote speaker during two series of speaking engagements on international franchising trends and strategies throughout Europe, which included presentations in London, Paris, Milan and Dusseldorf in the Spring and fall of 1994. He also served as a key speaker at an international franchising conference in South Africa in June of 1994 sponsored by the **South African Franchise Association**. He has been a keynote speaker for three consecutive years at the annual "Latin American Franchising Conference" in Miami from 1994 to 1997, and was a keynote speaker at an international franchising and technology transfer conference in Singapore in November of 1994 which was sponsored by the **Singapore International Franchise Association** and the **Malaysian Franchise Association**. He served as a keynote speaker for the "Second Annual Malaysian Franchise Conference" which was held in Kuala Lumpur in September of 1995, which was sponsored by the Malaysian Franchise Association. He was the only U.S. lawyer selected to serve on the panel of a special international franchising seminar held in Toronto in November of 1995 and sponsored by four of Canada's leading law firms, where he delivered a speech on "International Franchising: Strategies For Penetrating The U.S. Market and Beyond." He served as a speaker at a special conference on economic development in Africa, sponsored by the **U.S. Department of Commerce's International Trade Administration**, where he gave a speech on international franchising matters and trends in South Africa. Mr. Sherman was a keynote speaker on "**The Legal and Strategic Aspects of International Franchising"** at Global Franchising '97, an international franchising and business growth conference held in Singapore in September of 1997, and was the featured speaker on **"International Franchising: Strategies for Penetrating the U.S. Market and Beyond"** at an international franchising conference for Canadian franchising held in Toronto, Ontario in October of 1997. He served as a speaker for the **Mexican Franchise Association** for a seminar on "Understanding the Legal and Strategic Aspects of Franchising in the United States" in September of 1999.

Mr. Sherman has spoken at a wide variety of national and regional programs which focused on the growth and development of entrepreneurial businesses owned by women, minorities, physically-challenged persons and disadvantaged youth. He was a featured speaker in 1995 and 1996 at major regional conferences on growth strategies for women entrepreneurs, was a speaker at the first annual conference of the Deaf Entrepreneurs Association, has served as a speaker for the National Association of Minority Contractors, has served as a speaker at over twenty-five (25) different national and regional programs on minority business development and minorities in franchising, and participated as a lecturer for a special entrepreneurship training program for incarcerated youth.

Mr. Sherman was the developer and lecturer for the Padgett-Thompson course on "**Strategies for Protecting Trademarks, Copyrights and Trade Secrets**" and for the American Management Association's Council on Growing Companies courses on "**Growth-Oriented Distribution Strategies**" and "**How to Grow Your Company in Cash-Tight Times.**" In 1991, he was selected to serve as part of a nationwide panel of six (6) experts by **Money** magazine to discuss the future and growth of small businesses in the United States.

He has served for 10 (ten) consecutive years since 1989 as a guest lecturer at the Dickinson School of Law, (now part of the Penn State University system since 1997), one of only four law schools in the United States to offer a regular course on franchise law taught by Professor William J. Keating and as a guest lecturer on franchise law at Louisiana State University in the franchising course taught by Professor Robert Justis. He has served as a guest lecturer on business law at George Mason University, as a speaker for the Business Law Society at American University, as well as a guest lecturer for several undergraduate and MBA classes on entrepreneurship at Georgetown University and the University of Maryland. He has been selected on multiple occasions to serve as part of a special panel to evaluate and analyze business plans at both Georgetown University and George Washington University.

PROFESSIONAL AFFILIATIONS AND EDUCATION

Mr. Sherman is active in several local and national business organizations. From 1989 to 1991, he served as a co-founder, the first president, and until June of 1992, served as a founding board member and chairman of the Washington, D.C. chapter of the **Association for Corporate Growth**, where he continues to be a member of the Capitol Region chapter. He has served as General Counsel to the **Young Entrepreneurs Organization** (YEO) since its inception in 1987, an international organization made up of the founders or chief executives of over 3000 rapidly-growing companies in 20 countries and which maintains synergistic strategic alliances with the **Young President's Organization** and **The Kauffman Foundation**. He also served as legal counsel to the **Association of Collegiate Entrepreneurs** from 1989 until it ceased operations in 1993. He served as a director of **The Venture Clinic** from 1986 to 1990, and as a director of **The Entrepreneurship Institute** from 1987 to 1990.

Mr. Sherman is also an active member of several professional associations, including the American Bar Association's (ABA) section on Business Law, the ABA's Subcommittee on Domestic and International Business Structures and Agreements of the International Business Law Committee, the District of Columbia Bar section on Corporations and Business Law, the ABA Forum Committee on Franchising and the Society of Franchising, and the IAA's Council of Franchise Suppliers. He serves on the Legal/Legislative Committee of the IFA. He is also a contributor to the IAA's Educational Foundation, serves on its Strategic Advisory Council, and is a member of its Century Club. He serves as the sole U.S. legal affiliate to EF*LAW, an association of franchising lawyers representing twelve (12) different European countries. He has been a member of the **Licensing Executives Society (LES)** since 1988. He was selected by the White House to serve as a key advisor and participant in a series of strategic planning meetings relating to the development and promotion of the **1995 White House Conference on Small Business**.

Mr. Sherman is deeply committed to the education and development of children. He served on the Board of Directors of the Maryland Chapter of the Special Olympics from 1990 to 1992, the Board of Directors of **The National Foundation for Teaching Entrepreneurship to Disadvantaged and Handicapped Youth (NFTE)** since 1990, and as a speaker and author for Junior Achievement (JA) International. He has also served as **General Counsel** to NFTE since 1991 and served as its **Chairman of the Board** from December of 1993 until January of 1996. Through NFTE, and as general counsel to one of the nation's first socially-responsible venture capital funds, Mr. Sherman has developed a strong interest in the legal and strategic issues affecting socially responsible investment trends and management practices, as well as the activities of groups such as the Social Venture Network (SVN), the Private Investor's Network, the Investor's Circle, Businesses for Social Responsibility (BSR) and the Students for Responsible Business (SRB). Since 1995, he has also served on the **International Board of Governors** of **Opportunity International**, a non-profit foundation which fosters international micro-enterprise development in over thirty (30) countries worldwide. He serves on the Board of Directors of **Youth Services America (YSA)**, a national non-profit umbrella organization which supports a variety of youth volunteer activities and programs, and also serves on the Advisory Board of YSA's **Fund for Social Entrepreneurs**. He has also been a member of the **Inner Circle** at the University of Maryland's **Dingman Center for Entrepreneurship** since 1995, a regional non-profit resource center which manages a wide variety of support and training programs and services for small and emerging growth companies.

Mr. Sherman received his undergraduate degree in Political Science from the University of Maryland and his law degree from American University. He has also successfully completed course work in finance and marketing towards a Masters in Business Administration at Virginia Tech and at

American University.