Uniform Franchise Offering Circular (UFOC)

If you're interested in purchasing a franchise, you'll want to be sure to get a copy of their Uniform Franchise Offering Circular (UFOC) and review it from cover to cover. It's after you've contacted a franchisor and filled out their questionnaires to determine whether you fit the profile of "their kind" of franchisee that you'll receive two documents in the mail. One will be the UFOC, which contains 23 items of information about the franchise, and the other will be the franchise agreement. State and federal laws require that the franchisor give you these documents at least 10 days before taking your deposit and signing you on as a franchisee. If you don't receive them, you should be sure to ask about them.

Carefully examine the information in these documents before consulting with your CPA and attorney. Just because these documents appear to comply with the FTC rules and/or various state filing requirements doesn't mean they do or that the terms are in your favor. Most of those regulations only require the franchisor to make complete and full disclosure of various categories of information the law requires in the document. So long as the disclosure is made in the proper manner, the franchisor can draft the terms and conditions of its franchise and its obligations to you as a franchisee in almost any manner it wishes.

The first section in the UFOC is a brief history of the franchise. The history should document who founded the company, when it began doing business, incorporation dates if any, and when it first started franchising. This data lets you know what kind of expertise and experience the franchisor has to offer. A franchisor who has only been in business for a few years and began franchising a year after start-up doesn't have a lot of experience in the business.

The next section discusses franchise fees and royalties. The front-end franchise fee and royalties are fully disclosed. The continual royalty (usually monthly) may run up to 15 percent, and an additional advertising royalty may be 5 percent or more. The front-end franchise fee may be $1,000 to $300,000 or more. It usually does not include the costs involved in actually starting the business, such as inventory, equipment, facility, and leases. Make sure to include these fees in your financial projections, so you can accurately gauge the business' ability to generate profits in the future.

Next is a section that contains a brief summary of the officers, directors, and other executives. Read carefully to determine their level of experience and expertise. See if any have ties with suppliers or vendors from whom you'll purchase supplies or inventory and whether such ties present conflicts of interest.

The UFOC will also include a brief description of any major civil, criminal or bankruptcy actions that the officers and executives have been involved in or that the franchise company is a party to. Lawsuits are common today, and the fact that someone has been sued or has filed suit does not necessarily indicate problems.

However, if the lawsuits involve problems with franchisees or vendors, or if they are numerous, investigate further to determine the stability and integrity of the franchisor.

The terms of the franchise agreement are one of the most crucial parts of the UFOC and one that you need to review carefully. Many franchisors offer initial terms of five to ten years with options to renew for additional periods. However, it is not uncommon to encounter agreements for five-to-ten year terms with no option for renewal. This means that when the initial term expires, the franchisor may terminate the franchise and open his own company store, or charge the franchisee a large fee to continue. If the franchise agreement does not give you an option to renew, you have no protection and could lose all the goodwill you built up during the period you operated the business.

Franchisors are required to list an approximation of the initial costs of starting the franchise in addition to the franchise fees. Those costs usually include equipment, inventory, operating capital, and insurance. Keep in mind that these costs are estimates and are not inclusive. In fact, many franchise litigation specialists point out that franchisors show zero working capital or an unrealistically low figure. If there is a working capital figure located in Item Seven of the UFOC, ask if it includes operating expenses for the business until it is fully self-supporting, including an owner's salary. When interviewing other franchisees, ask them what they consider sufficient working capital for the first year of operation. Most important, have your CPA help you put together your own estimates.

Although some franchisors will supply you with projections of the sales and expenses of a new franchise location, most won't. This area is heavily regulated by the FTC to prevent franchisors from making unfounded claims. Now, however, more franchisors are beginning to provide projections. This shift in philosophy is due to regulatory changes in the late 1980s, which provided guidelines for franchisors on how to present earnings information.

A large section of the UFOC lists the many reasons a franchisor may terminate before the contract expires. They include poor condition of the location, failure on the part of the franchisee to pay royalties in a timely manner, failure to supply an account, and excessive customer complaints.

If you're deemed a "good," i.e. "profitable," franchisee, the franchisor will not use these clauses to end its relationship with you. However, if the franchisor thinks it can operate the location better than you can, or has a more desirable applicant for the location, it may use one of those reasons to attempt to terminate you. Therefore, if you sign on, you must be careful to comply with all conditions that, if not met, permit termination.

Regardless of the UFOC provisions permitting termination, some states have strong laws that can make it difficult for the franchisor to terminate a franchise early. Much of the litigation between franchisors and franchisees involves attempts on the part of franchisors to terminate franchisees' licenses prematurely.

Never assume that purchasing a franchise will give you an exclusive, protected territory. Many UFOCs state that you do not receive an exclusive territory but that it is the "policy of the franchisor" not to locate another franchise within three miles. However, "policies" can and do change. The UFOC may also say that if the franchisor decides to open another location in your area, you have the right of first refusal to purchase the new location. Another common provision allows you exclusivity in an area only if your sales are maintained at a certain predetermined level.

Read carefully the sections outlining the franchisor's responsibilities to you. Usually those obligations include providing you with a training manual, picking a suitable location, training you and/or an employee, helping plan or attending the grand opening, and offering some sort of continuing assistance with advertising and managing the store. In addition, you usually have the right to use certain trademarked symbols and names for the term of the franchise.

The UFOC usually includes only a general description of the duties the franchisor has to the franchisee. Therefore, before signing on, ask to see the manual, learn more about the training, and meet the franchisor's personnel who are going to assist you. And, if you're still interested, make sure to get your lawyer's and CPA's blessings before you sign on the dotted line.