

## Chapter SEC 34

## FRAUDULENT AND PROHIBITED PRACTICES

SEC 34.01 Application of proceeds

SEC 34.02 False, fraudulent and deceptive practices

**History:** Emergency rules covering general subject matter were adopted effective July 1, 1972.

**SEC 34.01 Application of proceeds.** A seller of franchises exempt from registration under ss. 553.22, 553.23 or 553.25, Stats., or registered under s. 553.21, Stats., or any person who is an officer, director or controlling person of the seller is deemed to employ a "fraudulent and prohibited practice" within the meaning of s. 553.41, Stats., and a "false, fraudulent and deceptive practice" within the meaning of s. 553.58 (1), Stats., if the person applies or authorizes or causes to be applied any material part of the proceeds from the sale of the franchises in any material way contrary to the purpose specified in advertising or oral representations utilized in connection with the offer to sell or sale of the franchise or in the prospectus required to be utilized in connection with the offer to sell or sale of franchises registered under s. 553.21, Stats., and, in any event, for a purpose not reasonably related to the business of the franchisor, as described in the advertising, oral representations, prospectus or any contract related to the offer or sale of the franchise.

**History:** Cr. Register, October, 1972, No. 202, eff. 11-1-72; am., Register, December, 1980, No. 300, eff. 1-1-81.

**SEC 34.02 False, fraudulent and deceptive practices.** In connection with an offer to sell or sale of a franchise in this state, any person authorizing, aiding in, or causing the offer to sell or sale of franchises shall be deemed to be engaging in a "false, fraudulent or deceptive practice" within the meaning of s. 553.58 (1), Stats., and in a "fraudulent and prohibited practice" within the meaning of s. 553.41, Stats., without limiting the authority of the commissioner under s. 553.28 or 553.55, Stats., or the authority of the department of justice or of any district attorney under s. 553.54, Stats., if he:

(1) Makes or causes to be made oral or written statements or representations with regard to:

(a) The exclusivity of the franchise rights granted to the franchisee without disclosure of the exact nature thereof;

(b) The sources from which franchisees must purchase their goods, services, equipment, inventory or real estate pursuant to the franchise agreement without disclosure of the affiliation, if any, between the sources and the franchisor and the relationship of the prices at which franchisees must make the purchases to the prevailing market price, if any, for the goods, services, supplies, equipment, inventory or real estate;

(c) Industry wide total income representations or a portion thereof applicable to the prospective franchisee, whether actual or projected, for

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the product or service marketed by the franchisor when not accompanied by disclosure of the relationship, if any, of the representations to the franchisor's and its franchisee's actual income experiences;

(d) Projections of operations or of income or gross or net profits capable of being obtained by operation of the franchise by the franchisee without selecting representative data for the basis for use of the same under s. 553.22 (3) (m) or 553.26 (16), Stats., and without:

1. In the case of a franchise of a type substantially similar to other franchises sold by the franchisor a majority of which have been operational for greater than one year the disclosure, orally at the same time or clearly and conspicuously immediately adjacent to the written representation, of the following:

“ REPRESENTATIONS ARE BASED ON THE AVERAGE ACTUAL EARNINGS OR PROFITS OF ALL OUR FRANCHISEES IN OPERATION DURING AT LEAST A PORTION OF THE MOST RECENT FISCAL YEAR. THESE FIGURES SHOULD NOT BE CONSIDERED AS POTENTIAL EARNINGS OR REPRESENTATIONS OF PROFITS OF ANY SPECIFIC FRANCHISEE”, or

2. In the case of each franchise of a type substantially similar to the one being offered to the prospective franchisee and which has been operational for greater than one year the disclosure, orally at the same time or clearly and conspicuously immediately adjacent to the written representation, of the following:

a. The name and address of the franchisee whose earnings or profits are being represented and the circumstances under which the earnings were made; and

b. The percentage of franchisees which the represented franchise equals; and

c. The average actual earnings or profits of all franchisor's substantially similar franchisees in operation during at least a portion of the most recent fiscal year together with the disclaimer called for in s. SEC 34.02 (1) (d) 1.; and

d. THIS REPRESENTATION IS BASED ON THE ACTUAL EARNINGS OR PROFITS OF THE NAMED FRANCHISEE DURING THE PERIOD ABOVE STATED. THESE FIGURES SHOULD NOT BE CONSIDERED AS POTENTIAL EARNINGS OR EARNINGS CAPABLE OF BEING ATTAINED BY ANY OTHER FRANCHISEE.

3. In the case where there have been no franchisees of a type substantially similar to that offered and sold by the franchisor which were operational during the 12-month period preceding the date of the representation or where less than a majority thereof sold have become operational without disclosure, orally at the same time or clearly and conspicuously immediately adjacent to the written representation, of the following:

“ALL REPRESENTATIONS OF POTENTIAL EARNINGS OR PROFITS ARE MERELY ESTIMATES. NO FRANCHISES HAVE

BEEN IN OPERATION LONG ENOUGH TO INDICATE WHAT, IF ANY, ACTUAL EARNINGS OR PROFITS MAY RESULT.”

(e) The actual income experiences of the franchisor or its franchisees without stating orally at the same time that certified audited financial statements are or are not available and if so, from what source or disclosing in writing immediately adjacent to the written figures the certified financial statements of the franchisor and its franchisees or a summary thereof, whether certified or unaudited, in the form required by s. SEC 35.05, Wis. Adm. Code;

(f) The net worth of the franchisor and its affiliates without disclosing orally at the same time whether and from where certified audited or unaudited financial statements of the franchisor are obtainable or, with regard to written representations, disclosing immediately adjacent to such written representations the certified audited, or unaudited financial statements of the franchisor if the use of the same is permitted by the commissioner under s. SEC 35.05, Wis. Adm. Code;

(g) The franchisor’s affiliation with any person or business entity, without disclosing at the same time orally the legal nature thereof or disclosing the legal nature of such affiliation immediately adjacent to the written representations;

(h) The endorsement or approval of the franchise or its business by any person or business entity without disclosing, orally at the same time or immediately adjacent to the written representations, the nature of such endorsement or approval and the compensation being given, if any, by the franchisor or the franchisees to the person or business for the making of the approval or endorsement;

(i) The date by which a prospective franchisee’s enterprise will be totally operational in connection with the offer to sell or sale of a franchise without disclosing the basis on which that date has been determined or is estimated and the average elapsed time between the signing of franchise contracts and the commencement of conduct of business of the franchisor’s other franchisees throughout the continental United States;

(j) The advertising support to be provided by the franchisee, and by the franchisor if such is the case, without disclosing the manner by which the monies of the franchisee and franchisor are to be raised and spent and the manner by which franchisees may obtain an accounting for the expenditures;

(k) The nature and number of the locations appropriate for the franchisee’s enterprise, whether or not to be obtained by the franchisor, without disclosing by whom the sites are to be secured, the manner by which their procurement is to be financed, whether by the franchisor or by the franchisee, the source and terms for the financing, the relationship, if any, between the site procurement and the execution of a franchise agreement, with whom, if anyone, the franchisor has a binding obligation for the procurement of the locations, and whether use of the site by the franchisee will entitle the franchisee to become affiliated with any existing enterprise or will create an obligation on the part of the franchisor or franchisee to any third party;

(l) Any payment, giving of consideration, contract, release or execution of any negotiable or other written instrument or portions thereof to

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be executed in furtherance of the consummation of a franchise agreement without disclosing the complete contents thereof and the significance of execution, tender or delivery thereof in the franchise sale transaction;

(m) The willingness of other individuals to enter into a franchise agreement substantially similar to that being offered or sold without disclosing, at the same time orally or immediately adjacent to the written representations, the source of the information and the identity, including names and addresses, of the individuals;

(n) The total number of franchises substantially similar to that being offered or sold established or to be established in a geographical area without disclosing graphically the area discussed or without disclosing whether or not such franchises are operating or have conducted business as defined by s. SEC 31.01 (1), Wis. Adm. Code;

(o) The qualifications or experience, if any, a potential franchisee should possess without disclosing what additional personnel will be required for operation of the franchisee's business if the qualifications are not possessed by the potential franchisee;

(p) The extent of training, supervision and technical assistance, if any, to be provided by the franchisor under the franchise agreement without disclosing the frequency thereof, the cost of the training, supervision or technical assistance to the franchisee, and the effect of failure of the franchisee to participate in the same in accordance with any provisions of the franchise agreement;

(q) Recovery of a portion or all of a franchise fee or other investment without disclosing whether the franchise fee or other investment is secured or guaranteed and, if so, in what manner, or, if not secured or guaranteed, over what period of time, based on the actual income experience of other franchisees of the franchisor, the franchisee might expect to recover the franchise fee or other investment although the disclosure required herein shall not in and of itself constitute a representation that that franchisee will recover his franchise fee or investment within the specified period of time;

(r) The application for a franchise agreement without disclosing that the document constitutes only an application and not the agreement by which the franchise is being or will be sold or consummated;

(s) Aid or assistance to be given by the franchisor to the franchisee in training, obtaining locations for conducting business, or in marketing the product or service of the franchisor without citing the contractual provisions in the franchise agreement obligating the franchisor to accomplish the same or if none, so stating to the franchisee prior to execution of the franchise agreement; or

(2) Makes any representation with regard to:

(a) Approval of or endorsement of a franchise or a franchisor by the office of the commissioner of securities of the state of Wisconsin, the Wisconsin department of justice, or any agency of the state of Wisconsin or by any other public agency or employes thereof;

(b) A finding by any agency of any state or of any public agency or by its agents or employes that any contents of advertising is true and not misleading;

(c) The name of the state of Wisconsin or any agency thereof or the name of any public agency or any agents or employes thereof in connection with promoting, advertising, offering or selling a franchise other than to state that compliance with the applicable laws has been accomplished and to demonstrate the same by a showing of copies of correspondence or official records to that effect; or

(3) Fails to make the following representations:

(a) When a relationship exists between the franchisor and any other person or business entity which has offered, is offering or will offer a franchise program substantially similar to that being offered or sold, to state the nature of such relationship and to disclose the similarity, if any, of the trademark or commercial symbol and production and marketing plan of the other person or business entity to that of the franchise being offered or sold;

(b) When there are other franchises which have been sold by the franchisor, to state the names and addresses of 1% or 5, whichever is greater, of other franchisees of a substantially similar type located in the state of Wisconsin, or if none therein, within the continental United States so that the same may be contacted by the prospective franchisee;

(c) When any closings, terminations or refusals to renew of franchises of a substantially similar type being offered and sold have occurred within 12 months immediately preceding such offer or sale, to state the names and addresses of such franchisees which have gone out of business and the reasons therefor;

(d) Where purchase of goods, services, equipment, inventory or real estate by franchisees from designated sources including the franchisor, is required under the franchise agreement, to state:

1. In the case of sources other than the franchisor, the affiliation, if any, of the franchisor with the sources, and

2. The cost to the seller of the goods, services, equipment inventory or real estate if the source is affiliated with the franchisor, and

3. The prevailing market price, if any, for the goods, services, equipment inventory or real estate, and if none, an explanation as to the inability of the seller to determine and disclose the same, and

4. The manner, if any, in which the availability of such goods, services, equipment, inventory or real estate will be ensured by the franchisor or its affiliates under the terms of the franchise agreement, and;

(e) Any representation required to be made by s. 553.22 (3) or 553.26 (1) through (22), Stats., or any disclosures referred to in sub. (1) (a) through (s) of this rule which are part of the franchise agreement being offered or sold; or

(4) Misrepresents:

(a) That execution of any document in connection with the offer or sale of a franchise constitutes only an application for such franchise

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when, in fact, execution of the subject document or documents creates a binding obligation;

(b) The number of franchises of the franchisor which are identical in type which are conducting business or have conducted business within the meaning of s. SEC 31.01 (1), Wis. Adm. Code, within a given area at any time;

(c) That the franchise agreement and all of its obligations is or are embodied in one or several documents presented to, made available to or executed by the prospective investor when, in fact, the execution of additional documents or the giving by the franchisee of additional consideration is required for the purpose of the franchise or execution of some of such documents are not related to or necessary for the sale of the franchise;

(d) Any element of a franchise agreement or of the business of a franchisor required to be made by s. 553.22 (3) or 553.26 (1) through (22), Stats., or any disclosures referred to in sub. (1) (a) through (s) of this rule.

**History:** Cr. Register, October, 1972, No. 202, eff. 11-1-72; am. Register, December, 1980, No. 300, eff. 1-1-81.