



Y2K Implications for Franchising

BY THOMAS M. PITEGOFF

Most public companies, including public franchise companies, have been making Year 2000 (Y2K) disclosures in their annual and quarterly securities filings at least since the first quarter of 1998. The high degree of Y2K disclosure by public companies for securities law purposes is in stark contrast to Y2K disclosure in franchise offering circulars, a topic that franchisors are only now beginning to consider.



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Should franchisors make Y2K disclosures to prospective franchisees as part of their franchise offering circulars? Like securities prospectuses, franchise offering circulars are intended to provide information to investors for their protection. Purchasers of franchises, like purchasers of securities, are entitled to receive information that may have a material effect on their investments and might affect their decision to invest. Although there are significant differences between securities and franchise laws, there is good reason for franchisors to consider making some form of Y2K disclosure to prospective franchisees.

Aside from the disclosure question, some franchisors may have contractual responsibilities that would imply an obligation to assist their franchisees with their Y2K compliance. Finally, both franchisors and franchisees should be assessing the impact of the Y2K problem on their operations for the sake of their own business survival.

What is the Y2K Problem?

As every business executive and attorney knows by now, the Y2K problem results from the fact that many software programs and computing devices store year values in two

digits.¹ These programs and devices recognize the value "98" as "1998," but incorrectly read the value "00" as "1900" instead of "2000." This misreading of the year can result in a system failure or miscalculations causing business disruptions. The software or device may be unable to process transactions, send invoices, or engage in similar normal business activities. Some software that recognizes the year 2000 may not recognize it as a leap year. The problem can arise early, as some data base programs recognize 9/9/99 as a place holder rather than a date, or when businesses find that their insurance companies have excluded Y2K risks. Any company's assessment of the problem cannot be confined to its internal operations. Suppliers may be unable to fill orders. Banks may be unable to extend credit. Franchisees may be unable to supply accurate reports or to make required payments to franchisors.

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(Including cases on: implied duty of good faith and fair dealing; arbitration; jurisdiction and venue; Petroleum Marketing Practices Act; enforcement of contractual provisions; and others)

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Y2K and Franchising

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Remediation Methods

Of the many possible approaches to "remediating" the Y2K problem, the most straightforward is to change each line of code that reads a year in two digits to four. This date expansion method is time-consuming. Large companies, in particular, may have millions of lines of code. In addition to the modification of program code, all existing date data must also be modified. Aside from the cost, a company may have so many lines of code that it simply will not have enough time to fix every line of code and to test the modified software before the year 2000. Regardless of the remediation approach, testing is a large portion of a Y2K remediation effort, and many companies may find that they do not have adequate time for testing new or remediated software or systems before the year 2000.²

Other remediation methods include "windowing" and data compression. When a windowing technique is used, the software reads "98" as "1998" and "02" as "2002," with an arbitrary line drawn at a specific date, so that "80" might mean "1980," while "79" might mean "2079". This approach is called a "fixed window" technique that delays the Y2K problem but does not eliminate it.³ A "sliding window" technique also maintains a window of 100 years, but does so by maintaining a consistent number of years in the past and the future. The data compression method uses letters or other characters in addition to numbers, thereby placing more information in two digits. One problem with both windowing and data compression is that different companies may use different techniques. When the computer systems of the two companies communicate, the data from one might cause the program in the other to stop functioning or to yield incorrect results. This becomes crucial when companies use electronic data interchange or are otherwise dependent on each other's computer systems or data.

Some software is developed in-house or by outside programmers for a specific company. In these cases, the code may not be well documented, or the company may not have the source code or the right to modify it under copyright law or the relevant contract. A manager outside the IT department may have written an undocumented spreadsheet using two-digit years. Even if the people who created these programs can be identified, they may no longer be available to modify the code.

Often, the source code is owned by a company that licenses it to others and provides ongoing maintenance or support for an annual fee. Such a licensor may agree as part of this maintenance to supply a Y2K compliant version or upgrade by a particular date. Many companies are dealing with the problem by taking the opportunity to install brand new, Y2K-compliant computer systems in place of older systems.

In addition to the software problem, some processing chips measure years in two digits rather than four. These embedded chips cannot be reprogrammed, but must be iden-

tified and replaced. They may be found in equipment other than computers, such as elevators, automobiles, telephone systems, security systems, and others.

Estimates of the cost of remediating the Y2K problem worldwide run in the hundreds of billions of dollars, and some have said that the cost of litigation and judgments resulting from the Y2K problem will far exceed a trillion dollars.

SEC Disclosures

Many public companies, including franchisors, now commonly make Y2K disclosures in their securities filings and offering documents.⁴ Public companies have a strong incentive both to deal with the Y2K problem and to make Y2K disclosures. The officers and directors of such companies can be held personally liable for failing to take reasonable steps to deal with the problem and to disclose material information relating to the problem.⁵ At least one law firm is known to be gearing up to represent plaintiffs in shareholder suits arising out of the Y2K problem.⁶

The need for such disclosure became clear when the staff of the Securities and Exchange Commission (SEC) recommended in a staff bulletin in 1997 that public companies include Y2K disclosures in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" (MD&A) section of their annual and quarterly reports.⁷ The SEC staff bulletin advised public companies to include such disclosure if: (a) the cost of addressing the issue is a material event or uncertainty that would cause reported financial information to be not necessarily indicative of future operating results or financial condition, or (b) the costs or the consequences of incomplete or untimely resolution of the issue represent a known material event or uncertainty that is reasonably expected to affect future financial results or cause reported financial information to be not necessarily indicative of future operating results or future financial condition. The SEC staff bulletin also stated the staff's position that if a company has not made an assessment of its Y2K issues or has not determined whether it has material Y2K issues, then disclosure of this known uncertainty is required.

The staff's position was that Y2K disclosure should be based on whether the Y2K issues are material to a company's business, operations, or financial condition. If so, then reasonably specific and meaningful disclosures should be made, including the company's general plans to address the issue and the total dollar amount that the company estimates will be spent to remediate the problem, if such amount is expected to be material to the company's business, operations or financial condition, and any material impact these expenditures are expected to have on the company's results of operations, liquidity and capital resources. The staff emphasized that companies should review, on an ongoing basis, the need to disclose costs, problems and uncertainties associated with the Y2K issue.

The public companies that made Y2K disclosures in the

first quarter of 1998 appear to have their Y2K projects well under control. A number of public companies made no Y2K disclosures in their SEC filings in the first quarter of 1998, presumably because they have determined that the Y2K problem will not have a material effect on the company. The fact that so many companies appear to have the problem under control should not lead others to complacency.⁸ Some companies are spending substantial sums to ensure Y2K compliance, and it may well be that some privately-held companies have undisclosed Y2K problems or that some public companies do not yet know the true extent of the risk.

Remediation Cost Disclosures

In the annual and quarterly reports filed to date with the SEC, many public companies have not given specific dollar estimates of the cost of their Y2K remediation and testing, but have reported that the cost will not be material.⁹ Many public franchise companies have taken this general approach. For example, Interim Services Inc., a franchisor of staffing, consulting, and career management services, reported that it must upgrade certain of its systems to ensure that they operate after the year 1999: "The Company believes that these upgrades will take place in the ordinary course of business without significant incremental cost." Interim also reported that some software purchased from third parties will have to be made Y2K compliant and that the vendors of those products have announced upgrade versions that will be available in the first half of 1998 that will be Y2K compliant. Interim reported that "the costs of these upgrades are included as part of the ongoing maintenance fees." Several other public franchise companies have taken a similar approach.¹⁰

Other public companies have given specific estimates of the cost of their Y2K remediation and testing. Citibank, perhaps the biggest Y2K spender of all, estimates an expenditure of approximately \$600 million over the three-year period from 1997 through 1999.¹¹

Several public franchise companies have also given specific numbers. Wendy's International, Inc. estimates that it will spend \$70 to \$80 million to install a new enterprise-wide information system and a new store management system, and another \$3 to \$4 million to modify existing software.¹² Tri-con Global Restaurants, Inc., formed in 1997 as the spinoff of the PepsiCo businesses of KFC, Pizza Hut, and Taco Bell, estimates a cost of \$40-\$45 million for testing and conversion of their systems and applications.¹³ Cendant Corporation, created in December 1997 through the merger of CUC International, Inc. and HFS Incorporated, estimates the total future cost of compliance to be approximately \$30 million.¹⁴ Cardinal Health Inc., which owns the Medicine Shoppe franchise and other businesses, estimates its compliance cost at approximately \$20 million. Budget Group, Inc., the car rental company, reports that it expects to spend approximately \$2.2 million on Y2K modifications in 1997 and approximately \$6.7 million in 1998 and 1999. Dollar Thrifty Automotive Group, Inc., another car rental company, estimates a cost of \$5 million. Triarc Companies, Inc., which owns the Arby's restaurant business as well as Snapple,

Mistic, and Royal Crown beverages, estimates its cost of remediation at approximately \$2 million.

Y2K Risk Disclosures

When a company estimates the cost of Y2K remediation or states that it does not anticipate that the cost will be material, such statement will often be followed by language explaining that there can be no guarantee that these estimates are correct.

Other companies go one step further by including disclosures in their SEC filings to the effect that there may be adverse effects if the estimates are wrong. Wendy's International, Inc., for example, reported that if the company's new systems and modifications are not implemented on a timely basis there will be "adverse financial and operations effects" and that the extent of these effects is not known.¹⁵

Like Wendy's, Red Roof Inns, Inc. is using the Y2K problem as an opportunity to replace outdated systems. Red Roof Inns, Inc. reported that the company is replacing its accounting software with a system that is Y2K compliant. The company reported that it expects the new system to cost approximately \$3 million and that its costs for Y2K compliance are not anticipated to be material in any given year. The company stated, however, that "there can be no guarantee that these estimates will be achieved and actual results could differ from these estimates."

Cendant, like several other public franchise companies, reported that the company is in the process of "identifying, evaluating and implementing changes to computer systems and applications necessary to achieve a year 2000 date conversion with no effect on customers or disruption to business operations." Cendant warned that if the necessary "modifications and conversions are not made, or are not completed timely, the year 2000 issue could have a material impact on the operations of the Company." Budget similarly warned that a failure in its reservation and rental transaction processing systems "could cause significant disruption in customer service levels and therefore materially impact the Company's operating results and financial condition."

Other companies that disclosed similar warnings include: Cardinal Health Inc.¹⁶ (The Medicine Shoppe); ServiceMaster,¹⁷ owner of TruGreen-ChemLawn, Terminix, Merry Maids, and other businesses; New Horizons Worldwide Inc.,¹⁸ a computer training center franchisor; CDI Corp.,¹⁹ which owns Management Recruiters and other personnel-related companies; Norrell Corp.,²⁰ a provider of franchised staffing, outsourcing, and professional services; and Papa John's International, Inc.,²¹ a pizza restaurant franchisor.

Franchise Disclosures

Disclosures to Prospective Franchisees

As yet, the Federal Trade Commission (FTC), the North American Securities Administrators Association (NASAA), and individual states have not issued any guidance to franchisors on the extent to which Y2K risks should be disclosed to prospective franchisees in franchise offering documents.²² Nevertheless, some franchisors have begun to consider

whether they should add Y2K disclosures as part of their franchise offering circulars.

To what extent might franchisors be required to make Y2K disclosures in franchise offering circulars? The answer may depend on many factors, including the degree to which franchisors rely on computer systems, the degree to which franchisees depend on them, the types of computer systems used, and the status of the franchisor's Y2K compliance project.

Generally speaking, there is far less need to make a Y2K disclosure in a franchise offering circular than in a securities registration statement. The SEC staff has advised that the MD&A of securities annual and quarterly reports is the appropriate place to include Y2K disclosures. There is no MD&A in franchise offering circulars, just as there is no "business judgment" rule in franchising. Directors and officers of a privately-held franchisor may be personally liable for fraud, but not for a failure to exercise reasonable business judgment.

Franchise offering circulars are directed at prospective purchasers of franchises, just as securities reports are directed at prospective purchasers of securities. One important difference, though, is that securities reports are also intended to keep the markets and the investing public informed of the status of a company from quarter to quarter, to enable investors to make decisions about selling securities as well as buying. Investors buy and sell securities and are not usually active managers in the businesses that those securities represent. Franchise purchasers, on the other hand, generally are active participants in the business and do not usually sell on the basis of disclosures made in offering circulars after they have purchased the franchise. Selling a franchise amounts to selling a business, and is very different from selling a passive investment. Given these differences between securities law and franchise law, it is not surprising that the disclosure obligations are very different.

Are franchisors under an obligation to prospective franchisees to assess their Y2K risks and estimated costs? Are they under an obligation to disclose the fact that they have made no Y2K assessment? Given the amount of high-profile publicity that the Y2K issue has received at least since mid-1997, it would be difficult for any franchisor to argue that it did not know about the problem. A franchisee who purchases a franchise in 1999 or late 1998 from a franchisor who has taken no steps to deal with the issue and has made no Y2K disclosure in the offering circular but then suffers damages due to a Y2K failure of the franchisor's computer system may be able to argue that the absence of a Y2K warning constitutes a breach of the franchisor's contractual obligations or that it constitutes negligence. It is not clear, however, that it would constitute a violation of the franchise disclosure laws.

The Federal Trade Commission trade regulation rule on franchising (the FTC Rule) requires only that specific disclosures be made, and these do not include anything as broad as the MD&A. The FTC Rule prohibits franchisors from including information in the disclosure document unless it is required by law.²³ A Y2K disclosure does not appear to be required by law. A failure to make a Y2K disclosure may not even be an unfair or deceptive practice under section 5 of the Federal Trade Commission Act, at least not unless there is

something that may virtually amount to fraud.²⁴

If a franchisor uses the UFOC format of franchise offering circular to comply with the FTC Rule, this format also does not have a category in which a Y2K disclosure would be appropriate. One place such a disclosure might be appropriate under the UFOC format would be the risk factors on the cover page. NASAA requires that certain specific risk factors be listed on the cover page. These do not include Y2K risks. The UFOC guidelines state that different state administrators may require additional risk factors. So far, none has required Y2K disclosures.

Can franchisors list their own additional risk factors? NASAA's Instruction iii with respect to the cover page appears to indicate that franchisors may list their own additional risk factors. This instruction provides, in part: "Exclude non-required information unless necessary as a risk factor or required by a state regulator." The words "necessary as a risk factor" can only be read to mean information that is not specifically required by the UFOC instructions or by a state regulator. Stephen Maxey, senior examiner with the Division of Securities and Retail Franchising of the Virginia State Corporation Commission and former chair of the NASAA Franchise and Business Opportunities Committee, agrees with this position.²⁵

The state disclosure laws have language that is generally patterned after Rule 10b-5 under the Securities Exchange Act of 1934. In New York, for example, it is unlawful, in connection with the sale of a franchise, willfully to make an "untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."²⁶ California and other states have similar requirements.²⁷ It is not clear that these laws would require the disclosure of information that is outside of the scope of the specific franchise disclosures.

Does this mean that franchisors should not include Y2K disclosures in the risk factors section of their franchisor offering circulars? Not necessarily. Certainly, disclosure in the form of a risk factor is an option in extreme cases. Consider, for example, a franchisor that sells a franchise with the knowledge that the franchisor's Y2K problem is likely to disrupt the business of the franchisor and the franchisee. Consider, too, a franchisor that relies on computer systems for its mission-critical business applications, or supplies software to its franchisees, or communicates electronically with its franchisees. In these extreme cases, a franchisor that fails to deal with the Y2K problem faces legal risks outside of the franchise disclosure laws. An injured franchisee might have an action against the franchisor for fraud or breach of contract under the right set of facts. However, disclosure as a risk factor in the franchise offering circular might also be appropriate.

In many cases, a franchisor may have good reason to communicate Y2K information to prospective franchisees without highlighting it in the risk factors of the offering circular. In such cases, franchisors might consider amending their franchise agreements to include Y2K disclosure, or preparing separate Y2K disclosure documents for new franchisees, and

filing these as material changes with the relevant state administrators. The contents of such documents would depend on the particular agreements that the new franchisees are asked to sign. They may include a warranty regarding the Y2K compliance of software supplied by the franchisor and a limitation of liability or damages. A Y2K warranty need not be a blanket statement that the franchisor's systems are compliant, or that the franchisor assumes no liability for Y2K failure. A more useful provision would state, among other things, that the franchisor and franchisee will cooperate in testing their systems to ensure a smooth Y2K transition for both.

A far weaker alternative would be for a franchisor to rely on its auditors to make Y2K disclosures. Once the cost of remediation has been estimated, the auditors might note this in the audited financial statements that are part of the offering circular. However, most franchisors file annual and not quarterly financials, which means that the disclosure might not be made in time to matter. Such a disclosure does not allow for the type of legal protection that a separate Y2K agreement can provide.

In any event, franchisors should not make Y2K disclosures to prospective franchisees outside of the franchise offering circular. The UFOC instructions clearly state that franchisors should not make disclosures to prospective franchisees that contradict or are materially different from the disclosures contained in the offering circular.²⁸

It would also be prudent for any prospective franchisee to inquire about the prospective franchisor's Y2K readiness, just as all businesses should be inquiring about the Y2K compliance of all their important suppliers. Unless a franchisor has adequately dealt with the question, a savvy prospective franchisee will make this a negotiating point before the franchise agreement is signed.

Dealing with Existing Franchisees

What rights do existing franchisees have against a franchisor that fails to disclose Y2K problems or a franchisor that fails to take any steps to assess whether the franchisor has a Y2K problem? Franchisees who purchased their franchises before a franchisor knew or should reasonably have known about a material Y2K problem would have no recourse under the franchise laws; state and federal franchise administrators would also have no such recourse. Instead, franchisees would have to look to other laws, such as contract law or common-law fraud, depending on the particular facts and circumstances of the case.

In all likelihood, the extent of a franchisor's liability for Y2K damage to its franchisees will be based on the contracts relevant to the particular issue, or on quasi-contractual promises. What contractual covenants, representations or warranties did the franchisor breach? Was the software supplied by the franchisor? If so, what do the contracts provide? Whose responsibility is it to remediate the problem? What warranties were given? Has the statute of limitations run? What promises were made? What actions did franchisees take in reliance on those promises? Did the franchisor know that there was a material Y2K problem when the promises were made?

Franchisees by definition are vitally interested in the continued success of their franchisor. The degree to which franchisees depend on their franchisor varies from system to system. While this dependency does not in itself create a fiduciary duty, a franchisor may be obligated to act in certain cases based on the implied covenant of good faith and fair dealing. In egregious cases, a franchisee might argue that a franchisor's failure to assess its Y2K problem amounts to negligence or fraud.

Both franchisors and franchisees should consider the extent of their contractual liabilities to one another in light of the Y2K problem. Franchisors should be examining their contracts with franchisees to see the extent to which they may be liable to franchisees to fix Y2K problems. Franchisees should be doing audits with respect to franchisors as they would with respect to any supplier. Such Y2K legal audits will entail an analysis of the relevant agreements to determine, among other things, who is responsible for performing fixes, who has the right to change the source code and whether the cost of Y2K compliance is included as part of a maintenance agreement.²⁹ Franchisors and franchisees should review all relevant agreements from a Y2K perspective, including agreements with suppliers of computer hardware and systems, license agreements for software and data, development agreements for software or databases, maintenance and support agreements, computer service agreements, documentation and promotional materials from vendors, and merger and acquisition agreements.

In some cases, a franchisor might be able to offer computer systems or services to existing franchisees under new agreements that contain Y2K warranties but limit the franchisor's liability for Y2K problems. This might be the same or a modified version of an additional agreement that a new franchisee would be asked to sign covering the Y2K issue.

Regardless of the potential legal issues, it is in the business interest of franchisors and franchisees that computer systems used in the franchise system work after 1999, both the internal systems of the franchisor and those used by franchisees. At least one franchisor reported in its last 10K that it plans to report on Y2K risks to existing franchisees.³⁰ Other franchisors are working with franchisees on the Y2K issue or plan to do so but have not indicated this in their securities registration statements. Franchisors and franchisees should review their computer software, equipment or systems, determine which ones are critical to their businesses, and take steps to ensure that they are Y2K compliant. In franchise systems that include electronic data interchange, in particular, franchisors and franchisees may need to work together closely to fix or remediate noncompliant computer systems and to test remediated software for Y2K compliance.

Conclusion

Because of the added impetus of securities law liability and the prodding of the SEC staff, public companies have a head start on many privately-held companies in coming to grips with the Y2K issue. Privately-held franchisors, however,

should be concerned about complying with their contractual obligations, which may be affected by a Y2K problem. While it may not be appropriate to make Y2K disclosure as a risk factor in the franchise offering circular, a franchisor may want to add an agreement to the franchise offering circular specifically dealing with the Y2K issue.

More fundamentally, both franchisors and franchisees should be concerned with Y2K compliance for their self-preservation. Every franchisor and franchisee should be assessing its computer systems for Y2K compliance. They should be questioning all of their suppliers to be sure that their systems are also Y2K compliant and that the techniques used by any company connected to their network will continue to work after December 31, 1999. As part of this Y2K audit, every franchisor and franchisee should be reviewing its contracts to determine who has the responsibility to fix specific software and equipment, and the extent of those parties' liability for Y2K failure. Those who are contractually responsible should act promptly to fix noncompliant software or to find another solution. Those who are not contractually responsible should nevertheless take prompt action if those who are contractually responsible are unwilling or unable to remediate mission-critical software or systems. Taking these steps will improve the likelihood that the transition to the year 2000 will be uneventful.

Endnotes

1. Much has been written on the Y2K issue. A list of books on the subject can be found by searching the phrase "Year 2000" on the Website amazon.com or barnesandnoble.com. These books include, for example: YOURDON, *TIME BOMB 2000* (Prentice Hall 1998); BOURNE, *YEAR 2000 SOLUTIONS FOR DUMMIES* (IDG Books 1997); and Scott and Reid, *YEAR 2000 COMPUTER CRISIS: LAW, BUSINESS, TECHNOLOGY* (Glasser LegalWorks 1998). One of the best ways of researching the Y2K issue is to visit some of the many Websites devoted to the subject. Three Y2K sites worth noting here are those of the American Bar Association (www.abanet.org/tech/ltrc/2000/home.html), Law Journal Extra (www.ljx.com/practice/computer/ct_y2k.html) and de Jager & Company (www.year2000.com/).

2. Experts commonly conceptualize a company's Y2K compliance in the following sequence of stages: awareness, inventory, assessment, remediation, testing and implementation. Testing is generally regarded as the stage that requires the most time and effort.

3. Expanding all year fields from two digits to four also does not eliminate the problem, but it does delay the problem until the year 10,000.

4. Brian Lane, the Director of the SEC's Division of Corporate Finance, summarized the law governing Y2K disclosure as follows:

Under the federal securities laws, disclosure is one of the principal means of protecting investors. Investors need sufficient information to make informed investment decisions—whether to buy or sell, or in some cases, whether to tender shares or how to vote. Public companies are not directly regulated by the Commission, but they must file information with the Commission on a regular basis to provide the trading markets with detailed information about their business and financial condition. In the case of the Year 2000 issue, . . . investors need to know if there is likely to be a material financial impact on the company.

Concerning the Disclosure Obligations of Public Companies Presented by the Year 2000, Before the Subcomm. on Financial Services and Tech-

nology Comm. on Banking, Housing, and Urban Affairs (Oct. 22, 1997) (Testimony of Brian Lane, U.S. Securities and Exchange Commission).

5. On the topic of securities law liabilities for inadequate Y2K disclosures, see generally Dennis J. Block and Stephen A. Radin, *Year 2000 Director Liability Issues*, N.Y.L.J., Jan. 13 & 20, 1998; and LEONARD T. NUARA, *IS IT 658 DAYS OR 65X LEGAL ISSUES TO THE YEAR 2000?*, (Advanced Computer Law Institute 1998).

6. It is well known in Y2K circles that the New York law firm Milberg Weiss Bershad Hynes & Lerach is gearing up to represent plaintiffs in Y2K litigation. See, e.g., Simon, *Threat of Computer Glitch in 2000 Has Lawyers Seeing Dollar Signs*, WALL ST. J., Nov. 6, 1997, at B12.

7. On October 8, 1997, two divisions of the SEC (the Divisions of Corporation Finance and Investment Management) issued a Staff Legal Bulletin reminding public companies to consider disclosure obligations relating to anticipated costs, problems and uncertainties associated with the Y2K issue. The bulletin, which was revised January 12, 1998, is not a statement of formal Commission position, but represents the views of the staffs of the two divisions as advice to the public. The document, Staff Legal Bulletin No. 5, is available online at the SEC's Year 2000 page (www.sec.gov/news/home2000.htm).

8. An SEC Report to Congress began by stating the following "essential principle" concerning Y2K issues:

It is not, and will not, be possible for any single entity or collective enterprise to represent that it has achieved complete Year 2000 compliance and thus to guarantee its remediation efforts. The problem is simply too complex for such a claim to have legitimacy. Efforts to solve Year 2000 problems are best described as 'risk mitigation.' Success in the effort will have been achieved if the number and seriousness of any technical failures is minimized, and they are quickly identified and repaired if they do occur.

Securities and Exchange Commission Report to the Congress on the Readiness of the United States Securities Industry and Public Companies to Meet the Information Processing Challenges of the Year 2000, June 1997, at 2 (available online).

9. These reports can be found online in the SEC's Edgar data base at www.sec.gov/edgarhp.htm.

10. New Horizons Worldwide, Inc., a franchisor of computer training centers, reported the following in its 10K405 for the year ended December 31, 1997:

The total cost to the Company of these Year 2000 Compliance activities has not been and is not anticipated to be material to its financial position or results of operations in any given year.

Papa John's International, Inc., the pizza restaurant franchisor, reported the following in its 10K for the year ended December 31, 1997:

The Company has completed an assessment and will have to modify or replace portions of its software so that its systems will function properly with respect to dates in the year 2000 and thereafter. Management believes the total Year 2000 project cost is immaterial to financial position, net income and liquidity. Much of the cost related to Year 2000 coincides with existing management plans to replace certain systems (principally the general ledger and related subsidiary systems) in order to accommodate the Company's planned growth.

Red Roof Inns reported as follows in its 10K for the year ended December 31, 1997:

The total cost to the Company of the Year 2000 compliance activities has not been and is not anticipated to be material to its financial position or results of operations in any given year.

ServiceMaster Co. reported as follows in its 10K for the year ended December 31, 1997:

ServiceMaster has conducted a review of its computer systems to identify systems that could be affected by the year 2000 problem and has determined that the Company will need to replace

or remediate many of its systems to facilitate their continuing reliable operation. The Company currently believes that expenses directly related to this effort will not have a material impact on the results of its operations.

11. See, e.g., *Companies Estimate "Year 2000" Computer Costs*, WALL ST. J., Apr. 9, 1998.

12. Wendy's International, Inc. reported as follows in its 10K for the year ended December 31, 1997:

The Company has initiated a plan to install a new enterprise-wide information system and a new store management system, which will include new software that is year 2000 compliant. The Company has made an assessment that some existing software will need to be modified since it will not be replaced by the new information systems. The modification is expected to cost \$3 million to \$4 million, of which \$1 million has been expensed in 1997, and the remainder will be expensed over the next two years. The new information systems are estimated to cost approximately \$70 million to \$80 million, a substantial portion of which will be capitalized.

13. Tricon Global Restaurants, Inc. reported as follows in its 10K for the year ended December 31, 1997:

Testing and conversion of systems and applications is expected to cost \$40-\$45 million from 1997 through 1999. Of these costs, approximately \$4 million had been incurred by year-end 1997 and approximately \$35 million is expected to be incurred in 1998. All costs are expected to be funded by cash flows from operations.

14. Candant Corporation, whose brands include Days Inn, Ramada, Howard Johnson, Super 8, Travelodge, Century 21, Coldwell Banker, Electronic Realty Associates (ERA), and others, reported as follows in its 10K for the year ended December 31, 1997:

The total future cost of compliance associated with identified actions is anticipated to be approximately \$30 million. The effect on the Company's future results of operations are not anticipated to be material in any given year.

15. Wendy's International, Inc. reported as follows in its 10K for the year ended December 31, 1997:

The Company anticipates timely completion of these projects which should mitigate the year 2000 issue. However, if the new information systems are not implemented on a timely basis and if modifications to existing systems can not be accomplished on a timely basis, there would be adverse financial and operational effects on the Company. The amount of these effects can not be ascertained at this time.

16. Cardinal Health, Inc. reported as follows in its 10Q for the quarter ended March 31, 1998:

The anticipated impact and costs of the project, as well as the date on which the Company expects to complete the project, are based on management's best estimates using information currently available and numerous assumptions about future events. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those plans. Based on its current estimates, the Company does not anticipate that the costs associated with this project will have a material adverse effect on the Company's consolidated financial statements in future periods. The Company has initiated formal communications with its significant suppliers and customers to determine the extent to which the Company may be vulnerable in the event that those parties fail to properly remediate their own year 2000 issues. While the Company is not presently aware of any such significant exposure, there can be no guarantee that the systems of third parties on which the Company relies will be timely converted, or that a failure to properly convert by another company would not have a material adverse effect on the Company.

17. ServiceMaster reported as follows in its 10K for the year ended December 31, 1997:

Although the Company believes that critical remediation efforts will be completed prior to the year 2000, the untimely completion of these efforts could, in certain circumstances, have a material adverse effect on the operations of the Company.

In addition, the Company is in the process of determining whether the external parties and systems with which the Company interacts and external systems for which the Company has certain maintenance responsibilities are in compliance and whether non-compliance of these systems could have a material adverse impact on the Company.

18. New Horizons Worldwide, Inc., reported as follows in its 10K for the year ended December 31, 1997:

The Company has identified all significant applications that will require modification to ensure Year 2000 Compliance. Internal and external resources are being used to make the required modifications and test Year 2000 Compliance. The modification process of all significant applications is substantially complete. The Company plans on completing the testing process of all significant applications by December 31, 1999.

In addition, the Company has communicated with others with whom it does significant business to determine their Year 2000 Compliance readiness and the extent to which the Company is vulnerable to any third party Year 2000 issues. However, there can be no guarantee that the systems of other companies on which the Company's systems rely will be timely converted, or that a failure to convert by another company, or a conversion that is incompatible with the Company's systems, would not have a material adverse effect on the Company.

The total cost to the Company of these Year 2000 Compliance activities has not been and is not anticipated to be material to its financial position or results of operations in any given year. These costs and the date on which the Company plans to complete the Year 2000 modification and testing processes are based on management's best estimates, which were derived utilizing numerous assumptions of future events, including the continued availability of certain resources, third party modification plans and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ from those plans.

19. CDI Corp. reported as follows in its 10K405 for the year ended December 31, 1997:

The Company recognizes the need to ensure that its operations will not be adversely impacted by Year 2000 software failures. Software failures due to processing errors potentially arising from calculations using the Year 2000 date are a known risk. The Company is in the process of conducting a comprehensive review of its computer systems to identify the systems that could be affected by the Year 2000 issue. The Company presently believes that, with modifications to existing software and converting to new software, the Year 2000 problem will not pose significant operational problems for the Company's computer systems as so modified and converted. However, if such modifications and conversions are not completed on a timely basis, the Year 2000 problem may have a material adverse impact on the operations of the Company."

20. Norrell Corp. reported as follows in its 10K405 for the year ended October 31, 1997:

If this issue is not addressed appropriately and in a timely manner, any of the Company's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000, resulting in a major system failure or miscalculations. The Company presently believes that, with planned modifications to existing software and conversions to new software, the Year 2000 issue will not pose significant

operational problems for the Company's computer systems as so modified and converted. However, if such modifications and conversions are not completed in a timely manner, the resulting Year 2000 problems could have a material adverse impact on the operations of the Company.

21. Papa John's International, Inc. reported as follows in its 10K for the year ended December 31, 1997:

The Company believes that with modifications to existing software and/or conversions to new software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed timely, the Year 2000 issue could have a material impact on certain administrative processes of the Company.

22. The Virginia State Corporation Commission's Division of Securities and Retail Franchising did send a notice to franchisors on May 4, 1998, expressing concern about the potential impact that the Y2K problem holds for franchisors and franchisees and urged management to act promptly to deal with the issue. The notice did not deal with disclosure.

23. Section 436.1(a)(21) of the FTC Rule provides as follows:

All of the foregoing information in paragraph (a)(1) through (20) of this section shall be contained in a single disclosure statement or prospectus, which shall not contain any materials or information other than that required by this part or by State law not preempted by this part. This does not preclude franchisors or franchise brokers from giving other nondeceptive information orally, visually, or in separate literature so long as such information is not contradictory to the information in the disclosure statement required by paragraph (a) of this section. Bus. Franchise Guide (CCH) ¶ 6121.

Section ID1e of the FTC Interpretive Guides provides as follows:

Franchisors and franchise brokers may not make any representation contradictory to those appearing in the disclosure documents. Similarly, no information may appear in the disclosure document unless it is required either by the rule or by non-preempted state law. Bus. Franchise Guide (CCH) ¶ 6227.

24. See Interpretive Guides to Franchising and Business Opportunity Ventures Trade Regulation Rule, Bus. Franchise Guide (CCH) ¶ 6229.

25. If applicable, the drafter must include certain mandatory risk factor disclosures concerning choice of forum for litigation (or arbitration), governing law, and "other risk factors required by a state regulator." By giving the states the ability to require further risk disclosures, the New UFOC appears to anticipate disclosure of risks specific to a particular franchised system that can be determined only after a review of the franchisor's agreements, financial statements and other offering materials. The New UFOC, however, does not address whether the franchisor should independently place additional risk factors on the cover page. The drafter should consider what other types of risks are presented. If there are risks inherent in the franchise that are likely to draw comment from state administrators, the drafter may be able to craft the disclosure in a more palatable fashion than the language a state administrator may dictate if the issue were otherwise left unaddressed. In addition, disclosing on the cover page risks that may not otherwise be disclosed in the offering circular (or that may be presented in a manner that does not highlight the risk) may be useful to notify the franchisee of matters that should be considered before purchasing and to estop the franchisee from later asserting a fraud or misrepresentation claim concerning those issues. Stephen W. Maxey, *The New Uniform Franchise Offering Circular: The Regulatory Perspective*, 14 FRANCH. L.J. 25 (Fall 1994).

26. N.Y. GEN. BUS. L. § 687(2)(b), Bus. Franchise Guide (CCH) ¶ 3320.08.

27. CAL. CORP. CODE § 31202, Bus. Franchise Guide (CCH) ¶ 3050.56.

28. Instruction 190 to the UFOC provides as follows:

Separate disclosure documents (for example, a confidential operations manual) must not make representations or impose terms that contradict or are materially different from the disclosure in the offering circular.

29. See, e.g., Michael D. Scott, *The Year 2000 Crisis: Conducting a Legal Audit*, in THE YEAR 2000 CRISIS - LEGAL ISSUES CONFERENCE (Glasser LegalWorks 1998).

30. Tricon Global Restaurants, Inc. reported as follows in its 10K for the year ended December 31, 1997:

We anticipate that in the second quarter of 1998, information will be provided to all franchisees regarding the potential business risks associated with the Year 2000 issues.