

Exemption-Based Franchising: Are You Playing in a Minefield?

KAREN B. SATTERLEE AND LESLIE D. CURRAN

Publication of the Amended Federal Trade Commission Rule (FTC Rule) in July 2008 created a potentially game-changing opportunity for franchisors to reevaluate their franchise programs. The addition of several new exemptions from the federally mandated disclosure requirements means that disclosure may not be necessary for certain franchisors selling qualifying franchises such as those found in the hotel and restaurant industries. Assuming (and this is a critical assumption) that franchisors can find an applicable state-level exemption from registration statutes, many franchisors may find that they can abandon their Franchise Disclosure Document (FDD) altogether.

Although relief from the cost and staff hours necessary to create and update FDDs may be appealing on the surface, many franchisors have not stopped to reflect upon whether a brave new world without FDDs is a good idea after all. Even if a franchisor can administer an exemption-based franchise program, should it? What are the pros and cons of exemption-based franchising? How does the relief from federal disclosure interplay with state registration and disclosure requirements that have not changed? Are franchisors opening themselves up to new causes of actions that were foreclosed by FTC and state law compliance? Should individual franchise systems continue with a traditional franchise registration and disclosure program?

This article will first explore why a franchisor would consider an exemption-based franchised program. Next, we will summarize the federal¹ and state exemptions that are available and the interplay between these federal and state exemptions. For convenience, we have included a chart that identifies some of the commonly used exemptions and the various jurisdictions that allow each exemption [see page 194]. Finally, we will address potential causes of action by franchisees, the pros and cons of an exemption-based franchising program, and the process that a franchisor should follow to utilize such a program.

WHY EXEMPTION-BASED FRANCHISING?

Developing and maintaining an FDD is an enormous undertaking. Not only are there significant legal expenditures for drafting, registering, and responding to comment letters relating to FDDs, it takes the time and effort of key business associates to develop and update the information contained in the FDD—time that they may feel would be better used managing the franchise business. Furthermore, a significant number of prospective franchisees neither need nor want the protection of

Karen B. Satterlee is Director of Franchise Licensing of Starbucks Coffee Co. in Seattle. Leslie D. Curran is a partner in the Reston, Virginia, law firm of Plave Koch PLC.



Karen B. Satterlee



Leslie D. Curran

governmental agencies purporting to impose restrictions on when and in what manner they may contract with franchisors.

Franchise regulation was imposed to protect the mom-and-pop investors who were significantly less sophisticated than companies selling franchise systems. Franchise regulation was, and still is in many registration states, an attempt to fashion the one-size-fits-all regulation of an industry. Over the years, the franchise community took note of the flaws of this approach to regulation, leading to a movement to amend the FTC Rule.

The FTC Rule varies from state registration statutes in that it simply requires franchisors to disclose the requisite FDD to a prospective franchisee. The FTC does not review FDDs and simply assumes franchisor compliance with the FTC Rule. In contrast, the purpose of state registration is to ensure that

franchisors are in fact complying with state law relating to franchising. Even so, each registration state provides franchisors with some ability to avoid the registration process, depending on the nature of the franchise program and the prior business experience of the prospective franchisee. The criteria for qualifying for an exemption vary by state but typically are designed to exempt franchise offerings that are considered low-risk, either by virtue of the operational experience of the franchisor, its financial strength, or the relative sophistication of the franchisee. In a perfect world, these exemptions would mirror one another, but they currently do not.

The primary advantage of exemption-based franchising is the cost savings, in both time and dollars. Another advantage of an exemption-based program is that it permits the franchisor to keep confidential the terms and conditions of its franchise offering and the manner in which it administers its system. No longer would a franchisor be capped at the royalty percentages set forth in its FDD. Therefore, being released from the burden of regulatory compliance could seem like a godsend for burdened franchisors.

That being said, exemption-based programs also have disadvantages. Whether a prospective franchisee should be given an FDD is usually a judgment call, and the burden of proof as to

whether a franchisee was exempt at the time of the sale falls on the franchisor.² If it makes the wrong call, even in good faith, a franchisor will find itself potentially liable to its franchisee base. There are administrative requirements, such as paying fees and filing the appropriate forms with the state regulatory authority, often on a deal-by-deal basis.³ These requirements must not be overlooked. Failure to pay the fee and file the correct forms with the state will result in the franchisor being unable to claim the exemption in an action for the sale of an unregistered franchise.⁴ Utilization of a traditional franchise program eliminates these risks entirely. Furthermore, and most significantly, even if one is able to qualify for an exemption on a federal and state level, many of those exemptions are only from registration and do not eliminate the requirement that the franchisor disclose an FDD to a prospect, thus eliminating the primary advantage of an exemption-based program. Franchisors should consider the pros and cons of exemption-based franchising prior to the launch of an exemption-based program and ensure that appropriate processes are developed to ensure compliance with the law on a federal and state level.

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FEDERAL EXEMPTIONS

Although a number of changes were made to the FTC Rule, two may be characterized as truly far-reaching: the large franchisee exemption and the large investment exemption.

Large Franchisee Exemption

The large franchisee exemption is the exemption that most franchisors are likely to use, given that it is straightforward in application and does not require the use of franchisor discretion or judgment. The rationale for this exemption is that large entities such as hotels, port authorities, grocers, and universities are capable of protecting their interests without the disclosure provided for in an FDD.⁵ To qualify for this exemption, the franchisee (an entity, its parent and affiliates, or an individual) must have been in business for at least five years and have a net worth of at least \$5 million.⁶ Business experience may be taken from parents and affiliates to meet the five-year requirement. Significantly, and perhaps questionably, the franchisee's business experience does not have to be in the area of the franchised business.⁷ However, a franchisor may want to consider whether the prospective franchisee has business experience that is easily transferable to the franchised concept as part of its due diligence process on franchise candidates.

Large Investment Exemption

The rationale for the large investment exemption mirrors its sister exemption, the large franchisee exemption, namely, sophisticated investors are capable of obtaining material information relating to the franchise investment without the assistance of government-mandated disclosures.⁸ In order

to qualify for this exemption, the franchisee's initial investment, excluding any financing received from the franchisor or its affiliates and the cost of unimproved land, must exceed \$1 million. The initial investment is limited to those costs set forth in Item 7, not the investment required over the life of the franchise agreement.⁹ In addition, this investment must come from a single investor rather than a pool of investors, the idea being that a group of small investors aggregating funds does not evidence the sophistication of the large single investor.¹⁰ In a similar vein, franchisor financing provided to the investor is excluded from the initial investments because FTC felt that it added "a measure of protection to the prospective franchisee because traditional lenders are very likely to require a due diligence investigation of the offering, whereas the franchisor or its affiliate likely would not."¹¹

In addition, the franchisor must obtain a written acknowledgment from the franchisee "verifying the grounds for the exemption."¹² The FTC Rule requires the following acknowledgment be used verbatim: "The franchise sale is for more than \$1 million—excluding the cost of unimproved land and any financing received from the franchisor or an affiliate—and thus is exempted from the FTC Franchise Rule disclosure requirements, pursuant to 16 CFR 436.8(a)(5)(i)." In the authors' view, the acknowledgment should be placed in the franchise agreement itself, rather than a side letter, although that is not required by the FTC Rule.

Fractional Franchises

Although not as likely to be useful to as many franchisors as the large franchisee and large investment exemptions, the fractional franchise may also be appropriate, depending on the franchisor's business model or the franchisee at issue.

A fractional franchise is an extension of, or add-on to, a product or service that the franchisee is already offering to the public. A fractional franchise may commonly be found in grocery stores, hotels, universities, airports, or facilities where the product or service offered is within the confines of another business. The rationale for this exemption is that the prospective franchisee should have the business acumen necessary to evaluate the costs, profits, and potential risks and benefits of the franchised business. Accordingly, the franchisee is unlikely to be misled through an incomplete or inaccurate disclosure.

A franchise is fractional if (1) the franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate have more than two years of experience in the same type of business; and (2) the parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20 percent of the franchisee's total dollar volume in sales during the first year of operation.¹³ This definition is a slight change from the original exemption, where only the experience of the franchisee, rather than the franchisee's affiliates and parents, could be considered.

The fractional franchise exemption is less attractive than the large franchisee exemption because of the degree of judgment required. For example, how does one determine whether the franchised concept is “in the same line of business” in which the franchisee is engaged? The FTC Interpretive Guides state that “[t]he required experience may be in the same business selling competitive goods, or in a business that would ordinarily be expected to sell the type of goods to be distributed under the franchise.”¹⁴ Does a hotel adding a coffee shop to the lobby or a department store adding a beauty salon meet those criteria? Reasonable minds can differ. Given that the candidate that is likely to qualify for this exemption is also likely to qualify for the large franchisee exemption, the utility of this exemption seems less important than it once was.

Further, there is some question as to whether the gross sales limitation relates only to the company/franchisee or extends to a site level. Although a fractional franchise is usually located within another business, the FTC Rule does not explicitly preclude the establishment of stand-alone units. An FTC informal staff opinion suggested that a fractional franchise located outside of the franchisee’s primary place of business was not, in itself, disqualified:

It is the nature of the franchisees’ business experience, not the location of its business per se, which may bring the business relationship within the fractional franchise exemption. Nonetheless, location is one factor we will consider in determining the similarities and differences between the established business and the new franchised business.¹⁵

Note that this opinion does not state that stand-alone units can qualify for use of the exemption, only that they are not inherently outside its scope. Given that a licensee that is qualified for a fractional exemption may also qualify for the large franchisee exemption, the franchisor should evaluate which exemption makes better sense for its circumstances.

Insider Exemptions

The third new exemption applies to franchisor owner/employees. This exemption is applicable if

[o]ne or more purchasers of at least a 50% ownership interest in the franchise: within 60 days of the sale, has been, for at least two years, an officer, director, general partner, individual with management responsibility for the offer and sale of the franchisor’s franchises or the administrator of the franchised network; or within 60 days of the sale, has been, for at least two years, an owner of at least a 25% interest in the franchisor.¹⁶

The underlying rationale for this exemption is that a prospective franchisee in this situation is more than likely already familiar with every aspect of the business system and the associated risks when he has been an owner, officer, or employee of the franchisor, mooted the point of disclosure and subjecting franchisors to the needless burden and expense of creating a disclosure document for isolated sales to company insiders. “To ensure that individuals qualifying for the exemption have recent

and sufficient experience with the business,” this exemption “is limited to individuals who have been associated with the company within 60 days of the sale and who have been involved for at least two years with the company.”¹⁷ This exemption is unlikely to be widely used as the basis of an exemption-based franchising program.

Miscellaneous Exemptions

Completing the list of federal exemptions are franchises that require minimal payments, oral franchises, leased departments, and transactions covered by the Petroleum Marketing Practices Act (PMPA).¹⁸ Although unlikely to be useful in a typical exemption-based program, it is possible that the nature of specific franchises may fit within the confines of these limited exemptions.

If a franchisor does not require a franchisee to make payments in excess of \$500 to itself or its affiliates within the first six months of commencing operation of the franchised business, the offering is exempt under the FTC Rule.¹⁹ The transactions are technically franchises but carry only a slight risk of financial loss. This exemption is useful for franchisors that are willing to defer payment of franchise fees for a six-month time period in exchange for not having to bear the expense of creating an FDD. In our experience, it is uncommon for a franchisor to be willing to do so.

Because the first two prongs of the definition of a franchise (association with a trademark and significant control or assistance) are universally present in a franchise concept, the minimum payment requirement is the only prong that a willing franchisor has available to it. Keep in mind that a minimum payment includes more than a license fee or royalty. Rent under a lease, equipment purchases, or training fees also count toward the minimum payment requirement. Although payments for goods purchased at bona fide wholesale prices would not count toward the minimum payment threshold, what does count is the money that the franchisor is likely to make with the purchase of the equipment that goes with the goods, such as a vending machine. These transactions may also be subject to business opportunity laws.²⁰

The FTC Rule continues to exclude arrangements where there “is no written document that describes any material term or aspect of the relationship or arrangement,” i.e., oral franchises.²¹ The reason for this exemption is that it would be virtually impossible to prove the terms of, or very existence of, such an agreement. For obvious reasons, any franchisor that has a protectable mark will not find this alternative appropriate for a franchise system.

The leased department exemption pertains to independent retailers that lease space from a big box business to sell their own goods and services inside a retailer’s larger box store. Examples of these arrangements include photography stores, optometry stores, beauty salons, and jewelry stores. These arrangements generally meet the definition of a franchise with the payment of fees and the imposition of quality controls. The leased department exemption is similar to the fractional franchise but without the 20 percent cap on gross sales. This exemption is lost if the retailer requires the lessee to buy goods and services from the retailer or its suppliers.²²

Finally, the FTC Rule explicitly excludes transactions covered by the PMPA.²³ Congress passed the PMPA, which applies to gasoline station franchises, to address issues relating to gasoline franchises and covers presale disclosure and franchise relationship issues. The FTC concluded that the Franchise Rule was largely duplicative of the PMPA and related federal regulations.²⁴

INTERPLAY BETWEEN FEDERAL AND STATE EXEMPTIONS

Even if the franchise sales transaction satisfies the criteria for an exemption under the FTC Rule, the analysis is not complete without a review of the relevant state statutes. The franchisor also must review any applicable state franchise law to determine if an exemption is available.²⁵ The FTC Rule permits states to regulate the franchise sales process, and a number of states have enacted franchise registration and disclosure laws. Just like the FTC Rule, these registration and disclosure laws are designed to protect prospective franchisees.

Under certain circumstances, the franchisor is exempt from complying with the state statutory requirements. State franchise registration and disclosure statutes were enacted to level the playing field between the Goliath franchisor and the small franchisee. The exemptions, which are created by statute, rule,

or order by state franchise administrators, recognize that the playing field is already level under some circumstances.

Although there is some overlap between the exemptions in the FTC Rule and some states, the exemptions vary significantly from jurisdiction to jurisdiction. If challenged, the franchisor bears the burden of proving that the sale was exempt. Accordingly, before proceeding with a nationwide franchising program based upon the exemptions, the franchisor must carefully review state registration and disclosure laws and determine that those laws include applicable exemptions from registration, disclosure, or both.

The state franchise registration process can be expensive and time-consuming and requires public disclosure of information relating to the franchisor, the franchise system, and franchise agreements. In the franchise registration states,²⁶ the franchisor cannot proceed with franchise sales unless and until the franchisor has filed the disclosure document, and, in some states, the state has reviewed and approved the disclosure document. If an exemption is available, the franchisor may avoid the need to prepare and file a disclosure document or avoid waiting for state approval prior to offering franchises.

Franchisors that sell franchises based upon exemptions should consider carefully whether the exemption criteria are met and, based upon potential changes in the laws or interpretations

EXEMPTIONS FROM REGISTRATION/DISCLOSURE

Jurisdiction	Large Franchisee (Net Worth & Experience)	Large/Substantial Investment (\$750,000 to \$1,000,000)	Fractional Franchise	Nominal Fee	Insiders (franchisor owner/employees)	Large Franchisor	Sales to Existing Franchisees	Renewal of Existing Agreement	Sale by Existing Franchisees	Institutional Franchisee	Sale of Single Franchise	Out of State Sales	By Order
FTC	X	X	X	X	X		X ³	X	X				
California	X ¹		X	X	X	X	X ²	X	X			X	X
Hawaii							X	X	X	X		X	X
Illinois		X	X	X		X		X	X	X			X
Indiana			X			X		X	X		X		X
Maryland		X		X		X	X	X	X	X		X	X
Michigan			X	X			X ²	X	X	X		X	X
Minnesota			X	X					X	X	X	X	X
New York			X			X	X ²	X	X	X	X		X
North Dakota						X		X	X				X
Rhode Island	X ¹				X	X	X ²	X	X			X	X
South Dakota	X	X	X		X				X	X			
Virginia			X			X			X	X			
Washington	X ¹			X	X	X	X ²		X	X	X		
Wisconsin		X	X	X			X	X	X	X		X	X

1. The exemption in California is based solely on minimum experience. The exemption in Rhode Island and Washington is based solely on a minimum net worth.

2. There is a minimum experience requirement and, in California and New York a notice filing required.

3. This exemption is available if the new franchise agreement is signed pursuant to a development agreement.

of the laws, should frequently revisit whether the criteria continue to be satisfied. Because certain states require filing forms or applications for certain exemptions, franchisors should develop a system to comply with these requirements and track the required filings.

OVERVIEW OF STATE EXEMPTIONS

Now, we explore some of the more commonly used exemptions available under the state franchise disclosure and registration statutes.²⁷ Many of these state exemptions are similar to the exemptions under the FTC Rule.

Experienced/High Net Worth Franchisor

This exemption is based upon the characteristics of the franchisor, not the franchisee. The rationale for this exemption is that the franchise registration process does not provide a significant benefit to franchisees where the franchisor is a large, sophisticated, seasoned franchisor. Over the years, states recognized that franchisors of this caliber were not involved with the egregious franchise sales abuses. And, in the event that a franchisee sought relief for an alleged sales process violation, these franchisors were able to be financially accountable.

Despite using slightly different names for their statutes, the states that have recognized this exemption are California, Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, Washington, and Virginia.²⁸ Generally speaking, if a franchisor satisfies the criteria for this exemption, the state statutes require the franchisor to file certain forms and pay the required fee annually. Although the state franchise administrators review the FDD and financial statements to verify that the franchisor satisfies the exemption criteria, the examiners do not review and comment on the contents of the FDD. Because the review and comment period for a registration filing may take months to complete and require multiple rounds of changes to the FDD and its exhibits, applying for the exemption from registration is likely to save the franchisor a significant amount of time and money. Franchisors that qualify for this exemption must still provide presale disclosures to prospective franchisees; however, in some states, the disclosures are not the same as the disclosures for registered franchises.²⁹

To qualify for this exemption, the franchisor (or the franchisor's parent)³⁰ must meet certain minimum net worth and experience requirements, which vary among the states: \$5 million (California, Illinois, Indiana, New York,³¹ Washington), \$10 million (Maryland, North Dakota, Rhode Island), or \$15 million (Virginia). Examiners review the financial statements, which must reflect the minimum net worth in the disclosure document. A franchisor can rely on its parent's financial statements provided that the franchisor has a minimum net worth of \$1 million.³² If the franchisor relies upon its parent's audited financials in Maryland, Rhode Island, and Virginia,³³ the parent must unconditionally guarantee the franchisor's obligations to franchisees.

With the exception of New York, all states include an experience prong for this exemption. Specifically, franchisors must have a minimum number of years of franchising or operational

experience. If a franchisor relies on its parent's experience, changes in the parent's ownership or organization may result in loss of the exemption. The experience requirement varies widely from state to state.

Extraordinary Franchisees

A number of states have exemptions that are based upon the net worth or business experience of the franchisee. Again, these exemptions vary by state and include, among others, exemptions for sales to existing franchisees, sales to high net worth investors, sales of franchises that require substantial investment, sales to "franchisor insiders," and sales to experienced franchisees. Franchisees that fit into these categories are perceived as having a stronger relative bargaining power than a typical franchisee and, accordingly, do not need the protections of the franchise statutes. In these instances, the states view the playing field as relatively even between the franchisor and the franchisee.

Existing Franchisee

If a franchisee has prior experience with the franchisor and the franchised business, the states perceive that the franchisee understands the risks associated with purchasing an additional franchise. California, Hawaii, Maryland, Michigan, New York, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin³⁴ provide an exemption for the franchisor to sell an additional franchise to an existing franchisee. Although this exemption varies among jurisdictions, some common themes include the following: (1) the sale must be to the same franchisee (or, in some states, an owner of the existing franchised business), (2) the franchisee must have a minimum amount of experience in the financial and operational aspects of the franchised business, and (3) the new franchised business must be similar to the one currently operated by the franchisee. With regard to the third prong, the franchisor may consider using a franchise agreement that is the same as, or substantially similar to, the original franchise agreement signed by the franchisee. Certain states (California and New York) require notice to be filed with the state. The states are a mixed bag in terms of the effect of satisfying the exemption criteria. For example, California and Maryland exempt the franchisor from registration while Michigan and Hawaii exempt the franchisor from registration and disclosure.

High Net Worth Franchisees

A handful of states have an exemption recognizing that franchisees that have amassed a certain amount of wealth are assumed to know how to evaluate the risks of purchasing a franchise. Rhode Island and Washington³⁵ provide an exemption for franchisees that have a high net worth. In Rhode Island, the franchisee's income in the previous two years must have exceeded \$200,000. Similarly, in Washington, for an individual, the franchisee must have a net worth over \$1 million (individually or jointly with spouse); or, for the preceding two years, the franchisee must have had an income over \$200,000 (or a joint spousal income over \$300,000) and have a reasonable expectation of reaching the same income level

in the current year. For an entity, the entity must have at least \$5 million of assets and cannot have been formed for the purpose of acquiring the franchise. Finally, in South Dakota, the exemption is available if the franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years and has a net worth of at least \$5 million. If the exemption criteria are met, the franchisor is not required to comply with disclosure or registration requirements.

Substantial Investment

Illinois, Maryland, South Dakota, and Wisconsin³⁶ provide an exemption for franchises that require the prospective franchisee to make a substantial initial investment. The meaning of substantial initial investment varies by state: Illinois and South Dakota, \$1 million; Maryland, \$750,000; Wisconsin, at least \$1 million and does not exceed 20 percent of the franchisee's net personal worth. In South Dakota, the investment cannot include any financing received from the franchisor or an affiliate or the cost of unimproved land. In addition, the states impose other requirements for this exemption.

In South Dakota, the franchisee is required to sign an acknowledgment verifying the grounds for the exemption. For Illinois, the franchisor must apply for exemption by order for a sale of a single-unit franchise. The filing requirements include, among other things, a cover letter requesting the exemption, a copy of the FOD, a certification page, and a list of all Illinois franchise sales since the last exemption application. To take advantage of this exemption in Maryland, the franchisor must annually file a notice of exemption, a consent to service of process, an undertaking agreeing to supply any additional information requested by the franchise examiner, and a copy of the FOD and must pay the required filing fee. In Wisconsin, the statute requires that the franchisor reasonably believe that the prospective franchisee has sufficient knowledge and experience in the type of business operated under the franchise such that the prospective franchisee is capable of evaluating the merits and risks of the prospective franchise investment.

All states except South Dakota require the franchisor to provide disclosure even if the criteria for this exemption are satisfied.³⁷ The reasoning behind the large investment exception is simply that those franchisees that can afford a large enough initial investment are more likely to be experienced in business and understand the risks or have the financial wherewithal to protect themselves.

Franchisor Insider

This exemption assumes that people who have been exposed to the inner workings of the franchisor have enough first-hand knowledge of the franchise system to make informed decisions about purchasing the franchise. California, Rhode Island, South Dakota, and Washington³⁸ provide an exemption for individuals (i.e., the franchisor's officers and directors) who are already familiar with the franchisor and the franchise being offered. These individuals are referred to as "franchisor insiders" and are assumed to have sufficient knowledge regarding the franchise to make informed decisions in the sales process. The states vary considerably on who is considered

a franchisor insider. Only California includes filing requirements for this exemption. Franchisors in California must provide disclosure, but those in Rhode Island and South Dakota are not required to do so.

Experienced Franchisees

Several states consider the franchisee's experience in determining the availability of various exemptions; however, only California includes an exemption that is based solely upon this factor. This exemption is available if the franchisee's owners have had at least two years of experience—within the seven years of the sale—managing the financial and operational aspects of a business that is similar to the franchised business.³⁹ The franchisor cannot control the franchisee owners, and the franchisor must timely submit the required notice of exemption and pay the filing fee. If the criteria are satisfied, the franchisor is not required to comply with the registration or disclosure requirements.

Fractional Franchisees

Similar to the FTC Rule, a number of states—California, Illinois, Indiana, Michigan, Minnesota, New York, Oregon, South Dakota, Virginia, and Wisconsin⁴⁰—provide an exemption for franchises that are ancillary to a franchisee's existing business. Typically, the franchisee is adding another line of business or another product offering to its already established or existing business. The rationales for this exemption are simple: the prospective franchisee has an established and varied source of revenue that minimizes the financial risks associated with purchasing the franchise and the franchisee has operational experience and understands the business risks associated with operating the franchised business.

To qualify for this exemption, the franchisee generally must have prior operational experience (usually two years) in a similar business, and the sales generated by the franchised business cannot exceed 20 percent of the franchisee's total sales. Virginia is the only state that does not require prior operational experience. With regard to the 20 percent requirement, Michigan, Minnesota, and Wisconsin⁴¹ apply this limitation to the first year that the franchise is in operation; however, California, New York, Oregon, and South Dakota do not include a time limit.⁴² Theoretically, therefore, if the sales of the franchised business in the latter states exceed the 20 percent mark in any year after the business opens, the exemption would be lost. If a transaction satisfies the exemption criteria, the sale is exempt from registration and, in some states, from disclosure.

Institutional Franchisee

Hawaii, Illinois, Maryland, Michigan, Minnesota, New York, South Dakota, Virginia, Washington, and Wisconsin⁴³ include exemptions or exclusions for various kinds of institutions (such as banks, trust companies, and insurance companies). These exemptions or exclusions recognize that these institutions are exempted or excluded from the franchise laws based upon public policy dictates and other legislation that addresses the institutions or that the statutory protections are unnecessary. The purchaser must be acting for itself and not for the purpose of reselling the franchise.

There are filing requirements that vary among the jurisdictions. In Maryland, South Dakota, and Virginia, the franchisor must provide disclosure; however, in the other states, the franchisor need not provide disclosure to the prospective franchisee.

EXEMPTIONS BASED ON SPECIAL CIRCUMSTANCES⁴⁴

Sale by an Existing Franchisee to a Third-Party Purchaser

The FTC Rule and the state franchise statutes for California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin include an exemption that permits franchisees to sell an existing franchised business to a third-party purchaser.⁴⁵ This exemption recognizes a simple business reality: business owners need to be able to sell their businesses.

From jurisdiction to jurisdiction, this exemption includes some common restrictions. For the exemption to be available, the sale cannot be “effected by or through” the franchisor. In most states,⁴⁶ merely approving or disapproving a transfer does not constitute sufficient control for the transfer to be considered effected by or through the franchisor. However, the more involved the franchisor becomes in the transfer process, the more likely that the line will be crossed. Any of the following activities might push the franchisor over the threshold: matching buyers and sellers, advising the parties on the financial terms, facilitating or identifying financing,⁴⁷ or requiring the purchaser to sign a new franchise agreement.⁴⁸

Most statutes also include the following limitations: the exemption is only available if the transaction is an isolated sale by an existing franchisee rather than a plan of distribution of franchises,⁴⁹ and the exemption is not available if the existing franchisee is an affiliate of the franchisor.⁵⁰ Finally, all of the states exempt the franchisor from registration; however, Minnesota, New York,⁵¹ North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin require the franchisor to provide disclosure to the third-party purchaser.

Renewal

California, Hawaii, Illinois, Indiana, Maryland, Michigan, New York, North Dakota, Rhode Island, and Wisconsin⁵² include exemptions for the renewal of an existing franchise agreement. Of course, there are some common limitations on this exemption. Among other things, the operation of the franchised business must not be interrupted, and the franchise relationship must not have been affected by any material modifications. Although the states exempt the franchisor from registration, this exemption does not exempt the franchisor from providing disclosure in North Dakota, Rhode Island, and Wisconsin.

State statutes in Minnesota,⁵³ South Dakota, Virginia, and Washington do not include this exemption—despite the fact that renewals are a common occurrence in franchise relationships. Before renewing franchise agreements, franchisors in these states must first prepare, file, and obtain approval of the FOD.

Single Franchise

A handful of states recognize that the franchise registration process can be costly for franchisors with a single franchise, and that, if the states impose a burden that is too heavy, franchisors may not do business in the state. Indiana, Minnesota, New York, and Washington⁵⁴ have an exemption for the sale of a single franchise, which allows franchisors to avoid the registration requirements. The key for this exemption is that the franchisor must limit the number of franchises offered for sale in that state; however, the statutes impose significantly different qualifying criteria.

Perhaps the simplest single franchise exemption is Indiana, which merely requires that the franchisor limit franchise sales to one sale in a twenty-four-month period. There are no filing requirements.

Minnesota includes a similar limit on the number of franchises that can be sold, i.e., one sale in any twelve-month period; however, the franchisor must comply with additional criteria. Specifically, the franchisor cannot direct franchise sales advertising to the general public, the initial franchisee fees must be deposited in an escrow account until the franchised unit opens, and a notice must be submitted to the state ten days prior to the franchise sale.

New York also includes a number of criteria. The offer must be directed to no more than two people, and the franchisor must either be domiciled in New York or have filed a consent to service of process with New York. New York caps the total isolated sales exemptions for a franchisor at two franchise sales.

In comparison, the exemption for Washington is much more restrictive. The exemption is only available if the franchisor delivers an FOD to the prospective franchisee, the franchisor has no franchises granted for units located outside of Washington, the franchisor grants no more than three franchises, the franchisor does not conduct public advertising for franchise sales, and the franchisee is represented by an attorney.

Out-of-State Sales

State franchise laws were originally enacted to protect franchisees—in particular, those franchisees that had some connection with the state. Accordingly, most state franchise laws apply when the offer or sale of the franchise is made in the state, when the franchised business will be located in the state, or when the franchisee is domiciled or resides in the state. Several states, including California, Hawaii, Maryland, Michigan, Minnesota, Rhode Island, and Wisconsin,⁵⁵ have out-of-state sales exemptions. This exemption allows a franchisor that is

State statutes may contain applicable antifraud provisions even if an exemption is available.

domiciled in a registration state to sell a franchise to a nonresident without having to comply with registration and disclosure requirements imposed by the franchisor's home state. Hawaii, Maryland, Michigan, Minnesota, Rhode Island, and Wisconsin also require that the residence of the franchisee and the location for the franchised business must both be outside the applicable state.⁵⁶ Michigan, Minnesota, and Wisconsin exempt the franchisor from registration but not disclosure; and California, Hawaii, Maryland, and Rhode Island exempt the franchisor from both registration and disclosure.

Nominal Franchise Fee

Because the franchise laws were designed to protect the prospective franchisee that invested a substantial portion of its life savings in a bogus business, this exemption is very logical. If the amount of money put at risk by the franchisee is minimal, there is less need to level the playing field. Illinois, Maryland, Michigan, and Wisconsin⁵⁷ include exemptions based upon the payment of only nominal franchise fees. In order to qualify, the franchise fees⁵⁸ paid to the franchisor cannot exceed a very low threshold that ranges from \$100 to \$1,000. For California, Maryland, Minnesota, and Wisconsin, the amounts are revised on an annual basis; and if, in any one year, the fees paid to the franchisor exceed the threshold, the exemption no longer applies.

California and Michigan exempt the franchisor only from disclosure. Maryland, Washington, and Wisconsin exempt the franchisor from registration but not disclosure. Illinois exempts the franchisor from both disclosure and registration.

Sales by Judicial Officers

Hawaii, Michigan, Minnesota, Oregon, Rhode Island, South Dakota, and Washington⁵⁹ exempt sales by individuals acting in a judicial or legal capacity. Statutes vary significantly as to which individuals are covered. For example, statutes may include executors, administrators, sheriffs, marshals, receivers, trustees in bankruptcy, guardians, or conservators. The rationale for this exemption is that these individuals are not engaged in the business of selling franchises and should be permitted to carry out their legal or court-appointed duties without regulatory oversight. In connection with an exemption-based franchise program, this exemption is likely to be of limited value.

Exemption by Order

This is the most flexible of all exemptions; however, it is rarely used by franchisors. California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, and Wisconsin⁶⁰ allow an exemption from registration, disclosure, or both by administrative order. The statutes recognize that if the franchise sale is not the type of transaction that the statutes were intended to cover, the public interest would be served by granting an exemption. In requesting such an exemption, franchisors should include information demonstrating that the prospective franchisee does not need the protections of the statute, including the franchisee's size, wealth, knowledge, experience, or coverage by another statutory scheme.

OTHER LEGAL CONSIDERATIONS

Even if the transaction qualifies for an exemption from registration and disclosure under federal and state law, franchisors should be aware of and comply with other legal requirements during the franchise sales process. Statements that are potentially false or misleading can result in a number of claims by franchisees. The following is a brief overview (but not an exhaustive list) of some possible claims by franchisees of which franchisors should be aware.

False or misleading information may provide the franchisee a basis for a claim for common law fraud or a claim for violation of the antifraud provisions of state franchise laws. Generally, to establish a claim for fraud, the franchisee would need to prove that the franchisor knowingly made a false representation that the franchisor knew the franchisee would rely upon and that the franchisee actually relied upon the statement.⁶¹

Along the same line, a franchisee could also assert a claim for negligent misrepresentation, which has elements similar to common law fraud. To prevail on that claim, the franchisee would need to prove that the franchisor made an untrue representation as to a past or existing material fact, the franchisor made the representation without any reasonable basis for believing its truth, and the franchisor made the statement with the intent to induce reliance by the franchisee. In addition, the franchisee must have been unaware that the statement was false and must have acted in reliance on the statement's truth and have been justified in relying upon on the statement. Finally, the franchisee must have sustained damages as a result of its reliance.⁶²

Several state franchise statutes contain antifraud and other provisions that apply even if an exemption is available. If false or misleading information is provided to a prospective franchisee that is protected by a state franchise law, these types of provisions may afford the franchisee a cause of action against the franchisor. For example, the Illinois Franchise Disclosure Act of 1987 makes it unlawful for any person, in connection with the offer or sale of any franchise made in the state,

directly or indirectly to: (a) employ any device, scheme, or artifice to defraud; (b) make any untrue statement of 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 are made, not misleading; or (c) engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.⁶³

Accordingly, even if the transaction is exempt from registration and disclosure obligations, franchisors should be aware of the statements being made and be cautious that no misleading or false statements are made to prospective franchisees.

REMEDIES FOR STATUTE VIOLATION

A franchisor's failure to disclose to a prospective franchisee in the absence of an exemption under the FTC Rule and state law exposes the franchisor and its owners, employees, and franchise brokers to significant civil liability. Although there is no private right of action under the FTC Rule, the FTC is empowered to

grant injunctive relief, freeze assets, assess civil fines of up to \$11,000 per violation, and require rescission or reformation of the franchise agreement.⁶⁴

There are similar penalties for violating state franchise registration and disclosure statutes, all of which provide for a private right of action. Fourteen registration states also provide for criminal liability.⁶⁵ Terms of imprisonment range from one year (New York and California) to ten years (Washington State) and may include fines ranging from \$1,000 (New York) to \$100,000 (California).⁶⁶

Liability under the FTC Rule and state statutes is joint and several⁶⁷ with the applicable statute of limitations ranging from three to seven years.⁶⁸ Simply failing to register or to have the requisite exemption is enough to violate state statutes; neither bad faith nor a bad motive is necessary for liability under state statutes.⁶⁹

When faced with a disclosure or registration violation, it is a best practice to offer rescission of the franchise agreement to the affected franchisee. First, rescission is available as a remedy in all registration states.⁷⁰ The franchisor should examine the state statutes at issue to see if the statute requires that the offer of rescission be in a certain format. Offering rescission will typically bar the later recovery of damages by the franchisee on this theory.⁷¹ For example, in certain states a franchisee may not maintain suit against its franchisor if the franchisor offered, in writing, to refund the consideration paid together with interest, less the amount of income earned by the franchisee from the franchise.⁷²

PROCESS OF QUALIFYING EXEMPT FRANCHISEES

If a franchisor determines that prospective franchisees are likely to meet the criteria for one or more exemptions on a regular basis, it must develop a process for qualifying them. Given the complexity and nuance of federal- and state-level exemptions, it is ideal for the franchisor's legal counsel to administer the program with the assistance of a paralegal well-versed in franchise law. In-house counsel also can bring a certain discipline to adhering to process and exercising the judgment that is often required in evaluating candidates for state-level exemptions. It is inevitable that some franchise candidates will not meet the criteria. If the franchisor is unwilling to turn down prospective franchisees that do not meet the strict requirements of the federal rule and state statutes, the franchise should not engage in exemption-based franchising or, at the least, must operate a traditional franchise program as a backup to its exemption-based program.

It is a best practice to document the basis for the federal- and state-level exemptions and the exercise of any discretion that the franchisor has made in the decision to grant the license. At Starbucks, for example, each prospective candidate is evaluated

using a licensee qualification worksheet, which is used to qualify prospective franchisees for various exemptions at the state and federal level.⁷³ A second-best practice is to insert provisions in the franchise agreement that require the franchisee to acknowledge the basis for the federal and state exemption. Such provisions should contain a citation to the federal and state statutes that form the basis of the exemptions to franchise registration and disclosure. If the franchisor is working with multiunit operators, the franchisor may want to insert provisions stating that an exemption must be obtained for future franchise operations in states outside the original grant and specifying who will bear the cost of obtaining such exemptions. Franchisors may also want to take this opportunity to disclaim the making of financial performance representations and other presale statements.

Attorneys for prospective franchisees may well attempt to cut these provisions from the franchise agreement, generally on the ground that the representation calls for a conclusion of law. These critical provisions should not

be eliminated. The prospective franchisee is in a much better position to know whether it is truly exempt than is the franchisor. The franchisee has already represented that it qualifies for the exemption by providing information necessary during the qualification process. In the authors' opinion, these representations are not objectionable, and a franchisor should not grant a license to an entity that is not willing to make them. Frequently, when the underlying reasoning for requiring the representation is explained in those terms to counsel for the franchisee (who may not have been involved in the qualification process), the franchisee relents and executes the franchise agreement.

Conclusion

Under the Amended FTC Rule, the best case scenario exists for franchisors that can fit their franchise sales under one of the federal exemptions and, if there is an applicable state franchise statute, also have a corresponding state exemption. In this instance, the franchisor may be able to dispense with preparing, filing, and approving the disclosure document and with providing disclosure. The obvious benefit is reduction of direct and indirect costs and expenses. However, franchisors must carefully assess whether an exemption is available at the federal and state levels. In addition, even if an exemption is available under state law, the franchisor must be clear on what the exemption covers, i.e., registration or registration and disclosure. Finally, even assuming that exemptions are available, franchisors may decide to prepare, file, and provide disclosure documents given other considerations, such as difficulty in maintaining a program, significant variation in the laws among jurisdictions, and the necessity of making judgment calls with potentially imperfect information.

Endnotes

1. Certain relationships that could arguably meet the definition of

It is a best practice to document the basis for the federal- and state-level exemptions.

a franchise were listed as exclusions in the original FTC Rule. These relationships included the employer-employee relationship, cooperative associations, certification and testing services, and single trademark licenses. The Commission eliminated these exclusions from the new FTC Rule.

2. *See, e.g.*, WASH. REV. CODE § 19.100.220(1).

3. *See, e.g.*, CAL. CORP. CODE § 31108(f).

4. *See* Dollar Sys., Inc. v. Avacar Leasing Sys., Inc., 890 F.2d 165 (9th Cir. 1989); *Morris v. Int'l Yogurt Co.*, 729 P.2d 33 (Wash. 1986).

5. *Id.*

6. 16 C.F.R. § 436.8(a)(6) (2007).

7. 72 Fed. Reg. 15,528 (Mar. 30, 2007).

8. *Id.* at 15,523.

9. *Id.* at 15,522.

10. *Id.* at 15,526.

11. *Id.* at 15,525.

12. 16 C.F.R. § 436.8(a)(5)(i) (2007).

13. 16 C.F.R. § 436.8(a)(2).

14. 44 Fed. Reg. 49,968 (Aug. 5, 1980).

15. Informal Staff Adv. Op. 99-5 (July 2, 1999).

16. 16 C.F.R. § 436.8(a)(6).

17. Rules and Regulations, 72 Fed. Reg. § 436.8(a)(6) (Mar. 30, 2007).

18. 15 U.S.C. § 2801 (2007).

19. 16 C.F.R. § 436.8(a)(1). Note that the Commission may adjust this monetary threshold and all other monetary thresholds every four years for inflation.

20. Some states exempt franchisors from the applicability of the statute when the franchisor complies with the FTC Rule. *See, e.g.*, ALASKA STAT. § 45.66.220(2); IOWA CODE §§ 523B.1.4, 523B.3.1.b; NEB. REV. STAT. § 59-1722; OHIO REV. CODE § 1334.13; S.D. CODIFIED LAWS § 37-25A-3(b); TEX. REV. CIV. STAT. ANN. § 16.06; UTAH CODE ANN. § 13-15-2(1)(b).

21. 16 C.F.R. § 436.8(a)(7).

22. 72 Fed. Reg. 15,462 n.178 (Mar. 30, 2007).

23. 15 U.S.C. § 2801 (2007).

24. 45 Fed. Reg. 51,766 (Aug. 5, 1980).

25. *See, e.g.*, CAL. CORP. CODE § 31110.

26. The franchise registration states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

27. For additional information on exemptions, *see* Robin Day Glenn & Mary Beth Trice, *A Scenic Tour of Exemptions and Exclusions to Franchise Registration Laws*, ABA 24TH ANNUAL FORUM ON FRANCHISING (2001); Earsa R. Jackson & Karen Satterlee, *Navigating the Exemption/Exclusion Maze Under the Amended FTC Rule and State Laws*, ABA 31ST ANNUAL FORUM ON FRANCHISING (2008).

28. CAL. CORP. CODE § 31101; ILL. ADMIN. CODE tit. 14, § 200.202(e); IND. CODE § 23-2-2.5-3(a), (b); MD. CODE REGS. § 02.08.10(d); N.Y. GEN. BUS. LAW § 684(2); N.D. CENT. CODE § 51-19-04(1); R.I. GEN. LAWS § 19-28.1-6(a); 21 VA. ADMIN. CODE § 5-110-75; WASH. REV. CODE § 19.100.030(4)(b).

29. *See, e.g.*, CAL. CORP. CODE § 31101; IND. CODE § 23-2-2.5-3(c); N.Y. GEN. BUS. LAW § 684(2)(c).

30. *Parent* is generally defined as a company that owns at least 80 percent of the franchisor. *See, e.g.*, CAL. CORP. CODE § 31101.

31. New York also has a superlarge franchisor exemption that

requires the franchisor to have a minimum net worth of \$15 million. N.Y. GEN. BUS. LAW § 684(3)(a).

32. If the franchisor relies on its parent's financials for the superlarge franchisor exemption in New York, the franchisor must have a minimum net worth of \$3 million. N.Y. GEN. BUS. LAW § 684(3)(a)(i).

33. MD. CODE REGS. § 02.08.10(d); R.I. GEN. LAWS § 19-28.1-6(a)(1); 21 VA. ADMIN. CODE § 5-110-75(a)(1).

34. CAL. CORP. CODE § 31106(a)(3); HAW. REV. STAT. § 482E-4(a)(6); MD. CODE ANN., BUS. REG. § 14-214(b)(2); MICH. ADMIN. CODE r. 445.1506(1)(g); N.Y. GEN. BUS. LAW § 684(3)(d); OR. ADMIN. R. 441-325-030(3); R.I. GEN. LAWS § 19-28.1-6(f); S.D. Franchise Investment Act § 37-5B-14; 21 VA. ADMIN. CODE § 5-110.75(2); WASH. REV. CODE § 19.100.030(6); WIS. ADMIN. CODE § 32.05(1)(e).

35. R.I. GEN. LAWS § 19-28.1-6(d); S.D. Franchise Investment Act § 37-5B-13; WASH. ADMIN. CODE § 460-80-108(b)(6); WASH. REV. CODE § 19.100.030(5).

36. ILL. ADMIN. CODE § 200.201(c); MD. CODE REGS. 02.08.10(E)(1); MINN. R. 2860.8100-8300; S.D. Franchise Investment Act § 13(1); WIS. STAT. § 553.235(1)(a).

37. ILL. ADMIN. CODE § 200.201(c), (d).

38. CAL. CORP. CODE § 31106(a)(2); R.I. GEN. LAWS § 19-28.1-6(c); S.D. Franchise Investment Act § 37-5B-13(4); WASH. ADMIN. CODE § 460-44A-501(1)(d); WASH. REV. CODE § 19.100.030(5).

39. CAL. CORP. CODE § 31106(a)(1).

40. CAL. CORP. CODE § 31108; 815 ILL. COMP. STAT. 705/3; IND. CODE § 2-2.5(1); MICH. ADMIN. CODE r. 445.1506(h); MINN. STAT. § 80C.03, 301(a)(2); N.Y. GEN. BUS. LAW § 200.10(2); OR. ADMIN. R. 441-325-0030(1); S.D. Franchise Investment Act § 37-5B-12(3); VA. CODE ANN. § 13.1-559B; WIS. STAT. § 553.22.

41. MICH. COMP. LAWS § 445.1506(6)(1)(h); MINN. STAT. §§ 80C.03(f), 80C.01.18; WIS. STAT. § 553.22.

42. CAL. CORP. CODE § 31108; N.Y. COMP. CODES R. & REGS. § 200.10(2); OR. ADMIN. R. 441-325-0030(1); S.D. Franchise Investment Act of 2008 §§ 1(10), 12(3).

43. HAW. REV. STAT. § 482E-4(a)(2); ILL. ADMIN. CODE § 200.202(a); 815 ILL. COMP. STAT. 705/8; MD. CODE REGS. § 02-08-10(F)(1); MICH. COMP. LAWS § 445.1506(6)(1)(b); MINN. STAT. § 80C.03(c); N.Y. GEN. BUS. LAW § 684(3)(b); S.D. Franchise Investment Act 37-5B-14(2); VA. ADMIN. CODE § 5-110-75(4); WASH. ADMIN. CODE § 460-44A-501(1); WASH. REV. CODE § 19.100.030(3); WIS. ADMIN. CODE § 32.05(1)(c)(2).

44. This article does not cover exemptions under state laws for the following special circumstances: cooperatives, nonprofits, leased departments, securities, motor vehicle dealers, petroleum marketers, and farm machinery purveyors.

45. CAL. CORP. CODE § 31102; HAW. REV. STAT. § 482E-4(7); 815 ILL. COMP. STAT. 705/7; IND. CODE § 23-2-2.5-4; MD. CODE ANN. § 14-214(c); MICH. COMP. LAWS § 445.1506(6)(1)(f); N.Y. GEN. BUS. LAW § 684(5); N.D. CENT. CODE § 51-19-04.2; OR. ADMIN. R. 441-325-0030(4), 0040; R.I. GEN. LAWS § 19-28.1-6(c); S.D. CODIFIED LAWS § 37-5A-13; WASH. REV. CODE § 19.100.030(1); WIS. STAT. ANN. § 553.23.

46. In North Dakota, if the franchisor approves the transfer, the exemption is only available if the franchisor obtains the commissioner's approval.

47. *See, e.g.*, *Little Caesar Enters., Inc. v. OPPCO, LLC*, 219 F.3d 547 (6th Cir. 2000).

48. *See, e.g.*, *Johnson v. Mail Boxes, Etc., USA, Inc.*, 2000 WL 264026 (Wash. Ct. App. Mar. 6, 2000).

49. HAW. REV. STAT. § 482E-4(7); MICH. COMP. LAWS § 445.1506(6)(1)(e); N.Y. GEN. BUS. LAW § 684(5)(a); N.D. CENT. CODE § 51-19-04.2; OR. ADMIN. R. 441-325-0030(4)(c). Minnesota and South Dakota limit the exemption to one sale by a franchisee within twelve months. MINN. STAT. ANN. § 80C.03(a); S.D. CODIFIED LAWS § 37-5A-13.

50. IND. CODE § 23-2-2.5-4; R.I. GEN. LAWS § 19-28.1-6(b); WASH. REV. CODE § 19.100.030(1).

51. In New York, the franchisor must provide the third-party purchaser a copy of the currently registered disclosure document. If this requirement is taken literally, a franchisor that is exempt from registration or that no longer has a registered disclosure document cannot comply with this requirement and would be in violation of the New York statute. If the franchisor is exempt, New York permits franchisors to use the disclosure document that the franchisor uses in accordance with the FTC Rule or other state registration statutes. If the franchisor is no longer registered, New York permits the franchisor to use the most recent disclosure document along with updated information. N.Y. GEN. BUS. LAW § 684(5)(c).

52. CAL. CORP. CODE § 31108; HAW. REV. STAT. § 482E-4(a)(5); 815 ILL. COMP. STAT. 705/7; IND. CODE § 23-2-2.5-1(g); MD. CODE ANN., BUS. REG. § 14-203(c); MICH. COMP. LAWS § 445.1506(6)(1)(e), (2) (any disclosure documents prepared in compliance with state or federal law must be provided to the franchisee); N.D. CENT. CODE § 51-19-02(14)(a)(2); R.I. GEN. LAWS § 19-28.1-6(e); WIS. STAT. ANN. § 553.03(8r), (11).

53. Minnesota expressly includes any renewal in the definition of *offer or sale* of a franchise. MINN. R. 2860.0100.

54. IND. CODE ANN. § 23-2-2.5-3; MINN. STAT. § 80C.03(e); N.Y. GEN. BUS. LAW § 684(3)(c); WASH. REV. CODE § 19.100.030. For notice filing requirements, *see* WASH. ADMIN. CODE § 460-80-100.

55. CAL. CORP. CODE § 31105; HAW. REV. STAT. § 482E-4(a)(4); MD. CODE REGS. § 02.02.08.10(B), (H); MICH. COMP. LAWS § 445.1506(6)(1)(d); MINN. STAT. ANN. § 80C.03(h); R.I. GEN. LAWS § 19-28.1-7; WIS. ADMIN. CODE § 32.05(1)(d).

56. HAW. REV. STAT. § 482E-4(a)(4); MD. CODE REGS. § 02.08.10(B); MICH. COMP. LAWS § 445.1506(6)(1)(d); MINN. STAT. ANN. § 80C.03(h); R.I. GEN. LAWS § 19-28.1-7; WIS. ADMIN. CODE § 32/05(1)(d).

57. CAL. ADMIN. CODE § 310.011; 815 ILL. COMP. STAT. 705/3(1)(c); MD. CODE REGS. § 02.08.10(C); MICH. COMP. LAWS § 445.1506(6)(1)(c); WASH. REV. CODE § 19.100.030(4)(b)(iii); WIS. ADMIN. CODE § 32.05(1)(b).

58. The tricky consideration here is what qualifies as a franchise fee. As used in the franchise statutes, this term is very broad and can include almost any fee paid to the franchisor up to a period approximately six months after the business opens. Because this varies significantly from state to state, franchisors should carefully assess this requirement.

59. HAW. REV. STAT. § 482E-4(a)(1); MICH. COMP. LAWS § 445.1506(6)(1)(a); MINN. STAT. ANN. § 80C.03(b); 67 OR. ADMIN. R. § 441-325-030(5); R.I. GEN. LAWS § 19-28.1-6(7); S.D. CODIFIED LAWS § 37-5A-14(1); WASH. REV. CODE § 19.100.030(2).

60. CAL. CORP. CODE § 31100; HAW. REV. STAT. § 482E-4(b); 815 ILL. COMP. STAT. 705/9 (may not exempt the franchisor from disclosure

requirements, 815 ILL. COMP. STAT. 705/6); IND. CODE §§ 23-2-2.5-5, 6; MD. CODE REGS. § 02.02.08.10(G), (H); MINN. STAT. ANN. § 80C.03(g); N.Y. GEN. BUS. LAW §§ 684(1), (4); N.D. ADMIN. CODE § 51-19-04(3); *see also* N.D. ADMIN. CODE § 51-19-05; R.I. GEN. LAWS § 19-28.1-6(10); WIS. STAT. ANN. § 553.25.

61. *See* Cal. Bagel Co., 18 LLC v. Am. Bagel Co., Bus. Franchise Guide (CCH) ¶ 11,880 (C.D. Cal. 2000).

62. *See* B.L.M. v. Sabo & Deitsch, 55 Cal. App. 4th 823, 834 (1997); Christiansen v. Roddy, 186 Cal. App. 3d 780, 785-86 (1986).

63. 815 ILL. COMP. STAT. ANN. 705/6. Most other state franchise laws include similar provisions.

64. § 13(b) (15 U.S.C. § 53(b)); § 5(m)(1)(A) (15 U.S.C. § 5(m)(1)(A)); § 19(b) (15 U.S.C. § 57b).

65. CAL. CORP. CODE § 31300; HAW. REV. STAT. § 482E-9(b); 815 ILL. COMP. STAT. ANN. 705/26; IND. CODE § 24-5-8.16; MD. CODE ANN., BUS. REG. § 14-227(C); MICH. COMP. LAWS § 445.1531; MINN. STAT. ANN. § 80C.17; N.Y. GEN. BUS. LAW § 691.1; N.D. CENT. CODE § 51-19-12-1; R.I. GEN. LAWS § 19-28.1-21(a); S.D. CODIFIED LAWS § 37-5A-83; VA. CODE ANN. § 13.1-565; WASH. REV. CODE § 19.100.190(2); WIS. STAT. § 553.51.

66. CAL. CORP. CODE §§ 31410-31412; N.Y. GEN. BUS. LAW §§ 683, 687, 690; WASH. REV. CODE § 19.100.210.

67. *See, e.g.,* Kohr v. Gropp & Lehman Enters., Bus. Franchise Guide (CCH) ¶ 8124 (6th Cir. 1983); MD. CODE ANN., BUS. REG. § 14-227; MINN. STAT. ANN. § 80C.17; N.Y. GEN. BUS. LAW § 691.3; R.I. GEN. LAWS § 19-28.1-21; WIS. STAT. ANN. § 553.51; *see also* A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc., 663 N.E.2d 890 (N.Y. 1996); IND. CODE § 23-2-2.5-29; 815 ILL. COMP. STAT. 705/26; *see* Illinois v. Carter, 454 N.E.2d 189 (Ill. App. Ct. 1982) (franchisor's chairman of the board found guilty of various provisions, including the selling of an unregistered franchise).

68. The statute of limitations in Indiana, Maryland, Minnesota, and New York is three years. The limitations period in Michigan and Virginia is four years and in North Dakota, five years. CAL. CORP. CODE § 31303; HAW. REV. STAT. § 482E-10.5; 815 ILL. COMP. STAT. 705/27; R.I. GEN. LAWS § 19-28.1-22; WIS. STAT. § 553.51(4).

69. *See, e.g.,* Dollar Sys., Inc. v. Avacar Leasing Sys., Inc., 890 F.2d 165, 171 (9th Cir. 1989).

70. CAL. CORP. CODE § 31300; HAW. REV. STAT. § 482E-9(b); 815 ILL. COMP. STAT. 705/26; IND. CODE § 24-5-8.16 (arguably applicable only to business opportunities); MD. CODE ANN., BUS. REG. § 14-227(C); MICH. COMP. LAWS § 445.1531; MINN. STAT. ANN. § 80C.17; N.Y. GEN. BUS. LAWS § 691.1; N.D. CENT. CODE § 51-19-12.1; R.I. GEN. LAWS § 19-28.1-21(a); S.D. CODIFIED LAWS § 37-5A-83; VA. CODE ANN. § 13.1-565; WASH. REV. CODE § 19.100.190(2); WIS. STAT. § 553.51.

71. King Computer, Inc. v. Beeper Plus, Inc., Bus. Franchise Guide (CCH) ¶ 10182 (S.D.N.Y. 1993); Palazzetti Imp./Exp., Inc. v. Morson, 1999 WL 420403 (S.D.N.Y. 1999).

72. 815 ILL. COMP. STAT. 705/26; N.Y. GEN. BUS. LAWS § 691(2); N.D. CENT. CODE § 51-19-12 (4); WASH. REV. CODE § 19.100.190(2).

73. For an example of such a worksheet, *see* Jackson & Satterlee, *supra* note 27.