SO IT REALLY IS A FRANCHISE: BRINGING NON-COMPLIANT FRANCHISORS INTO COMPLIANCE

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October 15 - 17, 2014
Seattle, WA

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SO IT REALLY IS A FRANCHISE: BRINGING NON-COMPLIANT FRANCHISORS INTO COMPLIANCE

I. INTRODUCTION

How should you advise your client if it has sold “licenses,” “dealerships,” “distributorships,” “joint ventures” (or even “franchises”) that qualify as a franchise, without having complied with federal or state franchise laws? What advice can you offer your client which has sold a franchise in a registration state while its registration was lapsed, or provided the wrong version of an FDD to a franchisee, or included misrepresentations in its FDD? This paper addresses those difficult situations. While there are no simple solutions, this paper analyzes the risks in such a situation (including enforcement actions and private litigation), the factors to evaluate in formulating an appropriate strategy, and the options for moving forward to bring the system into compliance (including through coordination with state examiners and provision of offers of rescission to franchisees).

II. COMMON REGISTRATION AND DISCLOSURE VIOLATIONS

Under the Federal Trade Commission’s (“FTC’s”) Franchise Rule, franchisors offering franchises, other than exempt franchises, anywhere in the United States or its territories must provide to prospective franchisees a copy of a Franchise Disclosure Document (“FDD”) at least 14 days before the prospective franchisee signs a binding agreement or makes any payment in connection with the franchise sale. The FTC does not register franchise offerings, review FDDs before they are provided to prospective franchisees, or require franchisors to file anything with that agency. The FTC Franchise Rule, however, does not preempt state franchise laws that provide for protections equal to or greater than the federal requirement, including requiring registration of franchise offerings and more extensive disclosures.

1 This paper represents the collective work of the authors. However, given the nature of the topic and its treatment, as well as the desire to analyze the topic in a unified paper, any particular views expressed herein do not necessarily represent the individual views of the authors. This paper does not express the positions or opinions of the Maryland Attorney General, the North American Securities Administrators Association (“NASAA”), Dentons US LLP, or 1-800-Radiator, Inc. The authors would like to acknowledge the contributions of Selena Medlen, Vice President and Associate General Counsel at 1-800-Radiator, Inc., as well as the assistance of Dentons US LLP summer associates John Ren and Daniel Rockower.

2 16 C.F.R. § 436.2. In addition, under 16 C.F.R. § 436.9, franchisors must furnish a copy of the franchisor's disclosure document to a prospective franchisee earlier in the sales process than required under § 436.2, “upon reasonable request.”

3 16 C.F.R. § 436.1, et seq.

4 16 C.F.R. § 436.10(b).

Fourteen states (“Registration States”)\(^6\) require franchisors to register their franchise offerings with the state before offering or selling franchises in that state. Registration requirements vary from state to state, although all states that require registration follow the same disclosure format for FDDs required under the FTC Franchise Rule, and all states require the payment of a filing fee. Ten of the fourteen Registration States\(^7\) conduct some type of substantive review of the FDD before granting registration. Three states\(^8\) make the registration effective immediately upon the franchisor filing its FDD and registration notification forms with the state franchise administrator, although those states may still review some or all of the FDD and issue comment letters seeking additional information or clarification about the franchise offering. One state (Michigan) simply requires the filing of a one-page notice with the state franchise administrator before offering or selling franchises in the state.\(^9\) In addition, a number of states require franchisors to file a notice with the state business opportunity administrator in order to exempt the franchise offering from the state’s business opportunity act.\(^10\)

A. Failure to Register

In the Registration States, it is unlawful to offer or sell a franchise subject to registration unless the franchise offering is currently registered or exempt from registration. Registration violations occur for a variety of reasons. In some cases, a franchisor may be unaware that its registration in a state has lapsed as it continues to offer and sell in that state. In other cases, a franchisor may be unaware that the offer and sale to a prospective franchisee requires registration in a particular state. Some companies are simply unaware that what they are offering constitutes a “franchise.” These “accidental franchisors” are becoming increasingly more common, and state enforcement agencies are experienced in handling enforcement matters involving them, while private litigants pursue litigation against them and possibly even individuals who control the franchisor.

1. The “Accidental Franchisor”

Example: In the 1970s, a California man founded a business selling chicken from gasoline convenience stores under a license agreement with the store owners. The founder supplied the chicken and a patented heating and serving kiosk to the store owners, and the parties split the profits from the sale of chicken to the public. Within a few years, the founder developed a logo of a chicken in a super hero outfit, and the founder required the store owners


\(^7\) California, Hawaii, Illinois, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, Virginia and Washington.

\(^8\) Indiana, Wisconsin, and South Dakota.

\(^9\) MICH. COMP. LAWS § 445.1507a.

to display the logo and sign a trademark license agreement. Eventually the company started licensing its chicken kiosk to other types of convenience stores and even restaurants. Over the years, the founder developed an operating manual, and he included a clause in the license agreement requiring licensees to follow the manual to ensure uniform standards for the chicken and the process of selling the chicken. By the time the founder consulted a lawyer to start franchising “Super Chicken,” he had several thousand licensees operating across the US, Canada and Mexico.11

Every year, state franchise enforcement agencies receive information about business arrangements that operate like a franchise but are called something other than a franchise. The arrangement may be termed a “license,” “distributorship,” “dealership,” “joint venture,” “consulting arrangement,” or even “partnership agreement.” If the arrangement contains the elements of a franchise under applicable law,12 it will be deemed to be a franchise regardless of what the parties call the arrangement, even when the parties specifically disclaim that the arrangement is a franchise.13 State enforcement regulators learn of accidental franchises in a variety of ways. For example, an accidental franchisor may register a new franchise offering that includes disclosure of existing “licensees” in Item 20 of its FDD.14 A registered franchisor that competes with the accidental franchisor may report its competitor’s alleged violation to state or federal franchise regulators.15 A disgruntled “licensee” may contact the state agency to complain about the parties’ contractual arrangement. Finally, a state enforcement agency may

11 All of the italicized examples in this paper are based on actual events, although some facts have been changed to avoid identifying the subjects.

12 The definition of what constitutes a franchise varies by state. In many states, the fact that a business opportunity is not specifically described as a “franchise” does not necessarily mean that the business is exempt from the registration and disclosure requirements of the state statute, if the business otherwise meets the definitional elements of a “franchise”. See, e.g., People v. Kline, 168 Cal. Rptr. 185, 189 (Cal. Ct. App. 1980); Calderon v. Southwestern Bell Mobile Sys., 390 F. Supp. 2d 714, 719-720 (N.D. Ill. 2005); Quist v. Best Western Int’l, Inc., 354 N.W.2d 656, 660 (N.D. 1984) (noting that definition of “franchise” within the statute was intended to be broadly construed); Blanton v. Texaco Refining & Marketing, Inc., 914 F.2d 188 (9th Cir. 1990) (a stipulation in the parties’ contract that the agreement did not constitute a franchise did not control the determination as to whether the relationship was a “franchise” under Washington law).


14 State franchise examiners routinely search FDDs to discover unregistered sales in their states. In Item 20 of the FDD, a franchisor should disclose all outlets of a type substantially similar to that offered to the prospective franchisee. 16 C.F.R. § 436.5(t). In Item 1, a franchisor should disclose if it entered into agreements offering a business similar to the franchised business, such as “license agreements” that could constitute franchises. 16 C.F.R. § 436.5(a).

15 For franchisors that are conscientious about franchise law compliance, it can be aggravating to see competitors ignoring them and making sales. Before filing a complaint about a competitor with a state regulator or the FTC, however, a franchisor should ensure its own house is in order. If the violator finds out the tipster’s identity, it may monitor the tipster’s franchise filings, disclosure documents, and sales practices for any cracks that could support a retaliatory complaint.
learn of a potential registration violation from other state enforcement agencies and even press reports.  

2. **Acknowledged Franchisor Not Registered in State**

   *Example: Between 2008 and 2011, a Pennsylvania-based franchisor of hot yoga studios sold 11 franchises throughout Pennsylvania, Ohio, West Virginia, and Western Maryland. During this time, the company provided a form of disclosure document it entitled “Uniform Franchise Offering Circular” to prospective franchisees. That document contained no financial statements, although Item 21 disclosed the gross revenues earned by three studios owned by an affiliate of the franchisor. In 2011, the franchisor filed its “UFOC” with the Maryland Securities Division for registration. By that time, the franchisor already had 3 outlets in Maryland.*

Franchisors may fail to register in Registration States for a variety of reasons. Some franchisors, especially those who only offer franchises regionally in selected parts of the U.S., are unaware of the registration requirements in the Registration States. Other franchisors may be unaware that they are subject to registration under the specific jurisdictional provisions of a state franchise law. For example, a Virginia franchisor registered in Virginia may enter into a franchise agreement with a Virginia resident for a franchise with a territory of Northern Virginia, Washington, DC, and Southern Maryland, unaware that the Maryland Franchise Law requires registration of an offering to a non-Maryland resident when the franchise business is to be operated, in whole or in part, in Maryland.

In some cases, a franchisor may have relied on counsel who provided improper legal advice about the applicability of the laws of a Registration State or simply didn’t consult a lawyer with experience in franchise issues. For example, a foreign franchisor might sell the master franchising rights to a foreign restaurant concept for the entire United States, unaware that the sale of subfranchising rights for the United States is itself the sale of a franchise, triggering the registration requirements for that subfranchise offering in all of the Registration States. In another case, a franchisor might sell “fractional franchises” in a variety of Registration States, unaware that the self-executing exemption for fractional franchises under the FTC Franchise Rule does not apply in all of the Registration States.

3. **Expired or Lapsed Registration**

   *Example: A quick serve restaurant had been registered in all of the Registration States for several years. The franchisor filed its annual renewal in April, but several states responded with comment letters. The franchisor’s lawyer failed to respond to the comment letters or show them to the franchisor, and the applications for renewal were eventually abandoned in those states. The franchisor continued to offer and sell franchises in all of the Registration States in*

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16 In one recent example, a local business journal profiled the owner of a popular restaurant in a Registration State who sought to expand the restaurant concept by adding new locations. The article included an interview with a restaurant consultant who was working with the restaurant owner. The consultant was quoted as stating that, because there are a lot of legal and operating systems that must be in place in order to franchise, the owner likely will use “licenses” rather than “franchises” to open new locations.

17 MD. CODE ANN., BUS. REG. § 14-203(a)(2).
an effort to increase cash. The next year, when it was time for the franchisor to file its annual renewal, the franchisor’s counsel admitted that the registration had lapsed in several states.

Perhaps the most common registration violation that state law enforcement agencies encounter occurs when a franchisor’s registration has lapsed in a Registration State, but the franchisor, or a franchisor’s sales staff, continues to offer and sell franchises in that state.

In every Registration State, a franchisor must renew its registration annually in order to continue offering and selling in that state. Some state franchise registration laws tie the renewal requirement to the franchisor’s own fiscal year end, while other state franchise registration laws tie the renewal requirement to the anniversary date of the franchisor’s last renewal. A franchisor must keep track of its registration status in all of the Registration States to ensure that it does not offer or sell a franchise after a registration has lapsed.

In some Registration States, a franchisor whose registration renewal has not been made effective by the state franchise administrator may be forced to cease offering or selling in that state, even if the franchisor made a timely application to renew its registration. The requirement to suspend sales pending notification of effectiveness is often called “going dark” or being in a “black out” period. For example, in Maryland, a franchisor that files an application to renew a franchise registration is not permitted to use the amended franchise disclosure document while the application is pending. The franchisor may not offer or sell franchises subject to the state law until the renewal application has been approved. In other states, most notably Illinois, a franchisor may continue to offer and sell franchises (and use its updated FDD prior to the state’s review) as soon as its annual report is filed with the Illinois Franchise Bureau, unless the state franchise administrator has issued an order suspending, terminating, prohibiting or denying the registration.

A franchisor that offers or sells a franchise during this lapsed period of registration risks violating the registration provisions of those states that do not provide for a continuous registration. In addition, if, while awaiting notice of renewal in some Registration States, the

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18 See Cal. Code Regs. tit. 10, §310.120 (in California, franchise is registered for a period to expire 110 days after franchisor’s next fiscal year end); 815 Ill. Comp. Stat. 705/10 (in Illinois, registration of a franchise expires 120 days after the franchisor’s fiscal year end); Haw. Rev. Stat. § 482E-3(d) (in Hawaii, filings expire 3 months after the end of the franchisor’s fiscal year); Minn. Stat. § 80C.08, Subdivision 1 (in Minnesota, annual report filing required within 120 days after franchisor’s fiscal year end); N.Y. Comp. Codes R. & Regs. Tit.13, § 200.8 (in New York, annual report required to be submitted within 120 days of the close of its fiscal year); R.I. Gen. Laws §19-28.1-9 (in Rhode Island, registration of a franchise expires 120 calendar days after the end of the franchisor’s fiscal year following the application date); S.D. Codified Laws § 37-5B-7(1) (in South Dakota, no filing required for updating FDD, but disclosure document must be updated within 120 days after the close of its most recent fiscal year).

19 See Ind. Code § 23-2-2.5-18 (in Indiana, renewal is effective for one year unless the commissioner specifies a shorter period); Md. Code Ann., Bus. Reg. §14-219 (in Maryland, registration expires on anniversary of its effective date unless renewed for additional one year terms); N.D. Cent. Code § 51-19-07.4b (in North Dakota, franchise offering deemed duly registered for a period of one year from the effective date of the registration); Va. Code Ann. § 13.1-561 (in Virginia, registrations, exemptions, and renewals expire at midnight on the annual date of their effectiveness); Wash. Rev. Code § 19.100.070 (in Washington, franchise offering registered for a period of one year from effective date of registration or filing).


franchisor provides a prospective franchisee with a copy of the previously registered but outdated FDD, the franchisor risks violating the disclosure provisions of the state’s franchise law. Secondly, if, while awaiting notice of renewal, the franchisor provides the prospective franchisee with a copy of the updated FDD submitted for renewal before it has been registered by the state administrator, the franchisor risks violating the registration provisions of the state’s franchise law.

In addition, state franchise registration laws also require a franchisor to amend a franchise offering when there is a material change in the information on file with the state franchise administrator. State law varies on the issue of how promptly a franchisor must file a material change amendment. Under the Maryland Franchise Law, a franchisor must amend its application “promptly.” Similarly, under the New York Franchise Law, the franchisor must “promptly notify” the state franchise administrator upon a material change in the franchise disclosure document. In Illinois and Minnesota, however, a franchisor can file an amendment application 30 days after updating a disclosure document to reflect a material change. In Washington, a franchisor must file an amendment application “as soon as reasonably possible” after a material adverse change, but in any case before the sale of additional franchises. Although enforcement cases against franchisors for failing to timely amend their FDDs are rare, the failure to amend an FDD when required can subject a franchisor to state enforcement action or private litigation, especially when the franchisor has provided a prospective franchisee with an FDD that does not reflect a material change to the franchisor’s offering.

**B. Disclosure Violations**

In every state, franchisors are governed by the federal franchise disclosure requirements. In fifteen states (the fourteen Registration States, plus Oregon), franchisors are also governed by the states’ own pre-sale disclosure requirements.

At the federal level, in the absence of an exemption, all franchise sellers must provide all prospective franchisees with the federally required written disclosures pursuant to the FTC Franchise Rule. If a franchisor does not make the required disclosures, the franchisor, its owners, employees and franchise brokers may be subject to significant civil and criminal liability.

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22 MD BUS. REG. CODE §14-220.
23 N.Y. GEN. BUS. LAW § 683.9(a).
24 815 ILL. COMP. STAT. 705/11; MINN. STAT. § 80C.07.
25 WASH. REV. CODE. § 19.100.070(3).
26 See 16 C.F.R. § 436.1, et seq.
28 16 C.F.R. § 436.2.
as discussed below. In the fifteen states with disclosure statutes, franchisors must make affirmative disclosures.

At the state level, although there are some differences, generally, the statutes contain antifraud language that is derived from state securities laws. That is, generally, the statutes prohibit any misrepresentations or omissions of any material facts in the offer or sale of a franchise. In addition, generally, the statutes prohibit a person from employing any device, scheme or artifice to defraud another person and from engaging in any act or practice that would operate as a fraud or deceit on another person.

Disclosure violations come in a variety of forms. Typically, accidental franchisors fail to comply with the disclosure laws completely, since they do not know of their legal obligations as franchisors. Acknowledged franchisors’ disclosure violations include (a) providing an FDD containing material omissions or misrepresentations; (b) delivery of the wrong FDD (a version of the FDD that is not current or the FDD for the wrong state); (c) failing to “re-disclose” to a current franchisee after amending the disclosure document; or (d) failing to deliver the FDD at least 14 days before the agreement is signed or consideration is paid or upon reasonable request earlier in the sales process.

1. **Delivery of an FDD Containing Material Omissions or Misrepresentations**

   While a franchisor is potentially liable for any material omission or misrepresentation in the FDD, the most commonly litigated omissions and misrepresentations involve alleged omissions and misrepresentations under Items 7, 8, and 19 of the FDD.

   a. **Item 7 – Estimated Initial Investment**

   In Item 7, franchisors must provide information about the franchisee’s estimated initial investment, including the initial franchise fee, training expenses, real property expenses, opening inventory costs and expenses for other equipment. Item 7 also must include a category called “Additional funds – initial period,” which should identify any other required

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31 See, e.g., CAL. CORP. CODE § 31202; 815 ILL. COMP. STAT. 705/6; N.Y. GEN. BUS. LAW § 687; WASH. REV. CODE § 19.100.170.

32 See, e.g., CAL. CORP. CODE § 31411; 815 ILL. COMP. STAT. 705/6; N.Y. GEN. BUS. LAW § 687; WASH. REV. CODE § 19.100.170.

33 16 C.F.R. § 436.2(a); see also, e.g., CAL. CORP. CODE § 31119; 815 ILL. COMP. STAT. 705/5; N.Y. GEN. BUS. LAW § 683; WASH. REV. CODE § 19.100.080.

34 16 C.F.R. § 436.5(g)(1).

35 Id. at § 436.5(g)(1)(ii).
expenses the franchisee will incur before operations begin and during the initial period of operations.\textsuperscript{36} A period of at least three months or whatever is standard in the industry is considered a "reasonable initial period" for purposes of this disclosure.\textsuperscript{37} Item 7 must describe how the franchisor came up with the amounts provided for additional funds.\textsuperscript{38}

The most common claim advanced by a franchisee under Item 7 is that the initial cost estimate was too low and that the basis upon which the numbers were provided was not accurate or reasonable.

b. **Item 8 – Restrictions on Sources of Products and Services**

Under Item 8, franchisors must disclose any obligation on the part of the franchisee to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items, related to establishing or operating the franchised business, either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications.\textsuperscript{39}

Franchisees' common disclosure-based claims under Item 8 include, among other things, (1) that the franchisor failed to disclose vendor rebates or other material consideration that the franchisor received as a result of franchisees' purchases from designated suppliers\textsuperscript{40}, (2) that the franchisor has not negotiated favorable supply agreements for the benefit of the system\textsuperscript{41}, (3) that the franchisor did not disclose revenue resulting from transactions where the franchisor purchased goods from a third-party supplier and resold the goods at a higher price to franchisees (markup disclosure),\textsuperscript{42} and (4) that the franchisor did not disclose information about suppliers in which an officer of the franchisor has an interest.\textsuperscript{43}

c. **Item 19 – Financial Performance Representations**

The FTC Franchise Rule imposes a strict requirement on franchisors to either make a reasonable and documented financial performance representation or to affirmatively disclaim

\textsuperscript{36} Id.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Id. at § 436.5(h).
\textsuperscript{42} 16 C.F.R. § 436.5(h)(8).
through a “negative disclosure” any intention to make a performance representation. The disclosure must include an indication of whether the representation is historical or predictive of future performance; specifics about each; and the material bases for any representations.

If a franchisor makes a negative disclosure under Item 19, the franchisor could violate the FTC Franchise Rule if the franchisor's representatives make financial performance representations outside of the context of the FDD. Common law fraud and negligent misrepresentation actions often go hand-in-hand with claims under Item 19. A financial performance representation will be deemed fraudulent if it is knowingly false or when material facts regarding any affirmative representation are concealed with the intent to deceive.

The FTC Franchise Rule specifically prohibits a franchisor from disclaiming or requiring a prospective franchisee to waive reliance on any representation made in the FDD or its exhibits or amendments.

2. **Delivery of the Wrong FDD**

Where a franchisor is involved in a multi-state transaction, the franchisor might be confused or make a mistake about residency of the prospective franchisee or fail to spot other jurisdictional triggers and fail to properly identify which FDD to deliver in the applicable states. For example, if the franchisee has its principal office in one state, and the franchised business is in another state, the law in which the franchisee’s principal office is located may apply if an offer is accepted in that state, along with the law of the state in which the franchise business is located. In addition, the law of the franchisor’s state may apply if the offer originates from that state. Thus, if a New York franchisor makes an offer for a franchise to be located in Virginia to a resident of Indiana, the franchise laws of all three states may apply.

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44 16 C.F.R. § 436.5(s). “Financial performance representation” is defined to mean:

[\text{[A]}ny representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.]

See 16 C.F.R. § 436.1.

45 Id. at § 436.5(s)(1)-(iii).


48 16 C.F.R. § 436.9(h).

49 See, e.g., IND. CODE § 23-2-2.5-2; N.Y. GEN. BUS. LAW. § 681(12); VA. CODE ANN. § 13.1-559.B.

50 See, e.g., N.Y. GEN. BUS. LAW § 681(12).

51 IND. CODE § 23-2-2.5-2; N.Y. GEN. BUS. LAW § 681(12); VA. CODE ANN. § 13.1-559.B.
as California, exclude out-of-state franchise locations from coverage of their franchise disclosure laws, making this jurisdictional problem less important.\(^{52}\) New York does not limit the reach of its franchise laws in this way.\(^{53}\)

Delivery of the wrong FDD also occurs when an outdated version of the disclosure document is delivered to a franchisee.

C. **Misreliance on Exemptions and Exclusions**

Registration and disclosure violations arise when franchisors wrongly believe an offer or sale is covered by an exemption from franchise registration and disclosure laws.\(^{54}\) To avoid a violation by relying on an exemption, an offer or sale must be exempt from both the FTC Rule and any applicable state statutes.

This requires careful attention to detail. Exemptions and exclusions vary from state to state, and the FTC Rule’s exemptions do not match the state exemptions.\(^{55}\) Exemptions can have both definitional element requirements and procedural requirements.\(^{56}\)

D. **Violation of State Business Opportunity Laws**

In addition to considering violation of state franchise laws, counsel must also consider violation of state business opportunity laws. Roughly half of the states have business opportunity laws, and the states’ definitions of business opportunity vary.\(^{57}\) Most of these laws prohibit sales of business opportunities unless the seller gives potential purchasers a pre-sale disclosure document that has first been filed with a designated state agency.\(^{58}\) The representations made during the marketing and sale of the business opportunity are key in determining coverage under these laws. Franchisees have a private right of actions under business opportunity laws, and the penalties for violating these laws can be extensive including

\(^{52}\) *Cal. Corp. Code* § 31105.


\(^{54}\) Some of the common exemptions and exclusions are referred to as the following: “Nominal Fee,” “Bona Fide Wholesale Price,” “Fractional Franchise,” “Large Investments,” “Large Franchisees,” “Franchisor Insiders,” “Large Franchisor,” “Sale by a Franchisee,” “Out-of-State Sales,” “Isolated Sales,” and “General Partnerships.”


\(^{56}\) Id.; see, e.g., *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*, 673 F. Supp. 1493 (C.D. Cal. 1987), *aff’d in part and rev’d in part*, 890 F.2d 165 (9th Cir. 1989) (franchisor who failed to file for large franchisor exemption in California and Maryland was subject to rescission action for sale of unregistered franchise).


\(^{58}\) Id.
damages, return of fees paid by a franchisee, rescission of the contract, injunctive relief, criminal penalties, and other remedies.\textsuperscript{59}

III. CONSEQUENCES OF NON-COMPLIANCE

The principal consequences of non-compliance with franchise registration and disclosure laws are (1) private litigation by franchisees and prospective franchisees, (2) enforcement actions by regulators, and (3) limitations on a system’s ability to grow.

A. Private Litigation

The FTC Franchise Rule does not provide a franchisee with a private right of action for registration or disclosure claims.\textsuperscript{60} However, both in Registration States and non-Registration States, an aggrieved franchisee may have state common law fraud claims and/or claims under state consumer protection/deceptive and unfair trade practice statutes (aka “Little FTC Acts”) that may allow private plaintiffs to enforce the FTC Rule by treating violations of the FTC Rule as violations of these state laws.\textsuperscript{61} The little FTC Acts are patterned after Section 5 of the FTC

\textsuperscript{59} See, e.g., CAL. CORP. CODE §§ 1812.203, 1812.215, 1812.217, 1812.218, 1812.219.

\textsuperscript{60} See, e.g., Akers v. Bonifasi, 629 F. Supp. 1212, 1221-1222 (M.D. Tenn. 1984); Baum v. Great Western Cities, Inc. v. New Mexico, 703 F.2d 1197, 1209 (10th Cir. 1983); Dreisbach v. Murphy, 658 F.2d 720, 730 (9th Cir. 1981); Fulton v. Hecht, 580 F.2d 1243, 1249 n. 2 (5th Cir. 1978); Alfred Dunhill Ltd. v. Interstate Cigar Co., Inc., 499 F.2d 232, 237 (2d Cir. 1974); and Holloway v. Bristol-Myers Corp., 485 F.2d 986, 988-992 (D.C. Cir. 1973).


However, at least one case has held that the failure of a franchisor to comply with the FTC disclosure regulations does not constitute an unfair trade practice under state law where there is no element of fraud, misrepresentation, deception, or unethical conduct in the creation of the franchise agreement. LeBlanc v. Belt Center Inc., 509 So. 2d 134 (La. Ct. App. 1st Cir. 1987).
Act, prohibit unfair and deceptive conduct, and provide for private actions for damages, attorney’s fees and sometimes multiple damages.\textsuperscript{62}

In the fifteen states with registration or disclosure statutes, private litigants have additional causes of action based on violations of the state registration and disclosure laws.\textsuperscript{63} The remedies for a franchise registration or disclosure violation vary by state and can include rescission and restitution, damages, treble damages, costs, attorneys fees, and interest.\textsuperscript{64} Depending on the state, private litigants may also have claims based on business opportunity laws.

Appendix A to this paper contains a chart, organized by state, of a franchisee’s potential civil remedies (rescission, damages, costs, attorneys’ fees, treble damages, interest, etc.) in Registration States and Oregon. The extent of civil liability for particular franchise law violations, and thus the franchisor’s likely exposure in a private cause of action, varies from state to state. Most states afford the plaintiff a rescission remedy, but it may be limited to specified violations (e.g., failure to register) or to willful violations. Under most state franchise laws, officers and other controlling parties of the franchisor face personal liability, as set forth in the personal liability column of the Table of Civil Remedies chart in Appendix A.

In private litigation based on registration and disclosure violations, franchisees and prospective franchisees commonly assert such claims as (1) violations of state franchise statutes (if in applicable state(s)); (2) common law fraud (and related actions like negligent misrepresentation); and (3) violations of states’ Little FTC acts. Here are a few examples of private litigation within just the last 2 years asserting registration and disclosure violations.

   \textit{(Maryland statute)}

   In \textit{Hanley v. Doctors Express Franchising, LLC},\textsuperscript{65} the franchisee alleged that the FDD contained misrepresentations in the form of information that the franchisor knew was no longer accurate about the required initial investment, the initial operating capital requirements, the physician credentialing and health insurance reimbursement contracting process, and the projected earnings and financial performance of the franchise. The representations were labeled as projections and estimates based on the operations of one affiliate facility and warned prospective franchisees that the projections and estimates could not be relied upon to accurately predict the future performance of a franchise. Nonetheless, the court held that the

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\textsuperscript{62} See, e.g., CAL. BUS. \& PROF. CODE § 17200; DEL. CODE ANN. tit. 6, § 2513; FLA. STAT. ANN. § 501.204; MASS. GEN. LAW. Ch. 93A, § 2; N.J. STAT. § 56:8-2; N.H. REV. STAT. § 358-A:2; OHIO REV. CODE § 1345.02; TEX. BUS. \& COM. CODE §17.46; see also CAL. BUS. \& PROF. CODE § 17204 (private cause of action); DEL. CODE ANN. tit. 6, § 2626 (private cause of action), § 2524(c) (damages); FLA. STAT. ANN. § 501.2105 (attorney’s fees); MASS. GEN. LAW ch. 93A § 9 (private cause of action); N.H. REV. STAT. § 358-A:10 (private cause of action); OHIO REV. CODE § 1345.09 (private cause of action, damages and treble damages); TEX. BUS. \& COM. CODE § 17.50 (private cause of action, damages, treble damages, and attorney’s fees).
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\textsuperscript{64} See Appendix A - Table of Civil Remedies.
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franchisee’s pleadings were enough to survive the 12(b)(6) motion to dismiss stage; the franchisee plausibly alleged that the projections (which were based on data from 2007-2008) were contrary to undisclosed facts within the franchisors’ possession at the time they were made. The court held that the disclaimers in Item 19 of the FDD did not bar the Maryland Franchise Law claims.


   In *Long John Silver’s Inv. v. Nickleson*, the franchisee claimed that the franchisor violated the Minnesota Franchise Act (“MFA”) by failing to present the franchisee with the current FDD (as opposed to the previous year’s FDD) at least seven days prior to the franchisee paying the franchise $10,000 for a site evaluation. The court agreed this was a violation of the MFA, but denied summary judgment to the franchisee on the MFA claim because the franchisee had not established damages caused by the untimely disclosure. The franchisee also alleged that the franchisor violated the MFA by making untrue statements of material fact in connection with the sale of the franchise, specifically by providing misleading and untrue information and omitting material facts regarding the estimated costs, revenues and profits of the franchise at issue and the financial state of other franchises.

   In its defense, the franchisor relied heavily on the franchise agreement's and FDD's disclaimers and integration clause. Essentially, the franchisor asserted that the franchisor disclaimed any representations regarding the costs, sale or profits of the franchise and made clear that franchisor representatives were not authorized to make such claims. Additionally, the franchise agreement's integration provision stated that it nullified any “agreements, understandings, representations, inducements and statements” between the parties prior to entering into the franchise agreement. The franchisor argued that any reliance on the representation was unreasonable as a matter of law due to the multiple disclaimers.

   The Court disagreed with the franchisor and held that the franchisee’s reliance was not unreasonable as a matter of law. Instead, the court found the parties presented a genuine issue of material fact as to reliance. The Court found that the franchisor could not use the disclaimers to defeat, as a matter of law, the franchisee’s misrepresentation claim under the MFA. Thus the franchisee’s MFA claim survived summary judgment.


   In *Mangione v. Butler*, the franchisor failed to register under the New York Franchise Sales Act. The owners of the franchisor entity were held personally liable to the franchisee for $714,000 (the amount of the initial franchise fees), plus interest, attorneys’ fees and costs. The bankruptcy court held that the owners and the franchisor entity had intentionally allowed its franchise license to lapse in New York and knowingly and willingly sold franchises to the franchisee in violation of New York law. Claims against the owners were not dischargeable in bankruptcy because they were monies obtained by “false pretenses, a false representation, or

66 923 F. Supp. 2d 1004 (W.D. Ky. 2013)

actual fraud” and because the claims arose from the owners’ defalcation. New York law imposed a trust relationship with respect to escrowing of franchise fees.

B. Enforcement Actions with Regulatory Remedies

1. FTC

Violations of the FTC Rule can result in an enforcement action by the FTC, including lawsuits in federal district court under Section 5 of the Federal Trade Commission Act. The FTC’s Bureau of Consumer Protection is the agency with the authority to enforce the franchise law at the federal level. Under the FTC Franchise Rule, it is an unfair or deceptive act or practice in violation of Section 5 of the FTC Act for any franchise seller, among other things, to fail to furnish a copy of the franchisor’s FDD to a prospective franchisee as required under the FTC Franchise Rule.68

The FTC can bring a civil action seeking injunctive relief to remedy any violation of law enforced by the FTC. In addition, as of April 10, 2014, the FTC can seek civil penalties of $16,000 per violation of the FTC Franchise Rule.69 The FTC has interpreted its authority to pursue a permanent injunction to entitle the FTC to obtain other types of equitable relief, including restitution and rescission of contracts to remedy past violations.70 The FTC also has sought and obtained a freeze of assets and the appointment of receivers in appropriate cases.71

Over the last decade, most of the enforcement actions brought by the FTC under the FTC Franchise Rule have involved cases against fraudulent business opportunity sellers rather than more traditional “franchise” sellers.72 The FTC has, on occasion, brought an action against a franchise seller when the violation alleged included more than the failure to provide a disclosure document.73

Starting in 1998, the FTC began using an Alternative Rule Enforcement Program administered by the International Franchise Association to resolve technical or minor violations of the FTC Franchise Rule that otherwise would be referred to the Department of Justice for civil penalty action. Franchisors that are referred to the program receive training in FTC Franchise Rule compliance and are monitored for a period of years. In addition, potentially injured


72 Until the FTC’s adoption of a separate Business Opportunity Rule in 2011 (16 C.F.R. Part 437), business opportunity sellers were covered under the FTC Franchise Rule.

73 FTC v. We the People Forms and Service Centers USA, Inc., www.ftc.gov/enforcement/cases-proceedings/0323213/we-people-forms-service-centers-usa-inc-et-al-us (last visited August 17, 2014) (injunction and civil penalty against legal preparation franchise for failure to disclose lawsuits brought by United States Trustee Program relating to the service’s preparation of bankruptcy petitions).
franchisees are notified about the violation and have the opportunity to resolve any claim, and possibly seek redress, against the franchisor through mediation. Violations involving fraud or unfair or deceptive business practices are not candidates for the program. Although the FTC has published few details about the program since its launch, the program remains viable, and it is another tool that the FTC can use to resolve technical violations of the FTC Franchise Rule where fraud is not an issue.74

2. **State Regulatory Examples and Powers**

The Registration States (and Oregon) have a variety of enforcement powers available to them to remedy violations of the state franchise laws.75 In general, the franchise laws of the Registration States (and Oregon) allow a state enforcement agency to bring actions for violations of the registration and disclosure provisions of the state’s franchise law.76

Appendix B to this paper contains a chart, organized by state, of state regulators’ enforcement powers and remedies in Registration States. Most states have broad investigative and enforcement powers, but the range of potential outcomes in a particular state varies depending on the precise powers and remedial options afforded by statute, as well as the state’s enforcement policies or protocol. Enforcement options and remedies for state regulators include the following, among others:

- denial, revocation, or suspension of the franchise registration;
- investigations and hearings;
- interim and permanent cease and desist orders;
- administrative penalties;
- prosecution or referral of the matter to the appropriate state or local authorities for prosecution of civil or criminal actions;
- restitution on behalf of injured parties;
- appointment of receivers;
- civil, administrative and criminal penalties;
- imprisonment for willful violations;
- costs, reasonable attorneys fees, investigative expenses, and other remedies.

In addition to civil penalties, all of the franchise laws of the Registration States provide for criminal penalties (including fines/penalties and imprisonment) for certain franchise law violations.77 However, in recent years criminal prosecutions of franchisors have been extremely rare. A comprehensive analysis of all of the states’ enforcement authority is beyond the scope of this paper, but the following discusses the authority of some Registration States, with


75 See Appendix B - Table of Enforcement Powers

76 Id.

77 Id. The Oregon statute provides that is does not limit the right of the state to punish a person for violation of any law. Or. Rev. Stat. 650.085.
representative samples of state enforcement actions, and Appendix B summarizes key aspects of the Registration States’ (and Oregon’s) enforcement powers.

a. **California**

The California Department of Business Oversight (“DBO”) (formerly the Department of Corporations) enforces the California Franchise Investment Law. The DBO’s enforcement powers are extremely broad. They range from the summary issuance of a stop order denying the effectiveness of or suspending or revoking the effectiveness of any registration, to instituting a civil action, to referring the matter to the Attorney General to pursue criminal charges (where available remedies can include fines up to $100,000, 1 year in prison for the franchisor’s owners or officers, or both). The DBO can pursue a variety of remedies, such as injunctions, appointment of a receiver, issuance of a stop order (to stop the offer or sale of franchises), issuance of a desist and refrain order (to refrain from all activity that is alleged to be in violation of state regulations), issuance of an order prohibiting a violator from acting as an officer of director of a franchisor, restitution, disgorgement, and damages, costs, reasonable attorneys’ fees, investigative expenses, citations and civil penalties.

**Sample California Enforcement Matter—Mars Venus Coaching, Inc.:** On March 4, 2013, the Enforcement Division of the BDO filed a “Desist and Refrain Order” against Mars Venus Coaching, Inc. and its president for allegedly offering in California franchises in the form of coaching businesses based upon the books from the author of “Men are From Mars, Women are from Venus.” The Desist and Refrain Order alleges that the Mars Venus businesses constitute franchises under the California Franchise Investment Law, and that the franchises were not registered with the California Department prior to being offered to California residents.

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78 CAL. CORP. CODE § 31000, et seq.

79 CAL. CORP. CODE § 31115.

80 CAL. CORP. CODE § 31405.

81 CAL. CORP. CODE § 31411.

82 CAL. CORP. CODE § 31400.

83 CAL. CORP. CODE § 31400.

84 CAL. CORP. CODE § 31115.

85 CAL. CORP. CODE §§ 31211, 31402, 31406.

86 CAL. CORP. CODE § 31400.1.

87 CAL. CORP. CODE § 31400.

88 CAL. CORP. CODE §§ 31406, 31410.

b. Illinois

The Office of the Attorney General of Illinois has the authority to investigate and enforce the Illinois Franchise Act. The Attorney General, acting as the Illinois franchise "Administrator," may institute proceedings in the circuit court in the name of the People of Illinois to enjoin violations of the Illinois Franchise Act, and to recover a penalty of up to $50,000 per violation of the Illinois Franchise Act. In addition, the Administrator or her designee may suspend, terminate, prohibit, or deny the sale of a franchise or registration for a violation of the law.

In many cases, Illinois resolves registration violations through the entry of an "Assurance of Voluntary Compliance." A typical Assurance will include provisions for a franchisor to send a Notice of Violation to affected franchisees and pay a fine to the Illinois Attorney General. An Assurance of Voluntary Compliance, unlike a Consent Decree, is not required to be disclosed as an injunctive order or decree under the FTC Franchise Rule.

Sample Illinois Enforcement Matter—Sharks Franchising, LLC: In 2013, the Illinois Attorney General filed a complaint for a permanent injunction under the Illinois Franchise Act. The complaint alleged that between 1998 and 2011, Sharks Franchising, LLC entered into "license agreements" with Illinois residents to open and operate restaurants under the Sharks name. At the time of the Complaint, there were 41 locations operating in Illinois. The complaint alleged that the license agreements were, in actuality, franchises under the Illinois Act. Sharks did not become registered to offer franchises under the Illinois Act until 2012. The parties entered into a "Final Judgment and Consent Decree" in which the defendant agreed to be permanently enjoined from offering franchises in violation of the Illinois Act, to make rescission offers to Illinois franchisees, and to pay penalties and costs to the Illinois Attorney General in the amount of $35,000.

c. Maryland

Under the Maryland Franchise Registration and Disclosure Law, the Maryland Securities Commissioner in the Office of the Attorney General may bring a civil action in circuit court to enjoin a violation of the law or to enjoin the law or any regulation under the law. The court has broad powers in a civil action under the Maryland Franchise Law to exercise equitable

90 815 ILL. COMP. STAT. 705/31.
91 815 ILL. COMP. STAT. 705/22.
92 815 ILL. COMP. STAT. 705/24.
93 815 ILL. COMP. STAT. 705/22.
94 815 ILL. COMP. STAT. 705/31(j).
96 MD. CODE ANN., BUS. REG. § 14-210(b).
remedies including an injunction, restraining order, the appointment of a receiver, revocation of corporate charter, and an award of damages.\footnote{Id.}

In addition, whenever the Securities Commissioner finds that a person has violated the Maryland Franchise Law, she may bring an administrative action to order the person to cease and desist from the offer or sale until the sale complies with the statute.\footnote{MD. CODE ANN., BUS. REG. § 14-210(a).} There are no provisions under the Maryland Franchise Law for the Commissioner to assess fines or penalties for violations. The Securities Commissioner also has authority to issue a stop order to deny, suspend or revoke a registration under the Maryland Franchise Law if there has been a violation of the statute or regulation and for other specific grounds.\footnote{MD. CODE ANN., BUS. REG. § 14-221.}

**Sample Maryland Enforcement Matter--Sweet Frog Enterprises, LLC:** In August 2012, the Maryland Securities Commissioner entered into a Consent Order with Sweet Frog Enterprises, LLC. According to the Consent Order, Sweet Frog entered into 8 “license agreements” in Maryland related to the sale of frozen yogurt businesses under the Sweet Frog trademark. The Maryland Securities Division alleged that the Sweet Frog license agreement constituted a “franchise” under Maryland law. Under the Consent Order, Sweet Frog agreed to cease and desist from violating the Maryland Franchise Law, and to pursue a franchise registration in Maryland. The Consent Order required Sweet Frog to notify Maryland licensees immediately of their right to rescind their license agreement, and then, once the Sweet Frog franchise offering was registered in Maryland, re-notify any remaining Maryland licensees of their right to rescind their license agreement. The Consent Order specifically stated that the licensees did not waive (as a result of the rescission offers required under the Consent Order) any private civil cause of action they may have.\footnote{Case No. 2012-0055, http://www.oag.state.md.us/Securities/Actions/2012/Sweet%20Frog%20CO_8_12.pdf (last visited August 17, 2014).}

**d. New York**

The New York Franchise Sales Act allows the Investor Protection Bureau of the New York Attorney General’s Office (the “Bureau”) to bring a plenary civil lawsuit to allege a law violation.\footnote{N.Y. GEN. BUS. LAW § 689(4).} The Attorney General may seek a penalty of up to $10,000 for each defendant, request a receiver, and pursue injunctive relief.\footnote{Id.} In such a plenary action, if a defendant refuses to be sworn or examined or to answer a material question or produce a book or paper relevant to an inquiry, the refusal is “prima facie proof that such defendant is or has engaged in any unlawful or fraudulent practice” and the court may issue a permanent injunction against that defendant.\footnote{N.Y. GEN. BUS. LAW § 689(1).} Upon a showing by the Bureau that a fraudulent practice has occurred, the Attorney General may institute a suit for restitution of any monies or property obtained by the
seller directly or indirectly in relation to the fraudulent practice.\textsuperscript{104} The New York Attorney General also has the authority under the New York Franchise Sales Act to bring criminal actions.\textsuperscript{105}

In New York, the making of a rescission offer extinguishes the right a franchisee may have to bring a future private civil action under the New York State Franchise Sales Act, whether the franchisee accepts or rejects the offer, as long as the conditions of the statute are satisfied.\textsuperscript{106} The standard New York rescission offer allows a franchisee to receive a refund of the consideration paid together with interest at six percent per year from the date of payment, less the amount of income earned by the franchise, conditioned upon tender of all items received for the consideration and not sold. A copy of the form of rescission offer required when there is no registration can be found on the website of the New York Investor Protection Bureau.\textsuperscript{107}

In many cases, franchise violations are resolved by the New York Investor Protection Bureau by the entry of a Consent Judgment filed in court, or by the issuance of an “Assurance of Discontinuance.” A Consent Judgment against a franchisor or any of its officers must be disclosed in Item 3 of the franchisor’s FDD, while an Assurance of Discontinuance need not be disclosed.

\textbf{Sample New York Enforcement Matter-- Maricopa Products, Inc.:} In 1999, the New York Attorney General brought an action against Maricopa Products, Inc. and related parties for alleged violations of the registration, disclosure and antifraud provisions of the New York Franchise Sales Act, including for making earnings projections. The Attorney General alleged that dozens of franchisees invested between $20,000 and $50,000 for distributorship routes along which to sell the franchisor’s exclusive line of snacks and beverages. After taking the money of franchisees, the promoter of the franchise encouraged them to purchase equipment and to lease warehouse space, which only further increased their losses. Although he promised success to investors, none made a profit. All lost money and two declared bankruptcy. The promoter never delivered on his promises to create an exclusive line of snacks and beverages. Instead, he only provided potato chips and a sparse line of flavored water. Stores stopped buying the flavored water when the labels peeled off to reveal another beverage's label, and the potato chips when the bags deflated and leaked oil. Not long after taking investors' money, the promoter closed his warehouse and did not return the telephone calls of franchisees. The New York Attorney General's Office eventually reached a settlement with the defendants in which they agreed in a Consent Judgment to pay in excess of one million dollars in fines.\textsuperscript{108}

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\textsuperscript{104} N.Y. GEN. BUS. LAW § 692(2).
\textsuperscript{105} N.Y. GEN. BUS. LAW § 692(1).
\textsuperscript{106} N.Y. GEN. BUS. LAW § 691(2).
\textsuperscript{107} http://www.ag.ny.gov/investor-protection/franchisors-franchisees (last visited August 17, 2014).
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e. **Virginia**

In Virginia, the Virginia State Corporation Commission ("Commission") has the authority to investigate and bring enforcement actions under the Virginia Retail Franchise Act.\(^\text{109}\) The Commission has investigatory powers and the authority of a court to issue injunctions against violations of the law and to enforce the injunctions through contempt.\(^\text{110}\) Upon a finding after a hearing that any person has violated the Virginia Franchise Act or attempted to defraud the Commission, the Commission has the authority to impose a civil penalty of up to $25,000 per violation.\(^\text{111}\)

The Commission may request franchisors to rescind any franchise and make restitution to affected franchisees and consider compliance with that request in determining the amount of any civil penalty to be imposed.\(^\text{112}\) Violators of the Virginia Franchise Act can be criminally prosecuted.\(^\text{113}\)

**Sample Virginia Enforcement Matter--Tengfei, Inc.:** In March 2013, the Commission issued a “Rule to Show Cause” against Tengfei, Inc. and its president Wei He Zhang related to the operation of “Jasmine Smoothie World and Bubble Tea” franchises. The Commission alleged that less than two years after entry of a previous Order against Tengfei for offering franchises in Virginia prior to registering with the Virginia Division of Securities, the defendants had committed at least 7 new violations of the Virginia Retail Franchise Act by, among other things, failing to provide material information to franchisees (including information regarding the entry of a consent order against the defendants by the Maryland Securities Commissioner), and failing to provide prospective franchisees with FDDs required under Virginia law. After a hearing, and upon the recommendation and findings of a hearing examiner, the Virginia Commissioner issued a “Judgment Order” in December 2013 ordering the defendants to be fined $250,000 for violating Virginia’s Franchise Act, with the fine to be waived upon completion of payment of $32,000 in restitution to a Virginia resident within 36 months of the date of the order.\(^\text{114}\)

**C. Effect on System and Growth**

Violations of franchise registration and disclosure laws can have far-reaching consequences for a business. They are not easy to hide -- franchisors must disclose in Item 3 of their FDD administrative, criminal, and civil actions alleging registration and disclosure violations.\(^\text{115}\) Depending upon how the matter is resolved, franchisors may have to disclose such


\(^{110}\) VA. CODE ANN. § 13.1-570.

\(^{111}\) Id.

\(^{112}\) Id.

\(^{113}\) VA. CODE ANN. §13.1-569.


\(^{115}\) 16 C.F.R. § 436.5(c).
actions for 10 years. Such disclosures may be impediments to the franchisor’s success in attracting new franchisees and growing its business. In addition, state examiners will often refuse to register the franchise until the franchisor stipulates to a cease and desist, pays a civil fine and, in some cases, offers rescission to the franchisees.

IV. INVESTIGATION, ASSESSMENT, AND REMEDIATION

In handling a possible franchise law violation, the first step is to determine whether a violation actually occurred under the FTC Rule or relevant state laws, by identifying which law or laws applies, checking for exemptions, and confirming the facts and law to determine whether there has been a violation. Assuming there was a violation (or that a finding of violation is probable), the next step is to consider possible affirmative or other defenses and to evaluate the legal and practical consequences of that violation, including the applicable civil remedies and enforcement powers and the circumstances of the affected franchisees and franchisor. The final step is to make and implement a strategic plan for remediation and to avoid future violations.

A. Determine Whether There Was A Violation

1. Identify Which Laws Apply

First, counsel should determine which state registration/disclosure laws (if any) are implicated. While each state statute’s jurisdictional reach is different, counsel should at minimum check for applicability of any state registration/disclosure laws in the state(s) where (1) the franchisee(s) is/are domiciled or reside; (2) the offer(s) was/were made; (3) the offer(s) was/were accepted or received; (4) the franchise is to be located or operated; and (5) the franchisor is domiciled.

Regardless of which state law(s) apply, barring an exemption, the FTC Rule will apply if the transaction involved an offer of a franchise to be located anywhere within the United States or its territories.

2. Check for Exemptions

Once jurisdiction of a regulating state is confirmed, counsel should next determine if the transaction is covered by an exemption. Franchise statutes usually place the burden of

116 Id.

117 This portion of the paper (IV. Investigation, Assessment, and Remediation) relies heavily upon Martin Cordell, Joseph Punturo & Mary Beth Trice, A Basic Guide to Handling Disclosure and Registration Violations, American Bar Association 30th Annual Forum on Franchising (2007).

118 Counsel must check the precise current language of each statute. See, e.g., CAL. CORP. CODE §§ 31013, 31105; HAW. REV. STAT. §§ 482E-3, 482E-4; 815 ILL. COMP. STAT. 705/3; IND. CODE §§ 23-2-2.5-2, 23-2-2.5-9; MD. CODE REGS. § 02.02.08.10; MICH. COMP. LAWS ANN. § 445.1504, 445.1506; MINN. STAT. ANN. § 80C.02, 80C.03; N.Y. GEN. BUS. LAW § 681.11; N.D. CENT. CODE § 51-19-03, 51-19-14; R.I. GEN. LAWS § 19-28.1-4, 19-28.1-7; S.D. CODIFIED LAWS ANN. 37-5B-2; VA. CODE § 13.1-559, 13.1-560; WASH. REV. CODE ANN. § 19.100.020; WIS. STAT. ANN. § 553.21, 553.59.

119 16 C.F.R. § 436.2.
proving entitlement to exemptions on the franchisor.\textsuperscript{121} To avoid a violation by relying on an exemption, an offer or sale must be exempt from both the FTC Rule (if it is a disclosure violation) and any applicable state statutes. The FTC Rule’s exemptions do not match the state exemptions.\textsuperscript{122}

The franchisor must meet the definitional elements and any procedural requirements for the exemption.\textsuperscript{123} Some state law exemptions require a notice filing, delivery of a disclosure document or satisfaction of other conditions; failing to timely meet these requirements may make the exemption unavailable, and hence unhelpful if the problem is discovered only after the sale of the franchise.\textsuperscript{124}

3. **Confirm Whether There Has Been a Violation of the Statute**

Counsel must check the statute and the facts to determine whether there has been a violation.

**B. Consider Possible Affirmative or Other Defenses**

If a disclosure or registration violation occurred, counsel should consider the following potential defenses. The availability of each of these varies by state, as well as based on whether the action is private litigation or a government enforcement action:

- Statute of limitations — when did the violation occur and when was it discovered? Applicable statutes of limitation for civil liability may be as short as one year from discovery of the violation to as long as seven years from the date of the violation; some may be shortened to as little as 30 days after the franchisor provides a notice of violation or rescission offer to the affected franchisees.\textsuperscript{125} Some state franchise

\textsuperscript{120} A description of possible exemptions is beyond the scope of this paper. Some examples of exemptions that might apply include large franchisee (net worth and experience), large/substantial investment, fractional franchise, insiders (franchisor owner/employees), large franchisor, sales to existing franchisees, and sale of single franchise. For a helpful source, see Karen B. Satterlee & Leslie D. Curran, *Exemption-Based Franchising: Are You Playing in a Minefield?*, 28 FRANCHISE L.J. 191 (Spring 2009).

\textsuperscript{121} CAL. CORP. CODE § 31153; HAW. REV. STAT. § 482E-5(d); IND. CODE § 23-2.5-39; MICH. COMP. LAWS § 445.1503(10); MINN. R. 2860.0300; N.Y. GEN. BUS. LAW § 681(18); R.I. GEN. LAWS § 19-28.1-24; S.D. CODIFIED LAWS § 37-5B-20; WASH. REV. CODE § 19.100.220.

\textsuperscript{122} See Karen B. Satterlee & Leslie D. Curran, *Exemption-Based Franchising: Are You Playing in a Minefield?*, 28 FRANCHISE L.J. 191 (Spring 2009).

\textsuperscript{123} See, e.g., *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*, 673 F. Supp. 1493 (C.D. Cal. 1987), aff’d in part and rev’d in part, 890 F.2d 165 (9th Cir. 1989) (franchisor who failed to file for large franchisor exemption in California and Maryland was subject to rescission action for sale of unregistered franchise).

\textsuperscript{124} See, e.g., CAL. CORP. CODE § 31106 (requiring filing of notice of exemption no later than 15 days after sale).

\textsuperscript{125} See Appendix A to this paper for a chart identifying statutes of limitation by state. *Kim v. SUK, Inc.*, No. 12-CV-1557, 2013 WL 656844, 2013 U.S. Dist. LEXIS 24703 (S.D.N.Y. Feb. 22, 2013) is a recent example where a franchisor successfully utilized a statute of limitations defense to a disclosure violation under the New York Franchise Sales Act.
laws provide for a specific statute of limitation for the state franchise agency to bring an enforcement action.\(^\text{126}\)

- Lack of reliance — Some disclosure violations require reliance. Did the franchisee actually rely on the defective disclosure in making the decision to purchase the franchise?\(^\text{127}\)

- Release — Has the franchisee signed a release in connection with a settlement, franchise transfer, renewal, or otherwise that might cover the violation?\(^\text{128}\)

- Waiver or estoppel — Has the franchisee waived, or is the franchisee’s estopped from asserting a violation, either expressly or through conduct?\(^\text{129}\)

- Reliance on counsel - Some lawyers are not aware that franchise laws exist or erroneously advise clients that they do not apply to particular licensing or distribution methods.\(^\text{130}\) If the franchisor’s violation resulted from incorrect legal advice from counsel, the franchisor should offer that as a mitigating circumstance in the context of an enforcement action or in self-reporting franchise law violations to a regulator. However, a franchisor’s mistake of law or reliance on counsel may not be a defense to criminal, administrative, or civil liability for the violation.\(^\text{131}\)

C. **Consider Consequences of Violation (Civil Remedies, Enforcement Powers)**

Assuming there is a violation and no affirmative defense is available, counsel should advise their clients on the consequences of non-compliance, including the risks of private litigation and enforcement actions, which are addressed above in Section III (Consequences of Non-Compliance). However, even if private litigation or enforcement actions are available, that

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\(^{127}\) See, e.g., Cal. Corp. Code § 31301.

\(^{128}\) However, the release may have limited utility. Many states with a franchise statute void (either through an explicit anti-waiver provision or under public policy), a release of franchise statutory violations in connection with the franchise sale. See, e.g., Cal. Corp. Code § 31512.


\(^{130}\) In addition to using the reliance on counsel as a defense, current counsel should consider any potential attorney malpractice claims against prior counsel. See, e.g., Beverly Hills Concepts, Inc., v. Schatz and Schatz, et al., 717 A.2d 724 (Conn. 1998) (franchisor who was subject to cease and desist order and fines for failure to register sought damages from law firm that failed to advise of registration obligation).

\(^{131}\) See, e.g., People v. Gonda, 138 Cal. App. 3d 774, 779-780 (1982) (reliance on advice of counsel not a defense to claims at issue there).
does not mean they will be pursued, or that if they are pursued, that every remedy will be sought.

1. **Consider Likelihood Private Litigation Will Be Initiated, and If It Is, What the Scope Will Be**

The reaction of regulators, and the potential exposure in civil litigation, changes depending upon whether the violation has harmed the franchisee in question, and the extent of such harm. Complaints from disgruntled franchisees are a key enforcement trigger — without a disgruntled franchisee, it is much less likely that there will be an enforcement action or a civil lawsuit, and if there is one, it is more likely to get resolved quickly and on reasonable terms. Similarly, if franchisees are succeeding in the system, they are unlikely to accept rescission offers.

Thus, as soon as a violation is discovered, counsel should identify the affected franchisees or prospective franchisees and learn about their circumstances, by asking the following questions, among others:

- How many franchisees were affected?
- Where is each franchisee?
- When was each offer made and has each franchise agreement been signed?
- Has each franchisee signed a lease, made other binding commitments or taken other potentially detrimental actions in furtherance of the franchise?
- Is each franchisee open for business?
- What amounts has each franchisee paid the franchisor in initial fees, royalties, other?
- What other franchisee-specific investments has each franchisee made in the business?
- Is each franchisee losing money or profitable and can losses be estimated or verified?
- Is each franchisee in compliance with the agreement?
- Is each franchisee’s relationship with the franchisee amicable, and, if not, has each franchisee made any formal complaints or demands?

2. **Consider Likelihood Enforcement Action Will Be Initiated, and If It Is, What the Scope Will Be**

An enforcement agency does not pursue every violation or every remedy for every violation. Some situations are clear cut. When the relationship at issue clearly constitutes a franchise and no exemptions or defenses apply, registration violations are one of the simplest enforcement actions a state enforcement agency can bring. The state franchise administrator maintains the records of registration. A franchisor is either registered as of a specific date or it is not. For that reason, absent some type of argument for exemptions or defenses, an attorney counseling a client whose business is clearly a franchise should try to resolve a registration violation with the state as simply and expeditiously as possible.

However, many situations are not so clear cut, and it is not as obvious whether, and how, regulators will react. Although not reflecting official policy, an informal survey of state regulators taken by the authors of an article in the Winter 2005 Franchise Law Journal indicates the most likely responses to violations, in order of preference, are to: (1) seek a consent decree barring future violations, or require the franchisor to make rescission offers to franchisees; (2) require
notification to franchisees of the violation; (3) impose fines; (4) temporarily or permanently bar
the franchisor from franchise sales in the state; and (5) initiate a civil or criminal action. 132

Of course, the circumstances of the violation (and sometimes the forthrightness and
professionalism of the franchisor and its counsel) can influence the state’s likely response.
According to the above-referenced survey, the primary factors the regulators would consider, in
order of significance, were:

- whether the franchisor self-reported the violation;
- litigation and violation history of the franchisor and its principals;
- the franchisor’s proposal for remediation;
- number of franchises sold in the state;
- actions taken by other states;
- when the violation occurred;
- whether there was a good faith belief the conduct was lawful;
- the amount of franchise fees paid;
- the size of franchisees’ investments;
- whether the franchisor relied on bad legal advice; and
- the number of franchises sold in other states. 133

Other influential factors also listed in that article were the seriousness of the violation, the level
of harm caused and whether fraud was involved. 134

The FTC appears to consider similar factors in deciding what actions to pursue. In 2001,
the United States General Accounting Office issued a report (GAO-01-776) entitled “Franchise
Trade Commission’s Enforcement of the Franchise Rule.” 135 The report stated: “FTC typically
considers a number of factors to determine whether it will open an investigation… On the basis
of these factors, as well as application of its criteria for screening complaints, most complaints
FTC receives are not investigated.” According to FTC staff, the FTC considers the following
factors:

- The type of problem alleged (i.e., is the problem a violation of the FTC rule, or is it
another kind of problem; FTC only pursues the former).

- The level of consumer injury and the number of consumers affected. FTC seeks to
focus on those complaints that will “accomplish the greatest good for the greatest
number of consumers.” Accordingly, as a matter of policy, FTC generally does not
pursue individual consumer complaints or intervene in disputes between individual
franchisees and franchisors. Rather, FTC focuses on those companies that exhibit a
pattern or practice of violations nationwide.

133 Id. at 192.
134 Id. at 192-193.
• **The likelihood of preventing future unlawful conduct.** FTC may also consider the likelihood that any enforcement action will prevent future unlawful conduct. For example, where would-be defendants are out-of-business, enforcement of the law would be futile.

• **The likelihood of securing redress or other relief.** FTC typically considers whether a law enforcement action will result in securing redress or other relief. In this regard, FTC considers the viability of law enforcement action (whether the evidence is sufficient to prove a law violation, including the availability of witnesses, the preservation of documents, and any applicable statute of limitations) the financial status of the business opportunity seller or franchisor, and any potential injury to existing franchisees.

• **Additional law enforcement considerations.** FTC may consider several additional factors, such as whether (1) the problem can be addressed at the state level, (2) individuals can remedy the problem on their own under existing state laws, and (3) there are serious law violations that can result in substantial consumer injury.

According to this same 2001 report (GAO-01-776), the FTC typically considers a number of factors to determine which cases it will pursue through the courts. Some of these criteria are the same factors the FTC uses in deciding to open an investigation, such as whether (1) there is an allegation of a violation of law enforced by the FTC, (2) the alleged violation is within the applicable statute of limitations, and (3) there is a pattern or practice of such problems. If these factors can be established, the FTC can then apply more specific case selection criteria, which include the following:

• **The viability of law enforcement action.** The FTC considers such factors as whether (1) the alleged violations are close to the statute of limitations; (2) witnesses can be located, and if so, how cooperative they will be; and (3) evidence is available and sufficient to demonstrate that a law violation occurred.

• **The viability of a meaningful remedy.** The FTC considers such factors as (1) whether the company has any assets that could be used to compensate those harmed or pay civil penalties and (2) what the deterrent effect on the company would be.

• **Alternatives to federal intervention.** The FTC considers such factors as whether (1) the franchisee(s) can sue under state law and (2) the matter is appropriate for referral to state authorities.

**D. Counsel Clients on Remediation Options**

1. **Self-Reporting and Cooperation with Regulators**

   When a franchisor discovers that it has violated a franchise registration or disclosure law, it may be able to take proactive measures to remediate the violation. If the violation occurred in a Registration State, the franchisor should notify the state franchise agency of the violation in advance of any subsequent filing for registration or renewal. When proposing resolutions of law violations, many agencies will take into account whether the franchisor self-reported the violation in good faith. The agency’s decision of whether to resolve a violation formally or informally, and the amount of any fines or fees the state may impose in connection
with the resolution of the law violation, is often based on the level of cooperation of the franchisor with the agency. Therefore, it is usually a good idea for a franchisor to self-report any violation and cooperate with applicable state franchise agencies to the extent possible.

2. **Notice of Violation and/or Rescission Offers to Franchisees**

When a franchisor has violated the registration requirements of a state franchise law, it should explore any options for sending a “Notice of Violation” to affected franchisees, if available. A Notice of Violation may be coupled with a rescission offer, depending on the Registration State. This should be done in cooperation with the relevant Registration States.

In California, for example, the Notice of Violation is filed with the California DBO for approval. The franchisor then sends the Notice of Violation to affected franchisees to inform them of the law violation. The delivery of a Notice of Violation requires affected franchisees to bring a civil action against the franchisor within 90 days or lose their rights to pursue a civil action for the violation disclosed in the Notice. That is, a franchisee who receives a Notice of Violation must bring any private civil action against the franchisor within 90 days after receipt of the Notice. The Notice of Violation includes specific language as well as a statement discussing the circumstances in which the franchise law violation arose, and the franchisee’s right of action, if any.

A franchisor that sends a Notice of Violation can be required to disclose that fact in Item 3 of the franchisor’s FDD, if the DBO, in its discretion, requires disclosure. In cases where the California examiner determines that a franchise law violation is purposeful, or is not easily remedied by the delivery of a Notice of Violation, the examiner may refer the matter to the Enforcement Division of the DBO for a more formal resolution. The Enforcement Division can still fine a franchisor who files a Notice of Violation, and can require that the franchisor make a formal rescission offer to franchisees, depending on the facts of the case.

In New York, the sending of a Notice of Violation also shortens the statute of limitations for filing an action under the New York Franchise Act to 30 days after of receipt of the Notice, provided it has been approved by the Investment Protection Bureau. Under the New York Franchise Law, a franchisor making an offer to rescind with a Notice of Violation may deduct from the calculation of the rescission offer any income a franchisee may have earned.

The Illinois Notice of Violation form also has the effect of shortening the statute of limitations under the Illinois Franchise Disclosure Law to 30 days after receiving the Notice, coupled with a rescission offer to return consideration paid and repurchase the franchise. Alternatively the franchisor has the option in Illinois to issue a Notice of Violation with no rescission offer, but that Notice reduces the statute of limitations under the Illinois Act to 90 days.

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136 [CAL. CORP. CODE §§31303, 31304.](#)

137 [Id.](#)

138 [N.Y. GEN. BUS. LAW § 691(2).](#)

139 [Id.](#)

140 815 ILL. COMP. STAT. 705/26.
after receiving the Notice. Unlike California and New York, a Notice of Violation sent under the Illinois Franchise Disclosure Law need not be pre-approved by the Illinois Attorney General’s Office.

Other Registration States do not have a formal mechanism for filing a Notice of Violation. In Maryland, for example, franchise registration violations are typically resolved through the entry of a formal Consent Order, coupled with a required form of rescission offer that does not have the effect of shortening the time a franchisee has to bring an action under the Maryland Franchise Law. The form of rescission offer used most frequently in Maryland requires a franchisor to return the initial franchise fees, with no deduction for any income a franchisee may have earned during the term of the franchise.

If a franchise is sold prior to registration, the franchisor faces potential rescission claims involving the return of large sums and damages. Therefore, a preemptive strategy may be preferable to continuation of the franchise relationship.

3. Remediation Prior to Sale

If a franchisor discovers a violation before the franchise is sold, the franchisor could register the offer or amend the disclosure document and provide the new disclosure document to the prospective franchisee before it makes a binding commitment. A franchisor in the same situation could also refuse to sell the franchise to the prospective franchisee, thereby eliminating any standing for the franchisee to pursue remedies under the registration and disclosure laws.

4. Remediation Under the FTC Franchise Rule

The FTC Franchise Rule does not expressly provide for any remediation options (such as rescission offers). When the FTC brings law enforcement actions in federal court, it can seek injunctive relief, return of deposits or fees paid for a franchise, modifications of contracts civil penalties, or other remedies. The actions are often settled.

E. Counsel Clients to Avoid Future Violations

After assessing the scope of the violation, the resulting potential liability, and the remediation options, the lawyer should offer to advise the client on how to ensure future compliance so that the violation is not repeated.

To avoid repeat offenses, the client may need to make significant changes in its franchise compliance policies and practices, and address the role and culpability of particular individuals. The client must appropriately train its franchise sales personnel about the legal requirements and must impose and enforce clear internal policies and procedures, with consequences for noncompliance.

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141 815 ILL. COMP. STAT. 705/27.

142 See, e.g., http://www.oag.state.md.us/Securities/Actions/index.htm (last visited August 17, 2014) (for list of franchise enforcement orders).
If counsel encounters franchisors who assign a low priority to compliance or who deliberately brush aside franchise law requirements when they impede sales, lawyers should encourage compliance by reminding them that they as individuals could face personal liability under state franchise laws and that violations can be criminal, with incarceration and fines. Counsel should be careful not to become complicit in client noncompliance because liability may result from the lawyer’s role, in theory at least. For example, one California court held that a lawyer who drafted a deficient disclosure document could be liable to the franchisees who purchased franchises in reliance on the disclosure document. Finally, when appropriate and possible, lawyers may counsel their clients on options for how to structure the relationship to fall outside the franchise laws.

V. CONCLUSION

Because of the nature of federalism and state-specific regulation of franchises, there are no simple solutions to registration and disclosure violations that span multiple states. Nonetheless, the best practice is to cooperate with the various state regulators and provide offers of rescission to the affected franchisees.

### Appendix A – Table of Civil Remedies

<table>
<thead>
<tr>
<th>State</th>
<th>Rescission Available</th>
<th>Damages, Other Relief</th>
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<tr>
<td>CA</td>
<td>Yes, for willful violations of §§ 31101 (large franchisee exemption), 31110 (registration), 31119 (disclosure document delivery), 31200 and 31202 (false, misleading filings and written disclosures) unless for violation of 31200 or 31202 the plaintiff knew about the untruth or the defendant with reasonable care would not have known of the violation.</td>
<td>Recovery of damages caused by violation unless claim is for a false or misleading statement and defendant can prove plaintiff knew facts or defendant, exercising reasonable care, was not aware of untruth or omission.</td>
<td>Liability for persons committing violation, persons who directly or indirectly control a person who is liable, all partners &amp; principal officers of firms that are liable, and employees who materially aid in transaction unless that other person had no reasonable grounds to believe that the violation existed.</td>
<td>Depending on statute violated, earlier of either 4 or 2 years after the violation or 1 year from discovery of facts or (for specified violations) 90 days after delivery of written notice to franchisee disclosing the violation.</td>
<td>Requires delivery of notice of violation approved by Dept. of Corp. and delivery of franchise disclosure document. Applies only to certain violations. Notice does not require inclusion of offer to rescind.</td>
</tr>
<tr>
<td>HI</td>
<td>Yes, for any violation of franchise act unless claim is for false, misleading statements or fraudulent practice and defendant proves plaintiff knew or should have known the facts or defendant exercised reasonable care and did not know of the falsity.</td>
<td>Recovery of actual damages, plus costs, attorneys' fees, and in court's discretion, treble damages.</td>
<td>Any &quot;person&quot; who offers or sells a franchise in violation is liable. Includes entities that effectively control other entities as well as individuals in control of activities of those entities.</td>
<td>Five years after date of violation or 2 years after discovery of facts (but not later than 7 years after violation).</td>
<td>No provision, but notification would commence running of SOL.</td>
</tr>
</tbody>
</table>

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144 This Exhibit A (Table of Civil Remedies) is an updated version of Exhibit A from Martin Cordell, Joseph Punturo & Mary Beth Trice, *A Basic Guide to Handling Disclosure and Registration Violations*, American Bar Association 30th Annual Forum on Franchising (2007).

145 CAL. CORP. CODE § 31300.

146 CAL. CORP. CODE §§ 31300, 31301.

147 CAL. CORP. CODE § 31302.

148 CAL. CORP. CODE §§ 31303, 31304.

149 But the 1 year discovery period is measured from the time plaintiff was aware of the act or transaction that violated the law, not from the time plaintiff discovered the act or transaction was unlawful. See People ex rel. Dept. of Corps. v. SpeeDee Oil Change Sys., Inc., 116 Cal. Rptr. 2d 497 (Cal. Ct. App. 2002).

150 A notice of violation must be accompanied by delivery of a franchise disclosure document. CAL. CODE REGS. Tit. 8, § 310.303, 310.304 (2014). Applies only to specified violations per Cal. Corp. Code §§ 31202 and 31304, including failure to register offer and making false, misleading statement in a filing with state or in a franchise sale, but apparently not if violation is the failure to deliver the franchise disclosure document as prescribed by Cal. Corp. Code § 31119.

151 HAW. REV. STAT. § 482-E-9(b).

152 HAW. REV. STAT. § 482-E-9(b), (c).

153 HAW. REV. STAT. § 482-E-9(b).

154 HAW. REV. STAT. § 482-E-2.

155 HAW. REV. STAT. § 482-E-10.5(b).
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<tr>
<td>IL</td>
<td>Yes, for violation of Section 5 (sale of unregistered franchise, failure to deliver disclosure statement, sale by unregistered franchise broker or filing of untrue report), 6 (fraud), 10 (failure to register), 11 (failure to amend for material change) or 15 (failure to escrow or impound fees required by the Administrator) of the Act unless franchisee fails within 30 days to accept an offer to return the consideration paid or to repurchase the franchise. 156</td>
<td>Recovery of damages caused by a violation, together with costs and reasonable attorney's fees. 157</td>
<td>Any person or principal executive officer or director of a corporation in violation is liable and any employee who materially aids in the violation is liable. 158</td>
<td>Earlier of 3 years after occurrence, 1 year after discovery, or 90 days after written disclosure to franchisee. 159</td>
<td>Not required, but written notification disclosing the violation would shorten the SOL. No suit for rescission if franchisee fails within 30 days to accept an offer to return the consideration paid or to repurchase the franchise. 160</td>
</tr>
<tr>
<td>IN</td>
<td>The commissioner may enter an order of rescission after notice and an opportunity for hearing. 161</td>
<td>Recovery of consequential damages plus 8% interest and reasonable attorney's fees. No recovery if the defendant proves that the plaintiff knew of the violation or the defendant, using reasonable care, would not have known of the violation. 162</td>
<td>Any person who materially aids or abets an act in violation unless that person had no reason to know of the violation. 163</td>
<td>3 years after discovery of facts constituting the violation. 164</td>
<td>No provision, but notification would commence running of SOL.</td>
</tr>
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156 815 ILL. COMP. STAT. 705/26.  
157 Id.  
158 Id.  
159 815 ILL. COMP. STAT. 705/27.  
160 815 ILL. COMP. STAT. 705/26.  
161 IND. CODE § 23-2-2.5-34.  
163 IND. CODE § 23-2-2.5-29.  
164 IND. CODE § 23-2-2.5-30.
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<td>MD</td>
<td>Yes, rescission and restitution to the franchisee is available for failure to register or sale by means of an untruth or omission of a material fact unknown to the franchisee.(^{165})</td>
<td>Recovery of damages sustained by the grant of a franchise.(^{166})</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or with similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable grounds to know of the facts that constitute the liability.(^{167})</td>
<td>3 years after the grant of the franchise.(^{168})</td>
<td>None specified.</td>
</tr>
<tr>
<td>MI</td>
<td>Yes, for violation of § 1505 (fraud or false statement of material fact) or § 1508 (disclosure statement).(^{169})</td>
<td>As an alternative to rescission, recovery of damages for violation of §§ 1505 or 1508, plus interest at 12% from the date of purchase (6% prior to June 20, 1984), plus reasonable attorney’s fees and costs.(^{170}) Damages are also available for noncompliance with section 1507a (annual filing of notice and fee with department).(^{171})</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or with similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable grounds to know of the facts that constitute the liability.(^{172})</td>
<td>4 years after occurrence of the act constituting the violation.(^{173})</td>
<td>Not required but suit may not be maintained if franchisee received a written offer of rescission and restitution with interest at 1 percentage point higher than the recoverable rate of 12% and the franchisee failed to accept the offer or did not own the franchise and failed to reject the offer in writing within 30 days of receipt.(^{174})</td>
</tr>
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\(^{165}\) MD. CODE ANN., BUS. REG. § 14-227(a), (c).
\(^{166}\) MD. CODE ANN., BUS. REG. § 14-227(b).
\(^{167}\) MD. CODE ANN., BUS. REG. § 14-227(d).
\(^{168}\) MD. CODE ANN., BUS. REG. § 14-227(e).
\(^{169}\) MD. CODE ANN., BUS. REG. § 14-227(e).
\(^{171}\) Id.
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<td>MN</td>
<td>Yes, for any violation of the Franchise Act. ¹⁷⁵</td>
<td>Recovery of damages available. ¹⁷⁶ Actual damages sustained, plus costs, disbursements and reasonable attorney’s fees are recoverable. ¹⁷⁷</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or with similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable grounds to know of the facts that constitute the liability. ¹⁷⁸</td>
<td>3 years after the cause of action accrues. ¹⁷⁹</td>
<td>None specified.</td>
</tr>
<tr>
<td>ND</td>
<td>Yes, for violation of any provision of the chapter or order of the commissioner. ¹⁸⁰</td>
<td>Recovery of damages, costs and disbursements, reasonable attorney’s fees. ¹⁸¹</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or with similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable grounds to know of the facts that constitute the liability. ¹⁸²</td>
<td>5 years from the date the victim knew or reasonably should have known about the violation, except for actions under §§ 51-19-09 (commissioner’s stop order) and 51-19-11 (fraud). ¹⁸³</td>
<td>Suit cannot be maintained if the franchisee received a written offer before the action commenced to refund consideration, less income from the franchise, with interest at 7% and failed to either accept the offer, or did not own the franchise and failed to reject the offer, in writing within 30 days. ¹⁸⁴</td>
</tr>
</tbody>
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¹⁷⁵ MINN. STAT. § 80C.17, subd. 1.
¹⁷⁶ MINN. STAT. § 80C.17, subd. 1.
¹⁷⁷ MINN. STAT. § 80C.17, subd. 3.
¹⁷⁸ MINN. STAT. § 80C.17, subd. 2.
¹⁷⁹ MINN. STAT. § 80C.17, subd. 5.
²⁰ N.D. CENT. CODE § 51-19-12(1).
¹⁸¹ N.D. CENT. CODE § 51-19-12.
¹⁸² N.D. CENT. CODE § 51-19-12(2).
¹⁸³ N.D. CENT. CODE § 51-19-12(5).
¹⁸⁴ N.D. CENT. CODE § 51-19-12(4).
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<td>NY</td>
<td>Yes, for willful and material violations of sections 683 (disclosure requirements), 684 (exemptions) and 687 (fraud).&lt;sup&gt;185&lt;/sup&gt;</td>
<td>Damages are available for violation of sections 683, 684 and 687, plus interest at 6% per year from the date of purchase, and reasonable attorney's fees and court costs.&lt;sup&gt;186&lt;/sup&gt;</td>
<td>Any person controlling a person liable; partners; principal executive officers or directors of corporations; people performing similar jobs or similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable ground to know of the liability.&lt;sup&gt;187&lt;/sup&gt;</td>
<td>3 years after occurrence of the act constituting the violation.&lt;sup&gt;188&lt;/sup&gt;</td>
<td>Suit cannot be maintained if the franchisee received a written offer to refund consideration, less income from the franchise, with interest at 6% and failed to either accept the offer, or did not own the franchise and failed to reject the offer, in writing within 30 days.&lt;sup&gt;189&lt;/sup&gt;</td>
</tr>
<tr>
<td>OR</td>
<td>Yes, for fraud.&lt;sup&gt;190&lt;/sup&gt;</td>
<td>A franchisee can recover the amounts it would be entitled to for rescission. Except for class actions, the court may award reasonable attorney's fees.&lt;sup&gt;191&lt;/sup&gt;</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable ground to know of the liability.&lt;sup&gt;192&lt;/sup&gt;</td>
<td>3 years from the date of sale.&lt;sup&gt;193&lt;/sup&gt;</td>
<td>None specified.</td>
</tr>
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</table>

<sup>185</sup> N.Y. Gen. Bus. Law § 691(1).
<sup>186</sup> N.Y. Gen. Bus. Law § 691(1).
<sup>189</sup> N.Y. Gen. Bus. Law § 691(2).
<sup>190</sup> Or. Rev. Stat. §§ 650.020(1) and (3).
<sup>192</sup> Or. Rev. Stat. § 650.020(5).
<sup>193</sup> Or. Rev. Stat. § 650.020(6).
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<tr>
<td>RI</td>
<td>Yes, for violations of sections 19-28.1-5 (failure to register), 19-28.1-8 (failure to deliver disclosure document) and 19-28.1-17(1)-(5) (fraud) of the Act, so long as the franchisee did not know the facts concerning the violation.</td>
</tr>
<tr>
<td>SD</td>
<td>Yes, for violation of 37-5B-4 (notice filing), 37-5B-7 (updating disclosure documents), 37-5B-8 (start-up financial statements) 37-5B-9 (phase-in of financial statements), and 37-5B-17 (delivery of disclosure document).</td>
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</tbody>
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<thead>
<tr>
<th>Damages, Other Relief</th>
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<tbody>
<tr>
<td>Costs, damages, and attorney’s and expert’s fees.</td>
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<tr>
<td>Actual damages, costs, and attorneys and experts fees for violation of 37-5B-4, 37-5B-7, 37-5B-8, 37-5B-9, and 37-5B-17. The court has discretion to grant up to treble damages.</td>
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<tr>
<th>Personal Liability</th>
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<tbody>
<tr>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable ground to know of the liability.</td>
</tr>
<tr>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable ground to know of the liability.</td>
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<tr>
<th>Statutes of Limitation</th>
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<tbody>
<tr>
<td>The earlier of 4 years after the violation or 90 days after receipt of a rescission offer in a form approved by the director.</td>
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<tr>
<td>For rescission - 1 year after the violation occurred; for damages, costs, and attorneys and experts fees - the earlier of 2 years after discovery of the violation or 3 years after the violation; if franchisee receives rescission offer in form - within 90 days.</td>
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<tr>
<th>Statutory Rescission Offer/Notice of Violation</th>
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<tbody>
<tr>
<td>A rescission offer made to a franchisee must be in a form approved by the director, but will shorten the SOL period.</td>
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<td>A rescission offer made to a franchisee must be in a form approved by the director, but will shorten the SOL period.</td>
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195 Id.
198 Id.
199 S.D. CODIFIED LAWS § 37-5B-49.
200 Id.
201 Id.
202 S.D. CODIFIED LAWS § 37-5B-50.
203 Id.
<table>
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<tr>
<th>State</th>
<th>Rescission Available</th>
<th>Damages, Other Relief</th>
<th>Personal Liability</th>
<th>Statutes of Limitation</th>
<th>Statutory Rescission Offer/Notice of Violation</th>
</tr>
</thead>
<tbody>
<tr>
<td>VA</td>
<td>The franchisee may declare the agreement void by sending a written declaration of the facts and reasons therefor to the franchisor within the statutory period of time. 204</td>
<td>Damages are available to any franchisee who has declared the franchise agreement void pursuant to section 13.1-565 or who has suffered damages for violation of section 13.1-564, 205 plus reasonable attorney’s fees and costs. 206</td>
<td>None specified.</td>
<td>4 years from accrual of cause of action. 207</td>
<td>None specified.</td>
</tr>
<tr>
<td>WA</td>
<td>Yes, for violation of the franchise law, except for violation of RCW 19.100.170 (fraud) where the franchisor proves that the franchisee knew of the facts concerning the untruth or omission or the franchisor with reasonable care would not have known of the untruth or omission. 208</td>
<td>Actual damages caused by violation of franchise law, and, in the court’s discretion, treble damages, reasonable attorney’s fees and costs. 209</td>
<td>Any liable person may recover contributions from any other person who would have been liable for the same judgment. 210</td>
<td>Washington’s “catch-all” 2 year statute applies and it runs from the date of the act, not discovery. 211 Limitations of action is tolled by the pendency of any other actions until one year after final judgment in the government action. 212</td>
<td>None specified.</td>
</tr>
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204 VA Code Ann. § 13.1-565. Franchisee may declare a franchise agreement void if: (1) offer to grant a franchise was invalid pursuant to Virginia Code section 13.1-560 (failure to register) or Virginia Code section 13.1-563 (fraud); (2) The franchisee was not afforded the opportunity to negotiate with the franchisor on all provisions within the franchise; (3) the franchisee was not furnished a copy of the franchise agreement and disclosure documents at least 72 hours prior to the execution of the franchise.

205 VA Code Ann. § 13.1-571. Section 13.1-564 deals with unlawful cancellation of a franchise or use of undue influence to coerce a franchisee to surrender a right granted by the franchise agreement.


207 VA Code Ann. § 13.1-571. Within 72 hours of discovery but not more than 90 days after execution for rescission under 13.1-560 or 13.1-563. VA Code Ann. § 13.5-565. 30 days for rescission because franchisee not afforded opportunity to negotiate all provisions within franchise. Id. 30 days for rescission because franchisee was not furnished a copy of the franchise agreement and disclosure documents at least 72 hours prior to execution. Id.


209 Id.

210 Id.


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<tr>
<th>State</th>
<th>Rescission Available</th>
<th>Damages, Other Relief</th>
<th>Personal Liability</th>
<th>Statutes of Limitation</th>
<th>Statutory Rescission Offer/Notice of Violation</th>
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<tr>
<td>WI</td>
<td>Yes, for violation of section 553.27(4) (providing the disclosure document) where the violation was material in the franchisee's decision to purchase the franchise.(^\text{213})</td>
<td>Damages are available for violation of sections 553.41(3), (4) or (5) if the franchisee did not know or have reason to know of the untruth or omission and relied on it, except where the franchisor proves that the franchisee did know or that the franchisor could not have known with reasonable care.(^\text{214})</td>
<td>Any person controlling a person liable; partners; principal officers or directors of corporations; people performing similar jobs or similar status; employees, if they materially aid in the act or transaction; except for those who did not know or have reasonable ground to know of the liability.(^\text{215})</td>
<td>The earlier of 3 years from the date of occurrence or 90 days after written disclosure from the franchisor.(^\text{216})</td>
<td>Not required, but a written notice disclosing the violation that is filed with the division would shorten the SOL.(^\text{217})</td>
</tr>
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</table>

\(^{213}\) **Wis. Stat.** § 553.51(1).  
^{214} **Wis. Stat.** § 553.51(2).  
^{215} **Wis. Stat.** § 553.51(3).  
^{216} **Wis. Stat.** § 553.51(4).  
^{217} *Id.*
## Appendix B – Table of Enforcement Powers

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<th>Jurisdiction</th>
<th>Denial, Suspension, Revocation of Registration</th>
<th>Investigatory Powers, Hearings</th>
<th>Civil Actions, Criminal Prosecutions</th>
<th>Fines, Penalties</th>
<th>Restitution for Injured Parties</th>
<th>Prison</th>
</tr>
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<tbody>
<tr>
<td>CA</td>
<td>The commissioner may issue a stop order denying effectiveness of registration for violation of act, if offer or sale would constitute misrepresentation to or fraud of the purchasers, and other listed reasons.</td>
<td>The commissioner has discretionary powers to make both public and private investigations; and may subpoena witnesses and information and administer oaths as required. There will be a hearing within 15 business days after a written request is made so long as that hearing is filed within 60 days of the date of service of the cease and desist order.</td>
<td>The commissioner may bring a civil action or request that the attorney general bring a civil action to enjoin the conduct violating the act and to appoint a receiver or conservator of the defendant and its assets. Willful violations are punishable by criminal conviction.</td>
<td>A civil penalty up to $10,000 for each violation may be assessed if an action is brought within 4 years of the wrongful conduct. A citation issued as an administrative remedy has a penalty up to $2,500. In an administrative action, the commissioner may recover costs, reasonable attorney's fees and investigative expenses. For criminal conduct, penalties up to $100,000 are recoverable in addition to imprisonment.</td>
<td>Yes, for restitution or disgorgement of damages if the commissioner determines it is in the public interest.</td>
<td>Yes, for willful violations of the act or fraud, prison time of no more than one year in either a state prison or a county jail is permissible unless the person proves no knowledge of the rule or order.</td>
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219 [CAL. CORP. CODE § 31115](http://www.courts.ca.gov/codes.html).

220 [CAL. CORP. CODE §§ 31401(a)-(b), 31402, 31407.](http://www.courts.ca.gov/codes.html)

221 [CAL. CORP. CODE §§ 31402, 31406.](http://www.courts.ca.gov/codes.html)

222 [CAL. CORP. CODE § 31400(a).](http://www.courts.ca.gov/codes.html)

223 [CAL. CORP. CODE §§ 31410, 31411.](http://www.courts.ca.gov/codes.html)

224 [CAL. CORP. CODE §§ 31405, 31406, 31408(b), 31410, 31411.](http://www.courts.ca.gov/codes.html)

225 [CAL. CORP. CODE §§ 31400(b), 31408(a).](http://www.courts.ca.gov/codes.html)

226 [CAL. CORP. CODE §§ 31410, 31411.](http://www.courts.ca.gov/codes.html)
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<tr>
<td>HI</td>
<td>The director may issue a stop order prohibiting sale of a franchise upon finding that such an order serves the public interest and the disclosure document is materially deficient, risk of fraud or other listed reasons.</td>
<td>Investigatory powers not specified. There is a hearing within fifteen business days of a written request for a hearing on a cease and desist order.</td>
<td>Yes, whenever it appears to the director that there has been or is about to be an act or practice constituting a violation. The order may specify whether existing executory contracts entered into by the respondent will be completed or suspended.</td>
<td>The director may bring a civil action to recover a penalty for violation of the act. The director may obtain a temporary or permanent injunction and have a receiver appointed.</td>
<td>A civil penalty of not more than $100,000 is recoverable for violations. In a criminal action, a person who violates the act shall forfeit to the State all interest or property acquired or maintained in connection with the violation. Class B felony if total value lost by victim is greater than or equal to 5,000 and Class C felony if total value lost by victim is less than $5,000.</td>
<td>The State shall dispose of forfeited property or other interest as soon as feasible making due provision for the rights of innocent persons.</td>
<td>A person convicted of a felony pursuant to the act is subject to a mandatory minimum sentence of one year without the possibility of parole.</td>
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227 HAW. REV. STAT. § 482E-8(a).
228 HAW. REV. STAT. § 482E-10.7(b).
229 HAW. REV. STAT. § 482E-10.7(a).
230 HAW. REV. STAT. § 482E-10.5.
231 HAW. REV. STAT. § 483E-10.7(e).
232 HAW. REV. STAT. § 482E-10.5(a).
233 HAW. REV. STAT. § 482E-10.6(a)-(b).
234 HAW. REV. STAT. § 482E-10.6(a).
235 HAW. REV. STAT. § 482E-10.6(d).
236 HAW. REV. STAT. § 482E-10.6(e).
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<tr>
<td>IL</td>
<td>The Administrator may suspend, terminate, prohibit or deny the sale or a franchise or registration upon a finding of violation, risk of fraud, or materially deficient disclosure statement. 237</td>
<td>The Administrator has discretionary powers to make both public and private investigations; and may subpoena witnesses and information and administer oaths as required. Failure to obey subpoenas is punishable by contempt. 238 Upon written request, there will be a hearing regarding the suspension or termination of a franchise within 10 days of receipt by Administrator. 239</td>
<td>The Administrator may issue an order stopping or denying the sale or registration if such order is within the public interest and if prompt written notice is given to the person or entity affected. 240</td>
<td>The Administrator may bring a civil action to prevent and restrain violations of the act and may seek injunction, revocation, forfeiture or suspension of the privileges of the business entity, dissolution of domestic corporations or associations, restitution or damages to the injured parties and reasonable attorney's fees and costs. 241 The Administrator may also commence criminal prosecutions. 242</td>
<td>A willful violation of the act constitutes a class 2 felony and is subject to punishment for that class of crime. 243 Administrator may bring a civil action to recover up to $50,000 per violation. 244</td>
<td>Yes, restitution or other damages for injured parties are recoverable. 245</td>
<td>Willful violation is a class 2 felony. 246</td>
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237 815 ILL. COMP. STAT. 705/22(a).  
238 815 ILL. COMP. STAT. 705/31.  
239 815 ILL. COMP. STAT. 705/23.  
240 Id.  
241 815 ILL. COMP. STAT. 705/22(b).  
242 815 ILL. COMP. STAT. 705/25.  
243 Id.  
244 815 ILL. COMP. STAT. 705/24.  
245 815 ILL. COMP. STAT. 705/22(b).  
246 815 ILL. COMP. STAT. 705/25.
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<tr>
<td>IN</td>
<td>The commissioner may issue a stop order without a hearing upon a finding of violation, risk of fraud or harm to prospective franchisees.(^{247})</td>
<td>The commissioner has discretionary powers to make both public and private investigations and may subpoena witnesses and information and administer oaths as required.(^{248}) Upon written request, there will be a hearing regarding the stop order within 15 days and regarding a cease and desist or other order within 45 days.</td>
<td>The commissioner may issue cease and desist orders for violations of registration or exemption provisions.(^{251})</td>
<td>The commissioner has discretion to bring a civil action seeking preliminary or permanent injunction, declaratory judgment, restraining order, appointment of a receiver, or other relief.(^{252})</td>
<td>Commissioner may impose a civil penalty in an amount not greater than $10,000 for each violation.(^{253})</td>
<td>Restitution by commissioner against a person who has violated this chapter.(^{254})</td>
<td>Willful violation is a Level 5 felony.(^{255})</td>
</tr>
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\(^ {247}\) IND. CODE § 23-2-2.5-14.
\(^ {248}\) IND. CODE § 23-2-2.5-33.
\(^ {249}\) IND. CODE § 23-2-2.5-15.
\(^ {250}\) IND. CODE § 23-2-2.5-34.
\(^ {251}\) IND. CODE §§ 23-2-2.5-34, 35.
\(^ {252}\) IND. CODE § 23-2-2.5-32.
\(^ {253}\) IND. CODE § 32-2-2.5-34.
\(^ {254}\) Id.
\(^ {255}\) IND. CODE § 23-2-2.5-37.
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<td>MD</td>
<td>The Commissioner may summarily issue a stop order to deny, suspend, or revoke a registration upon a finding of violation or risk of fraud or misrepresentation to prospective franchisees.</td>
<td>The Commissioner may investigate violations and may require or allow a person to submit written statements under oath. In conjunction with an investigation the Commissioner may subpoena witnesses and information and administer oaths.</td>
<td>The Commissioner may issue cease and desist orders whenever it finds a violation or threatened violation.</td>
<td>The Commissioner may bring a civil action to enjoin any violation or to enforce compliance with the act. The Commissioner may also refer the alleged violation to the state’s attorney for criminal proceedings.</td>
<td>In addition to injunctive relief a court may revoke charter authority or privileges of a business organization under the laws of Maryland, dissolve a corporation, award damages to any injured person, and appoint a receiver. For certain willful violations, there may also be up to a $10,000 fine for each violation.</td>
<td>Yes, restitution is among the remedies available to a court in an action brought by the Commissioner for a violation.</td>
<td>For certain willful violations, subject to imprisonment up to 5 years in addition to or instead of fine.</td>
</tr>
<tr>
<td>MI</td>
<td>None specified.</td>
<td>The department has discretionary powers to make both public and private investigations and may subpoena witnesses and information and administer oaths as required.</td>
<td>Unless the court waives the requirement, the department must offer the alleged violator an opportunity to cease and desist before bringing a civil action.</td>
<td>The department may bring a civil action to enjoin conduct, obtain restitution or enforce compliance with the act.</td>
<td>A violator may be fined up to $10,000.</td>
<td>Yes, the department’s civil action may include a claim for restitution.</td>
<td>Either as an alternative to or in addition to criminal fines, violation is punishable by up to 7 years in prison.</td>
</tr>
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</table>

256 MD. CODE ANN., BUS. REG. § 14-221.  
257 MD. CODE ANN., BUS. REG. § 14-208.  
258 MD. CODE ANN., BUS. REG. § 14-212.  
259 MD. CODE ANN., BUS. REG. § 14-210(a).  
260 MD. CODE ANN., BUS. REG. § 14-210(b).  
261 MD. CODE ANN., BUS. REG. § 14-211.  
262 MD. CODE ANN., BUS. REG. § 14-210(b).  
263 MD. CODE ANN., BUS. REG. §§ 14-228, 229, 230.  
264 MD. CODE ANN., BUS. REG. § 14-210(b).  
265 MD. CODE ANN., BUS. REG. §§ 14-228, 229, 230.  
266 MICH. COMP. LAWS § 445.1536.  
267 MICH. COMP. LAWS § 445.1535(2).  
268 MICH. COMP. LAWS § 445.1535(1).
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<tr>
<td>MN</td>
<td>The commissioner may issue orders denying, suspending or revoking any registration, amendment or exemption without prior notice or hearing upon a finding of violation of the act or any rule or order of the commissioner, risk of fraud or misrepresentation, or other risks to prospective franchisees. 272</td>
<td>The commissioner may issue cease and desist orders without prior notice or hearing upon a finding of violation of the act or any rule or order of the commissioner, risk of fraud, or other risks to prospective franchisees. 273</td>
<td>Authorized fines may be imposed in civil action brought by attorney general. 274</td>
<td>Each violation of the provisions regarding registration, disclosure, advertisement, and unfair practices is punishable by a fine of not more than $2,000. Failure to comply with a final judgment or court order regarding any part of the act is punishable by a fine of up to $25,000. Wilful violations of the act, as well as schemes to defraud, are punishable by a fine of up to $10,000. 275</td>
<td>None specified.</td>
<td>Yes, willful violation of the act or scheme to defraud is punishable by up to 5 years in prison, either as an alternative to or in addition to a fine. 276</td>
</tr>
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272 Minn. Stat. § 80C.12, subd. 1.
273 Minn. Stat. § 80C.12, subd. 1.
274 Minn. Stat. § 80C.16, subd. 2.
275 Minn. Stat. §§ 80C.16, subd. 2, subd. 3.
276 Minn. Stat. § 80C.16, subd. 3.
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<tr>
<td>ND</td>
<td>The commissioner may issue a stop order denying effectiveness of the registration or postponing, suspending or revoking its effectiveness pending a final determination if the commissioner finds that there has been any failure to comply with the act or the risk of fraud or misrepresentation to the purchaser.</td>
<td>The commissioner has discretionary powers to make both public and private investigations and may subpoena witnesses and information and administer oaths as required. There will be a hearing related to the stop order within 15 days of a written request.</td>
<td>Cease and desist orders may be issued if a person fails to reply to commissioner's letter with all required information within fifteen days of receipt. The commissioner can also order a franchisor to desist from offering a franchise without registration. There are also provisions for denial and suspension of registration as well as for injunctive relief.</td>
<td>The commissioner may bring a civil action to enjoin acts, to enforce compliance, or to obtain a preliminary or permanent injunction, restraining order, or writ of mandamus and appointment of a receiver. The commissioner may also refer evidence to a criminal prosecutor to institute criminal proceedings.</td>
<td>The commissioner may assess administrative penalties up to $10,000 for failure to register or for failure to comply with exemption requirements.</td>
<td>None specified.</td>
<td>Willful violation of the chapter or willful employment of a scheme to defraud is a class B felony.</td>
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</tbody>
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277 N.D. CENT. CODE § 51-19-09.  
279 N.D. CENT. CODE § 51-19-09.  
280 Id.  
282 N.D. CENT. CODE § 51-19-09.  
284 Id.  
285 Id.  
286 Id.  
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<tr>
<td>NY</td>
<td>None specified short of Department bringing civil action under §689(1)</td>
<td>The department may make investigations, require written statements to be filed, subpoena witnesses and information, and administer oaths as required. Failure to obey a subpoena issued by the department is a class A misdemeanor.</td>
<td>None specified short of Department bringing civil action under §689(1)</td>
<td>The department may bring a civil action to enjoin unlawful, fraudulent conduct. In such civil actions, the court may appoint a receiver. Any willful violation of the act is a class A misdemeanor, punishable by a fine of up to $1,000, or up to one year of prison time, or both. Yes, the department may seek restitution for fraudulent practices as defined by the article. The court may also determine that right or title to property in possession of the defendant belongs to an injured party “by due process.”</td>
<td>Yes, willful violation of the act for failure to obey the department’s subpoena may be punished by up to one year of prison.</td>
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288 N.Y. GEN. BUS. LAW § 688.
289 N.Y. GEN. BUS. LAW §§ 689(1), 689(4).
290 N.Y. GEN. BUS. LAW § 692(1).
291 N.Y. GEN. BUS. LAW § 690.
292 N.Y. GEN. BUS. LAW § 692(2).
293 N.Y. GEN. BUS. LAW § 689(4).
294 N.Y. GEN. BUS. LAW § 690.
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<td>OR</td>
<td>None specified.</td>
<td>The Director of the Department of Consumer and Business Services may make investigations, require written statements to be filed, subpoena witnesses and information, and administer oaths as required.</td>
<td>None specified other than for injunctive relief.</td>
<td>The director may bring a civil action to enjoin acts or practices in violation of the act, and may obtain appointment of a receiver.</td>
<td>The director may recover reasonable attorneys' fees for a civil action. A defendant who prevails and establishes that the director had no objectively reasonable basis for the claim or an appeal of an adverse decision may also recover reasonable attorney's fees.</td>
<td>Yes, in any action to enjoin acts or practices, the director may seek rescission and &quot;appropriate relief&quot; to the injured parties.</td>
<td>No explicit mention, but the act does not affect other civil or criminal remedies.</td>
</tr>
<tr>
<td>RI</td>
<td>Yes, the director may deny, suspend or revoke registration upon a finding of a failure to comply with the act, a risk of fraud or other wrongdoing.</td>
<td>The director may make both public and private investigations, require the production of relevant documents, subpoena witnesses and information, and administer oaths as required. Disobedience of a subpoena issued by the director is punishable by contempt. Defendant may make written request for hearing within 30 days after director issues order.</td>
<td>The director may issue a cease and desist order when there is evidence of a violation or threatened violation.</td>
<td>The director may bring a civil action to enjoin violation of the act. In addition to injunctive relief, the court may also appoint a receiver.</td>
<td>The director may recover a penalty of up to $50,000 per violation of the act. An administrative assessment of up to $5,000 for each violation of any stop order issued by the department is also recoverable. The director may also recover reasonable attorney's fees, costs, and expert expenses if it prevails.</td>
<td>None specified, although the court can grant &quot;appropriate ancillary relief&quot; in any civil action brought by the director.</td>
<td>Willful violation is a felony punishable by law.</td>
</tr>
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295 OR. REV. STAT. §§ 650.055, 650.060.
296 OR. REV. STAT. § 650.065(1).
297 Id.
298 OR. REV. STAT. § 650.065(1).
299 OR. REV. STAT. § 650.065(2).
300 OR. REV. STAT. § 650.085.
301 R.I. GEN. LAWS §§ 19-28.1-18(a), 1-25(c).
303 R.I. GEN. LAWS § 19.28.1-18(c)(1).
304 R.I. GEN. LAWS § 19.28.1-18(c)(2).
305 R.I. GEN. LAWS § 19.28.1-18(c)(3).
308 R.I. GEN. LAWS § 19.28.1-18(c)(2).
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<tr>
<td>SD</td>
<td>Yes, the director may deny, suspend or revoke registration upon a finding of a violation or risk of harm. 310</td>
<td>The director may make both public and private investigations, require the production of relevant documents and other tangible things, subpoena witnesses and information, and administer oaths as required. Disobedience of a subpoena issued by the director is punishable by contempt.311</td>
<td>The director may issue a cease and desist order when there is evidence of a violation or threatened violation.312</td>
<td>The director may bring a civil action pursuant to § 37-5B-49 if he or she has reasonable cause to believe a violation has happened or is about to happen.313</td>
<td>A civil penalty of up to $5,000 for each violation of any stop order issued by the department is also recoverable. 314</td>
<td>None specified, but other relief may be awarded as the court deems appropriate. 315</td>
<td>Fraudulent conduct in connection with the offer or sale of a franchise can be either a Class 4 or a Class 6 felony. 316</td>
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<td>VA</td>
<td>The Commission has the power to revoke the effectiveness of a Registration if it finds that such an order is in the public interest or there is evidence of violation or other misconduct.317</td>
<td>The Commission has discretionary powers to make public or private investigations, and any franchisor found guilty of a violation may have to pay the cost of the investigation.318</td>
<td>The Commission has the power of court to enjoin any violation, and power to enforce through contempt proceedings.320</td>
<td>The Commission does not need to commence a civil action, and may instead hold a hearing on 30 days' notice regarding a violation.321</td>
<td>The Commission may impose a civil penalty of up to $25,000 for any violation of the act.322 A willful violation is a Class 4 felony, punishable by a fine between $100 and $5,000.323</td>
<td>Yes, the Commission may request that the franchisor rescind the franchise and make restitution for the injured franchisee.324</td>
<td>Yes, prison time of 30 days - 1 year is available for willful violations of the act, in addition to or alternative to a fine.325</td>
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310 S.D. CODIFIED LAWS § 37-5B-41.  
311 S.D. CODIFIED LAWS §§ 37-5B-35, 37-5B-36, 37-5B-37.  
312 S.D. CODIFIED LAWS § 37-5B-41.  
313 S.D. CODIFIED LAWS § 37-5B-47.  
314 S.D. CODIFIED LAWS § 37-5B-43.  
315 S.D. CODIFIED LAWS § 37-5B-49.  
316 S.D. CODIFIED LAWS §§ 37-5B-24, 37-5B-25.  
319 VA. CODE ANN. § 13.1-562(B).
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<td>WA</td>
<td>Yes, where such an order is in the public interest and there is evidence of violation or other misconduct.(^{326})</td>
<td>The director has discretionary powers to make, annually or more frequently, both public and private investigations; and may subpoena witnesses and information and administer oaths as required.(^{327})</td>
<td>The director has power to issue a cease and desist order for any current or anticipated violation of the act.(^{328})</td>
<td>The attorney general or director may bring a civil action to enjoin violations. The court may appoint a receiver and a prevailing party is entitled to reasonable attorney's fees.(^{329})</td>
<td>Any violation of an injunction is punishable by a penalty up to $25,000, and each violation of provisions regarding registration, disclosure and bookkeeping are punishable by penalties of $2,000 per violation. A willful violation of the act or any rule or order issued under the act is punishable by up to $5,000.(^{331})</td>
<td>None specified.</td>
<td>Yes, prison time of up to 10 years is available for willful violations, in addition to or alternative to a fine.(^{332})</td>
</tr>
<tr>
<td>WI</td>
<td>The division may deny, suspend, or revoke a registration upon a finding of violation.(^{333})</td>
<td>The division may make public or private investigations and may subpoena witnesses and information and administer oaths. In addition, the department of justice may subpoena witnesses and information and administer oaths as required.(^{334})</td>
<td>None specified.</td>
<td>The department of justice or any district attorney may bring a civil action to enjoin violations. The court may order restitution or damages to injured parties, and may appoint a receiver.(^{336})</td>
<td>Violations of the act including willful fraud are Class G felonies and punishable by fines up to $25,000. Injunctive relief is also available. A receiver is also available.(^{337})</td>
<td>Yes, unless the defendant establishes that the injured party was aware of facts that would prevent recovery of restitution in a civil action.(^{338})</td>
<td>No more than ten years for violations of the act including willful fraud.(^{339})</td>
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\(^{320}\) **VA. CODE ANN.** § 13.1-568.
\(^{321}\) **VA. CODE ANN.** § 13.1-570.
\(^{322}\) Id.
\(^{323}\) **VA. CODE ANN.** § 13.1-569(B).
\(^{324}\) **VA. CODE ANN.** § 13.1-570.
\(^{325}\) **VA. CODE ANN.** § 13.1-569(B).
\(^{326}\) **WASH. REV. CODE** § 19.100.252.
\(^{327}\) **WASH. REV. CODE** §§ 19.100.242, 19.100.245.
\(^{328}\) **WASH. REV. CODE** § 19.100.248.
\(^{329}\) **WASH. REV. CODE** § 19.100.210(1).
\(^{330}\) **WASH. REV. CODE** § 19.100.210(2)-(3).
\(^{331}\) **WASH. REV. CODE** § 19.100.210(6).
\(^{332}\) Id.
\(^{333}\) **WIS. STAT.** § 553.28.
\(^{334}\) **WIS. STAT.** § 553.55.
\(^{335}\) **WIS. STAT.** § 553.54(3).
\(^{336}\) **WIS. STAT.** § 553.54(1)-(2)(b).
\(^{337}\) **WIS. STAT.** § 553.52, 553.54(2)(b).
\(^{338}\) **WIS. STAT.** § 553.54(2)(a).
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<td>FTC</td>
<td>N/A</td>
<td>The Commission may hold hearings to investigate any suspected violation. 340</td>
<td>Yes, for any violation. 341</td>
<td>The Commission may bring a civil action to enjoin violations and may obtain other relief including rescission, reformation of contracts, damages, and public notification of the violation. 342</td>
<td>Knowing violations of the Rule and violations of the Commission's orders are subject to penalties up to $10,000. 343</td>
<td>Yes, for any violation or unfair or deceptive practice. 344</td>
<td>Only in connection with contempt proceedings for violation of cease and desist orders. 345</td>
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340 Wis. Stat. § 553.52.  
342 Id.  
Appendix C – Franchise Law Violation Inquiry Regulators Contact List

California
Commissioner
California Department of Business Oversight
320 West Fourth Street, Suite 750
Los Angeles, CA 90013-2344
866-275-2677
71 Stevenson Street, Suite 2100
San Francisco, CA 94105
415-972-8577

Hawaii
Commissioner of Securities
Dept. of Commerce & Consumer Affairs
Business Registration Division
335 Merchant Street, Room 203
Honolulu, HI 96813
808-586-2722

Illinois
Office of the Attorney General
Franchise Bureau
500 South Second Street
Springfield, IL 62706
217-782-4465

Indiana
Secretary of State
Securities Division
302 West Washington, Room E-111
Indianapolis, IN 46204
317-232-6681

Maryland
Office of the Attorney General
Securities Division
200 St. Paul Place
Baltimore, MD 21202-2020
410-576-6360

Michigan
Michigan Department of Attorney General
Consumer Protection Division, Franchise Section
525 West Ottawa Street
G. Mennen Williams Building, 1st Floor
Lansing, MI 48933
517-373-7117

Minnesota
Minnesota Department of Commerce
New York
Bureau of Investor Protection and Securities
New York State Department of Law
120 Broadway, 23rd Floor
New York, NY 10271
212-416-8211

North Dakota
North Dakota Securities Department
600 East Boulevard Avenue, State Capitol, Fifth Floor
Bismarck, ND 58505-0510
701-328-4712

Rhode Island
Department of Business Regulation
Securities Division
Bldg. 69, 1st Floor, John O. Pastore Center
1511 Pontiac Avenue
Cranston, RI 02920
401-462-9527

South Dakota
Department of Labor and Regulation
Division of Securities
445 E. Capitol
Pierre, SD 57501
605-773-4823

Virginia
State Corporation Commission
Division of Securities and Retail Franchising
1300 East Main Street, 9th Floor
Richmond, VA 23219
804-371-9051

Washington
Department of Financial Institutions
Securities Division – 3rd Floor
150 Israel Road, S.W.
Tumwater, WA 98501
360-902-8760

Wisconsin
Office of the Commissioner of Securities
Department of Financial Institutions
345 West Washington Avenue, 4th Floor
Madison, WI 53703; phone: 608-261-9555
Appendix D – Sample Notice of Violation and Rescission Offer

Sample Notices of Violation and Rescission Offer

NOTICE OF VIOLATION OF
CALIFORNIA FRANCHISE INVESTMENT LAW
BY XXX, INC. D/B/A XXX

(a) THIS NOTICE DISCLOSING VIOLATION OF THE FRANCHISE INVESTMENT LAW HAS BEEN APPROVED BY THE COMMISSIONER OF CORPORATIONS ONLY AS TO ITS FORM. SUCH APPROVAL DOES NOT IMPLY A FINDING BY THE COMMISSIONER THAT ANY STATEMENTS MADE HEREIN OR IN ANY ACCOMPANYING DOCUMENTS ARE TRUE OR COMPLETE AND THE COMMISSIONER MAKES NO RECOMMENDATION AS TO WHETHER OR NOT RESORT SHOULD BE HAD TO THE CIVIL REMEDIES PROVIDED IN THE FRANCHISE INVESTMENT LAW.

(b) This notice is directed to the following persons:

John Doe
[address]
[phone number]
Date of Franchise Agreement: ____________
Initial Franchise Fee: $__________

Jane Doe
[address]
[phone number]
Date of Franchise Agreement: ____________
Initial Franchise Fee: $__________

(c) The violations of the California Franchise Investment Law arose in respect to the following:

(1) Each of the above persons to whom this Notice is directed purchased franchises for the operation of an XXX Restaurant from XXX, the franchisor, on the dates set forth above for the consideration set forth above.

(2) These transactions violated Section 31110 of the California Corporations Codes because in each case the offer of the franchise was not registered with the Department of Corporations as required by that section. Additionally, franchisees did not receive the offering circular required by Section 31119 of the California Corporations Code.

(3) The franchisor, XXX, is liable to the above named franchisees for these violations as provided in Section 31300 of the California Corporations Code.

(d) XXX, the franchisor, will continue to offer franchises for XXX Restaurants under the terms described in the attached offering circular, which has been registered with the Department of Corporations as required by Section 31110 of the California Corporations Code.
(e) Under Section 31300 of the California Corporations Code, each franchisee has the right to sue for damages caused by the violations of Sections 31110 and 31119 and if the violation is willful the franchisee may also sue for rescission of the agreement. As provided in Section 31303, no action may be brought to enforce these rights unless it is brought not later than 90 days after delivery of this Notice.

(f) Section 31303 of the California Corporations Code states:

No action shall be maintained to enforce any liability created under Section 31300 unless brought before the expiration of four years after the act or transaction constituting the violation, the expiration of one year after discovery by the plaintiff of the fact constituting the violation, or 90 days after delivery to the franchisee of a written notice disclosing any violation of Section 31110 or 31200, which notice shall be approved as to form by the commissioner, whichever is the first to expire.

(g) This notice is not subject to any condition not stated herein.

This notice will be delivered by Federal Express or hand delivery and each recipient will be requested to sign for receipt indicating the date of receipt of the notice as follows and provide a copy of the signed receipt to the franchisor or its representative:

RECEIPT

The undersigned acknowledges receipt of the above Notice of Violation of California Franchise Investment Law on _______________________, 20__.  

FRANCHISEE NAME:____________________________________

SIGNATURE:____________________________________
<DATE>

VIA CERTIFIED MAIL, RETURN RECEIPT REQUESTED

[franchisee's name and address]

Re: Notice of Violation and Opportunity to Rescind Franchise Agreement

Dear ____________:

This letter is to notify you that XXX, LLC (“XXX”) violated the Illinois Franchise Disclosure Act of 1987 by entering into the franchise agreement with you dated ____________ (the “Franchise Agreement”). XXX was not registered to offer franchises in Illinois at the time it offered or sold you this franchise.

Please be advised that you may rescind the Franchise Agreement if you notify XXX of your acceptance of the rescission offer described below within 30 days from the date you receive this letter. If you elect to rescind the Franchise Agreement, XXX will return to you the consideration you have paid under the Franchise Agreement, less any net income you have received from the franchised business, plus the legal rate of interest on any amounts to be returned to you. If you elect to rescind the Franchise Agreement, you and XXX will have no further rights, benefits and obligations under the Franchise Agreement. If you accept this offer, you will be required to return to XXX all manuals, promotional materials, and other items you have received from XXX, discontinue all use of the XXX name and service mark and discontinue using any confidential information or proprietary methods of XXX in your business.

PLEASE TAKE NOTE THAT IF YOU DO NOT ELECT TO RESCIND WITHIN 30 DAYS, YOU WILL LOSE YOUR STATUTORY RIGHT TO SUE FOR RESCISSION OF THE FRANCHISE AGREEMENT UNDER THE ILLINOIS FRANCHISE DISCLOSURE ACT. YOU MAY WISH TO CONSULT WITH LEGAL COUNSEL ABOUT THIS RESCISSION OFFER.

You are not required to rescind the Franchise Agreement, but you have the right to do so. If you wish to rescind the Franchise Agreement, please contact ____________ [NAME] at [PHONE NUMBER] immediately to work out the details and confirm the net amount to be returned to you. If you decide not to rescind the Franchise Agreement, it will remain in force unimpaired and in that case we look forward to a mutually satisfactory business relationship with you.

Very truly yours,

XXX, LLC
DALE E. CANTONE

Dale Cantone is an Assistant Attorney General for the State of Maryland and the Deputy Securities Commissioner for the Maryland Securities Division. Dale is the chief of the franchise and business opportunity unit of the Maryland Securities Division. In addition, since 1996, Dale has served as Chair of the Franchise and Business Opportunity Committee/Project Group of the North American Securities Administrators Association, Inc. (“NASAA”). NASAA is a group of state administrators that proposes model laws, policies, and initiatives to promote investor protection as well as uniformity at the state level. Among other initiatives, NASAA authored the Uniform Franchise Offering Circular Guidelines.

Dale has spoken at programs sponsored by the American Bar Association Forum on Franchising, the International Franchise Association, the American Franchisee Association, the Direct Sellers Association, the United States Department of Commerce, the Maryland State Bar Association, the Maryland Institute for the Continuing Professional Education of Lawyers, the New York Attorney General’s Office, the University of Maryland Law School, the U.S. Hispanic Chamber of Commerce, the Better Business Bureau, the International Franchise Expo, and the Coalition of Franchisee Associations. He also has spoken about franchise related issues to foreign delegations from Russia, Japan and China.

In 2001, NASAA presented Dale with its Outstanding Service Award for his work in franchising at the state level. In 2002, Dale testified about state franchise issues before the Commerce, Trade and Consumer Protection Subcommittee of the Energy and Commerce Committee of the U. S. House of Representatives. In 2005, the American Association of Franchisees and Dealer awarded Dale its Total Quality Franchising Chairman’s Award for Distinguished Contributions and Service to the Franchising Community.
KIM A. LAMBERT

For over 25 years, Ms. Lambert has concentrated her practice on representing franchisors in connection with domestic and international franchise law and distribution matters. Ms. Lambert is currently Senior Vice President and General Counsel of 1-800 Radiator & AC, and its affiliates, where she oversees franchise & compliance issues, negotiations of distribution, strategic alliance, media, marketing, vendor and technology contracts, suppliers, corporate governance management, dispute resolution matters, and brand protection issues. 1-800 Radiator Franchise, Inc. is the leading nationwide franchise system that distributes automotive parts to automotive repair shops, parts stores, body shops, and collision shops.

Prior to her current position, Ms. Lambert headed up the west coast practice for DLA Piper’s franchise & distribution group from 2010-2013. Ms. Lambert also served as General Counsel of California Closet Company, Inc., where she managed all of the company’s legal affairs and participated as a member of the company’s executive team. Prior to that, Ms. Lambert was in private practice with Piper Rudnick, one of DLA Piper’s predecessor firms, joining in 1985 as an associate and becoming a partner in 1997. She was also an associate and then a partner at Bartko, Zankel, Tarrant & Miller in San Francisco from 1988 through 1996, where she concentrated on franchise litigation and transactional matters, in addition to serving as the firm’s managing partner for two years.

Ms. Lambert has been a frequent writer and speaker on domestic and international franchise related topics for bar associations and other organizations, including the International Franchise Association and the ABA Forum on Franchising. She has also served in leadership positions for the State Bar of California and the ABA Forum on Franchising, including serving on the ABA Forum’s Governing Committee and Co-Chairing the 2001 Annual Forum on Franchising. Ms. Lambert served as Topics and Articles Editor of the ABA Franchise Law Journal from 1995 to 1998. She was the founding editor of The Franchise Lawyer and served as its editor-in-chief from 1998 to 2000. Ms. Lambert was also listed in The International Who’s Who of Franchise Lawyers from 1997 through 2001, and in 2013. Ms. Lambert was voted one of the Best Lawyers in America & Top Lawyers in California in 2014. She currently serves as a member of the State Bar of California Franchise Law Committee.
Karen is Counsel in the Silicon Valley and San Francisco offices of the international law firm Dentons US LLP. Karen’s national litigation practice focuses on franchise litigation and class action defense, as well as other complex civil litigation. Karen regularly represents franchisors in litigation arising out of the termination of the franchise relationship, including defending against statutory and common law claims, and seeking affirmative relief to protect franchisors’ trademarks against unauthorized use by former franchisees. She also defends franchisors against class actions and against third party claims alleging that the franchisor is legally responsible for acts of the franchisee.

Karen also advises franchisors on compliance with franchise laws across the country, on vicarious liability issues, on non-compete and trade secret issues, on M&A due diligence from a franchise regulatory perspective, and on systemwide issues, such as best practices for implementing systemwide changes, working with franchise associations, and enforcing system standards.

Karen is currently serving as an Associate Editor of The Franchise Lawyer and has served as an appointed member of the Franchise Law Committee, California State Bar Business Section. She has previously spoken at the ABA Forum on Franchising and the International Franchise Association Legal Symposium, and has been selected by Franchise Times as a Legal Eagle. She received her J.D. from the University of California, Berkeley, where she graduated in the top 10% of her class and was selected for Order of the Coif.