Exemption-Based Franchising Throughout the United States

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Today’s Agenda

• Introduction/Overview
• Exclusions
• Exemptions
• Implementation of a National Exemption-Based Franchise Program
• Penalties and Remedies for Violations
Introduction/Overview

• What is “Exemption-Based Franchising”

  • Registration Obligation?
  • Disclosure Obligation?
  • Partial vs. Complete Reliance on Exemptions
Why Consider Exemption-Based Franchising?

• Time
  • Preparation and Maintenance of FDD
  • Waiting for State Approvals
  • FDD and Franchise Agreement FTC Waiting Periods

• Money
  • Preparation and Maintenance of FDD
  • Cost of State Approvals
  • Cost of Audited Financials
Why Consider Exemption-Based Franchising?

• Risk Exposure
  • Outside the Scope of Franchise Laws?

• Technically Complex
  • Devil Is In the Details
  • May Not Be Able to Offer Franchises to Every Candidate
Exclusions

• Federal vs. State
• Sales Outside of the U.S.
• Employer-Employee Relationship
• General Partnership
• Cooperative Associations
• Testing/Certification Services
• Single Trademark Exemptions
Sales Outside the United States

• FTC Franchise Rule:
  • Franchise Operated Outside of the U.S.
  • Irrelevant Where Franchisor and Prospective Franchisee Are Domiciled

• State Laws:
  • Most States: Limitations for Out of State Sales Likely Apply
  • New York: Discretionary Exemption
Employer-Employee Relationship

• Typically Not an Issue, but: Buying a Job?
• Right of Control Test
  • Right to Control the Means and Manner By Which Work is Performed
General Partnership

• All Partners Must Be General Partners

• Narrowly Construed
  • Multiple General Partnerships, each similarly structured – NO
  • One Party Contributing Know-How and TM, the Other Capital – NO
  • One General Partner Controls the Other - NO
Cooperatives and Certification/Testing Services

- Cooperative Associations (Some State Law Overlap)
  - Agricultural Cooperatives
  - Retailer-Owned Cooperatives:
    - Operated by Independent Retailers
    - Organization Must Provide Service or Goods Primarily to Its Members

- Certification and Testing Services
  - Bona Fide Certification/Testing Services
  - *Anybody* Who Meets the Standards and Pay a Fee
Single Trademark License

• “The primary difference between simple trademark licensing and ... franchising is in the type and degree of control exercised by the franchisor and licensor”

• Control of End Product vs. Control of Method of Operation

• One-on-One Licensing Arrangement – TM Owner Licenses Manufacturer of Trademarked Goods

• License as Result of Settlement Negotiations in Trademark Infringement Litigation
In What situations May Exemptions Be Helpful?

• Ad Hoc Use of Exemptions Versus Exemption Based Program?
• Start Up Franchisor
• Mature Franchisor
• Sophisticated Buyer
• Existing Franchisee
• Sales During Dark Period
• Reflagging operating businesses
• Special circumstances?
Minimum Payment / Nominal Fee

• Why Included?
  • Relatively low risk to investor

• When Might It Be Used?

• Key Considerations
  • Amount of fee
  • Which fees / payments
  • Time period for payment
Minimum Payment / Nominal Fee

• FTC Rule
  • “The total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee's business is less than $570.” Section 436.8(a)(1)
  • Amount subject to CPI adjustment every 4 years
  • Which Fees?
  • Promissory Note? Defer Fees? Waive Fees?
Minimum Payment / Nominal Fee

• States with Exemption / Exclusion by Definition
  • CA, IL, MD, MI, MN, RI, SD, VA, WA, WI
• States without Exemption
  • HI, IN, NY, ND
Minimum Payment / Nominal Fee

• Purchase of Goods at *Bona Fide* Wholesale Prices
  • Excluded from the definition of “franchise fee”

• States with Exclusion by Definition
  • CA, HI, IL, IN, MD, MI, MN, ND, NY, RI, SD, VA, WA, WI

• States without Exemption
  • N/A
Challenges to Minimum Payment / Nominal Fee

- FTC & SD – same

- Limited Scope Likely to Reduce Potential Benefit
  - Amount on annual basis
  - Amount entire term
  - Relatively low $$ threshold
  - Easy to run afoul
Isolated Sale/Sale of Single Franchise

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Limited character of offering
  • Public interest
  • Often, 1 to 3 offerings in 12 to 24 months
Isolated Sale/Sale of Single Franchise

• FTC RULE
  • N/A but remember ....
  • Single trademark license exclusion
    • Trademark licensing arrangement not needed where a single licensee is granted the right to use the trademark
Isolated Sale/Sale of Single Franchise

- States with Exemption / Exclusion by Definition
  - IL, IN, MN, NY, WA
- States without Exemption
  - CA, HI, MD, MI, ND, RI, SD, VA, WI
Challenges to Isolated Sale/Sale of Single Franchise

• May require escrow of fees
• May require no franchise sales advertising
• Disclosure may still be required
• May require certain filings or notices
Insider

• Why Included?
  • Reasonable assumption that Insider is already familiar with franchise business system, associated risks, and disclosure would serve little purpose

• When Might It Be Used?

• Key Considerations
  • Who is covered?
  • Length of time in position or ownership
Insider

• FTC Rule
  • Officers, directors, general partners, or managers of a franchisor
    • Must seek to purchase 50% or more ownership in franchise and
    • Have at least 2 years of experience with franchisor in position (w/in 60 days of transaction)
  • Owners of a franchisor
    • Must seek to purchase 50% or more ownership in franchise and
    • Have owned at least 25% interest in franchisor for at least 2 years (w/in 60 days of transaction)
Insider

- States with Exemption / Exclusion by Definition
  - CA, IL, RI, SD, WA
- States without Exemption
  - HI, IN, MD, MI, MN, NY, ND, VA, WI
Challenges to Insider

• May still require disclosures
• May require exemption filings
• May require recordkeeping of insider(s) “relationship”
Oral Contracts/Franchise

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Purely oral relationships
  • No evidence memorializing a material term in writing, even if unsigned
  • Usually informal and nominal in nature
Oral Contracts/Franchise

- FTC Rule
  - Nothing in writing as to material terms (signed or unsigned)
  - Exemption is lost if later writing, including handwritten notes, if material
Oral Contracts/Franchise

• States with Exemption / Exclusion by Definition
  • SD, VA
• States without Exemption
  • CA, HI, IL, IN, MD, MI, MN, NY ND, RI, WA, WI
Challenges to Oral Contracts/Franchise

• Impractical and unreliable
• Exemption lost if any material term in writing
  • Including handwritten notes or electronic information at a later time
• Can be damaging to a claim under state law if no written agreement
Out-of-State Sales

• Why Included?
• When Might It Be Used?
• Key Considerations
Out-of-State Sales

• FTC Rule: Applies to the offer or sale of a franchise to be located in the U.S. or its territories

• States with Exemption / Exclusion by Definition
  • CA, HI, IL, IN, MD, MI, MN, ND, RI, SD, VA, WA, WI

• States without Exemption
  • NY
Out-of-State Sales

• In general, if offer and sale of a franchise is made entirely outside of a state, and not made to a state domiciliary, and business is not conducted wholly or in part in that state, then state franchise law/registration will not apply to the transaction

• However, additional rules may apply, such as:
  • Supplies being purchased from the jurisdiction = no exemption
  • May require compliance in jurisdiction of business, or that no violation of federal or state law
Fractional Franchise

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Prior experience:
    • What experience can be considered?
    • Timing of and period of experience?
  • Gross sales
    • Percentage limit
    • Time period for calculation
Fractional Franchise

• FTC Rule:
  • Prospective franchisee with at least 2 years experience in the same type of business as franchisor agrees to add new product or service line that will account for less than 20% of their expected gross sales in the first year of operation
  • Common examples: hotels, universities, airports that operate branded food service under a license from brand owner
Fractional Franchise

• States with Exemption / Exclusion by Definition
  • CA, IL, IN, MI, MN, NY, RI, SD, VA, WI

• States without Exemption
  • HI, MD, ND, WA
Challenges to Fractional Franchise

• What is “same business”
• What constitutes “experience”
• Trouble if inaccurate FPRs shared
• May require filings with states
Mature/Seasoned Franchisor

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Generally two criteria must be met to apply
    • Net Worth
    • Experience
Mature/Seasoned Franchisor

• FTC Rule:
  • State level only, exemption from registration

• States with Exemption / Exclusion by Definition
  • CA, IL, IN, MD, NY, ND, RI, VA, WA
• States without Exemption
  • HI, MI, MN, SD, WI
Mature/Seasoned Franchisor

• Generally two criteria must be met to apply
  • Net Worth – 5 million dollars
    • MD & ND is 10 million
    • VA is 15 million
    • Or combination with parent, and
  • Experience –
    • At least 25 franchisees throughout the last 5 years, OR
    • Has conducted such business, or parent
Mature/Seasoned Franchisor

- IL - minimum net worth of $15 MIL; no experience requirement.
- NY - no experience necessary if meet minimum net worth (discretionary and automatic)
- ND additional disclosures
- RI lower net worth threshold
Challenges to Mature/Seasoned Franchisor

- Still generally requires disclosure
- Exemption status WILL change if net worth drops below threshold
- Exemption status may change if
  - change in corporate structure,
  - name change, or
  - ownership change
- May require certain filings with states
Challenges to Mature/Seasoned Franchisor

- Franchisor should keep proof of net worth/experience
- Consider whose financials and which financials are required
  - Which entity?
  - Audited / unaudited?
Challenges to Mature/Seasoned Franchisor

• VA additional requirement:
  • need auditors report with no going concern warning

• WA additional requirements:
  • minimum $100,000 initial investment by franchisee
  • Franchisor must not have been found to have violated WA franchise and consumer protection laws
Sophisticated Franchisee – Large Franchisee

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Net Worth
  • Experience
Sophisticated Franchisee – Large Franchisee

• FTC Rule:
  • $5,715,500 net worth threshold
    • Subject to CPI adjustment every 4 years
  • Any kind of business experience for at least 5 years
    • Does not have to be related to franchise business

Notes:
• Written franchisee acknowledgement requirement
• Includes parents and affiliates (net worth and experience)
• Includes individuals as franchisees
Sophisticated Franchisee – Large Franchisee

- States with Exemption / Exclusion by Definition
  - CA, IL, RI, SD, WA
- States without Exemption
  - HI, IN, MD, MI, MN, NY, ND, VA, WI
Sophisticated Franchisee – Large Franchisee

- Net Worth of franchisee (IL, SD & CA $5 million, RI $1 million)
- Experience in business (IL & SD 5 years)
- Notes:
  - CA requires a number of other criteria
  - WA exemption based on “accredited investor” rule criteria
  - May also need threshold annual gross income
Challenges to Large Franchisee

• May still require disclosure
• May require certain filings with states
• May require affidavit by franchisee to franchisor
• May have to prove net worth
• Franchisor or its representative cannot “help” anyone to avoid registration requirements
Sophisticated Franchisee – Large Investment

• Why Included?
• When Might It Be Used?
• Key Considerations
  • Minimum initial investment
Sophisticated Franchisee – Large Investment

• FTC Rule:
  • $1,143,100 investment threshold
    • Subject to CPI adjustment every 4 years
    • Acknowledgement by prospect
    • Based on costs in FDD Item 7
    • Excludes cost of unimproved land and franchisor financed amounts
  • Single investor required, no pooling of investors
Sophisticated Franchisee – Large Investment

• States with Exemption / Exclusion by Definition
  • IL, MD, MN, SD, WI
• States without Exemption
  • CA, HI, IN, MI, NY, ND, RI, VA, WA
Sophisticated Franchisee – Large Investment

• Minimum initial investment:
  • Generally $750k - $1 million depending on state
    • WI only $100,000 but cannot exceed 20% of franchisee’s net worth and must have sufficient business experience
    • MN more than $200,000 if initial, unfinanced investment
  • In-depth application for exemption may apply
  • Acknowledgement requirement (SD)
Challenges to Large Investment

• May still require disclosure
• May require certain filings with states
• Exemption may be lost if franchisor combines multiple offerings in an FDD (MD)
Existing Franchisee Exemptions - Transfers

• Why Included?
• When Might It Be Used?
• Key Considerations
Existing Franchisee Exemptions - Transfers

**Transfers to a third party by a franchisee**

- **FTC Rule:**
  - "Sale of a franchise” does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee. 16 CFR §436.1(t)
  - Franchisor’s approval or disapproval of a transfer is not “significant involvement.”
  - Terms not materially different from existing agreement
Existing Franchisee Exemptions - Transfers

*State exemptions for franchisee transfers to a third party:*
- Sale must be for franchisee’s own account
- Franchisor cannot effect transfer, nor be significantly involved
  - State exemptions vary, but some factors to consider:
    - Approval or disapproval of transferee
    - Reasonable transfer fee
    - Materially different terms or current FA
    - Multi-unit franchisees and sale of entire territory
    - Transferee is not affiliate of franchisor
    - Disclosure required (NY)
Existing Franchisee Exemptions - Transfers

- States with Exemption / Exclusion by Definition
  - CA, HI, IL, IN, MD, MI, MN, NY, ND, RI, SD, VA, WA, WI
- States without Exemption
  - N/A
Existing Franchisee Exemptions - Transfers

• Challenges
  • Existing FA says buyer signs new FA
  • What level of involvement is too much?
    • New guarantees?
    • Matching buyer / seller?
    • Providing assistance with form sales docs like APA?
    • Etc.?
Existing Franchisee Exemptions - Renewals

• Why Included?
• When Might It Be Used?
• Key Considerations
Existing Franchisee Exemptions - Renewals

Renewals

• FTC Rule:
  • Sale of a franchise does not include extending or renewing an existing franchise agreement
    • No interruption in operation of the business
    • Unless materially different terms and conditions

16 C.F.R. §436.1(t)
Existing Franchisee Exemptions - Renewals

*State exemptions for renewals:*

- States with Exemption / Exclusion by Definition
  - CA, HI, IL, IN, MD, MI, MN, NY, ND, RI, SD, VA, WI
- States without Exemption
  - WA
Existing Franchisee Exemptions - Renewals

State exemptions for renewals:

- FDD required in some states (ND & RI)
- No interruption of operation of the franchised business
- No material changes in the terms and conditions
Existing Franchisee Exemptions – Addt’l Units

• Why Included?
• When Might It Be Used?
• Key Considerations
Existing Franchisee Exemptions – Addt’l Units

Sale of Additional Units to Existing Franchisee

• FTC Rule:
  • No FDD required if franchisee exercising a right under the franchise agreement to establish new outlets. Compliance Guide, p. 19
  • Implicit – use same or not materially different FA
Existing Franchisee Exemptions – Addt’l Units

• States with Exemption / Exclusion by Definition
  • CA, HI, MD, MI, MN, NY, RI, SD, VA, WA, WI
• States without Exemption
  • IL, IN, ND
Existing Franchisee Exemptions – Addt’l Units

State exemptions for sales of additional units to existing franchisee:

- Applies to an offer, sale, or transfer to an existing franchisee
- That has been engaged in substantially similar business
- For at least
  - 2 years - CA, RI, SD, VA & WA
  - 18 months - MI & NY
Existing Franchisee Exemptions – Addt’l Units

Notes:
• May still require filing with the state or disclosure
• Some states have much broader statutes, others narrow
• MI & NY – cannot be for resale only; must be existing franchisee of franchisor
• VA & WA – must be for franchisee’s account and underlying sale must have been registered at the time
Sales During Dark Period?

• Going Dark = Period when F’or is not approved to sell in a registration state
• Sales typically suspended in registration states pending approval.
• Offers while registration approval is pending?
• Exempt sales while registration pending?
• Is FDD required for exempt sale?
Sales During Dark Period?

- CA – Can make new offers under new FDD, but cannot close deal until new FDD approved
  - Additional disclosure/cover letter re FDD status w/CA, and
  - Must provide effective new approved FDD 14 days prior to execution or payment, whichever is first
Sales During Dark Period?

• NY – Can close deals while new FDD with material changes pending w/ NY
  • Use previous FDD and disclose prospect that amendment w/material changes pending w/NY
  • Any payment must be escrowed until NY approved/denies new FDD
  • Prospect has 10 days after receiving new registered FDD to rescind and be refunded
  • If NY refuses new FDD, must refund and agreements not enforced
Sales During Dark Period?

• RI – Statutory exemption:
  • Offer of franchise while registration is expired and pending renewal/amendment, if offeree receives newly registered FDD at least 14 days before execution or receipt of payment, whichever is first
  • Cannot close deal until new FDD approved.
Leased Department

• Why Included?

• When Might It Be Used?
  • “Store Within a Store” for an independent retailer tenant

• Key Considerations
  • Retail Location Required
  • No Required Purchases or Suppliers, Direct or Indirect
    • Retail tenant can pay rent
    • Retailer landlord can set appearance and quality standards
Leased Department

- FTC Rule

“Leased Department” means an arrangement whereby a retailer licenses or otherwise permits a seller to conduct business from the retailer’s location where the seller purchases no goods, services, or commodities directly or indirectly from the retailer, a person the retailer requires the seller to do business with, or a retailer-affiliate if the retailer advises the seller to do business with the affiliate.” Section 436.1(l)
Leased Department

• States With Exemption / Exclusion by Definition
  • HI, IL, MI, MN, RI, SD, VA

• States Without Exemption
  • CA, IN, MD, NY, ND, WA, WI
Challenges to Leased Department

- Care must be exercised regarding joint marketing activities
  - Fees should be based on cost-sharing or per rented square foot basis
  - Not on department revenues or production costs
Petroleum Marketing Practices Act

• Why Included?
  • Protections of PMPA Duplicative of FTC Rule

• When Might It Be Used?
  • FTC Intended Exemption to be Read Broadly
    • Ancillary goods and services – car repair centers, car washes, convenience stores offered under the same franchise agreement

• Key Considerations
  • Other Businesses Must be Sold Under Unified Franchise Agreement
    • Separate franchise agreements fall under FTC Rule
Petroleum Marketing Practices Act

• States With Exemption / Exclusion by Definition
  • CA, IL, SD
  • MN and NY-exemptions available, but based on other state laws governing the marketing and sale of motor fuel and/or motor vehicle fuel franchises

• States Without Exemption
  • HI, IN, MD, MI, ND, RI, VA, WA
Challenges to Petroleum Marketing Practices Act

• Disclosure still may be required
• State exemption or exclusion may cover fuel sales only; not the sale of ancillary goods or services (car repair centers, car washes, convenience stores)
• Other state laws may apply in lieu of or in addition to the PMPA
Cooperatives

• Why Included?
  • Excluded From Coverage Under the Amended Rule
    • Included in Original Rule; eliminated from Amended Rule
    • Not a policy change; streamlining of regulations (Compliance Guide pg. 16)
  • Does Not to Meet the Definitional Elements of a “Franchise”

• When Might It Be Used?
  • Agricultural Cooperatives
    • Covered by The Capper-Volstead Act (7 U.S.C. § 291)
  • Retailer-Owned Cooperative Chains
    • Operated by and for independent retailers
    • Organization must furnish goods and services primarily to members

• Key Considerations
Cooperatives

- States With Exemption / Exclusion by Definition
  - CA, MI, ND, WI

- States Without Exemption
  - HI, IL, IN, MD, MN, NY, RI, SD, VA, WA,
Sales by Executor, Trustee, Etc.

• Why Included?
  • Acting in a Fiduciary Capacity
  • Regulated by Other Laws or Agencies

• When Might It Be Used?
  • Probate / Estate Administration
  • Conservatorship / Receivership / Guardianship
  • Bankruptcy Proceedings

• Key Considerations
Sales by Executor, Trustee, Etc.

- States With Exemption / Exclusion by Definition
  - HI, MD, MI, MN, RI, SD, WA

- States Without Exemption
  - CA, IL, IN, NY, ND, VA, WI
Challenges to Sales by Executor, Trustee, Etc.

• No FTC exemption
• May not apply if sale is on behalf of the franchisor
• Disclosure still may be required
Sales to Banks

• Why Included?
  • Regulated by Other Laws or Agencies

• When Might It Be Used?

• Key Considerations
Sales to Banks

- States With Exemption / Exclusion by Definition to Banks
  - HI, IL, MD, MI, MN, NY, SD, VA, WA, WI

- States Without Exemption
  - CA, IN, ND, RI
Challenges to Sales to Banks

• No FTC exemption
• Doesn’t cover sales by banks
• Disclosure still may be required
• Purchases intended for resale may not be covered
The Left Overs

- Motor Vehicles
- Bank Credit Card Plans / Payments
- Negotiated Sales
- Securities

- Offers Made on the Internet
- Franchise Expo Exemption (NY)
- Modification of Existing
- Trading Stamp Programs
- Consignment Sales
Motor Vehicles

• Sale of motor vehicle dealerships, vehicle franchises, motor vehicle sales excluded from state law
• States with Exemption / Exclusion by Definition
  • HI, MN, SD, VA, WA
• States without Exemption
  • CA, IL, IN, MD, MI, NY, ND, RI, WI
Bank Credit Card Plans / Payments

- Banks which issue credit card plans are excluded from state law
- States may require reasonable service charge

- States with Exemption / Exclusion by Definition
  - CA, IN, IL, NY, ND, MI, MD, RI, WA, WI
- States without Exemption
  - HI, SD, VA
Negotiated Sales

• Offers that differ from the registered offer are exempted in SD, and exempt in CA if meet certain criteria such as:
  • Initial offer must be registered offer
  • A description or copies of all past negotiated offers made available
  • Must confer benefits to franchisee
  • Additional disclosures and certifications

• States with Exemption / Exclusion by Definition
  • CA, SD

• States without Exemption
  • HI, IL, IN, MD, MI, MN, NY, ND, RI, VA, WA, WI
Securities

• If a franchise or interest in franchise is a registered “security” under state securities laws, then also:
  • Exempt from state franchise registration law in WI, and from both franchise registration and disclosure in MN
  • Also applies if exempt under WI securities law

• States with Exemption / Exclusion by Definition
  • MN, WI
• States without Exemption
  • CA, HI, IL, IN, MD, MI, NY, ND, RI, SD, VA, WA
Offers Made on the Internet

- An offer to sell a franchise made through the internet is exempt from state franchise law if:
  - Not offered to residents of that state (offer must indicate this)
  - Offer not otherwise directed to any person in that state
  - No franchises are sold in that state until offering has been registered or is exempt in that state
    - NY requires additional disclosures
    - RI requires additional technical measures for internet communications

- States with Exemption / Exclusion by Definition
  - CA, MD, NY, RI

- States without Exemption
  - HI, IL, IN, MI, MN, ND, SD, VA, WA, WI
Franchise Expo Exemption (NY only)

- NYC hosts International Franchise Expo annually since 2012
  - Franchisors exhibiting must either be registered or have a specific temporary exemption granted by the NY Department of Law
  - Exemption does not permit selling franchises from or in NY or at the IFE show, or providing FDDs in NY
  - Exemption valid only during times specified in application (during dates and times of IFE)
  - Sign form – statements re failure to comply and remedies available
Modification of Existing Franchise

- In WI: Modification or amendment of an existing franchise where no interruption in operation of franchise business exempt from registration.
- In CA: Material modification to existing franchise is a sale and requires registration and disclosure unless it meets one of two exemptions:
  - Not a system-wide offer
  - Modifications do not adversely affect franchisee’s rights

- States with Exemption / Exclusion by Definition:
  - CA, WI
- States without Exemption:
  - HI, IL, IN, MD, MI, MN, NY, ND, RI, SD, VA, WA
Trading Stamp Programs

• Excluded provided that trading stamp company is licensed (MD)
• Excluded if issuer of trading stamps does so in connection with the retail sale of merchandise or service (CA, IL, IN, MI, ND)

• States with Exemption / Exclusion by Definition
  • CA, IL, IN, MD, MI, ND, NY, RI, WA
• States without Exemption
  • HI, MN, SD, VA, WI
Consignment sales

• Excluded by definition
  • Provided that the proceeds remitted from the sale of consigned goods are the wholesale price

• States with Exemption / Exclusion by Definition
  • HI, MD, MN, WA

• States without Exemption
  • CA, IL, IN, MI, ND, NY, RI, SD, VA, WI
Exemption by Order

• Why Included?

• When Might It Be Used?
  • Special circumstances with low risk
  • Sophisticated prospects who don’t require protection by the state
  • Limited nature of an offering

• Key Considerations
Exemption by Order

• States With Exemption / Exclusion by Definition
  • HI, IL, IN, MD, MN, NY, ND, RI, SD, WI
• States Without Exemption
  CA, MI, VA, WA
Exemption by Order

• Practice pointers
  • IN – If an exemption is available under the FTC Rule or another state law, franchisor can make a reasonable argument for obtaining a discretionary exemption
  • VA – Although the Virginia Retail Franchising Act states that a franchise may be exempted from registration “by rule or order of the Commission,” practically speaking, there is no procedure to apply for an exemption by order
Challenges to Exemption by Order

• No FTC exemption
• May require annual renewal filing
Interpretive Opinions

• Why Included?
• When Might It Be Used?
• Key Considerations
Interpretive Opinions

• States With Exemption / Exclusion by Definition
  • CA, IL, MD, SD, WA, WI

• States Without Exemption
  • HI, IN, MI, MN, NY, ND, RI, VA
Interpretive Opinions

• Practice Pointers
  • FTC Informal Staff Advisory Opinions
    • https://www.ftc.gov/policy/advisory-opinions
  • Amended Rule Frequently Asked Questions (FAQs)
    • https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs
  • State’s decision to provide an interpretive opinion is discretionary
  • Will not be provided for hypothetical situations or in preparation for or to support anticipated or pending litigation
Challenges to Interpretive Opinions

• Not available in all states
• Confidential opinions may not be available
Implementing an Exemption Based Franchising Program

Recapping the benefits and challenges of exemption based franchising:

✓ Not all potential franchisees will be exempt
✓ Creating and maintaining an FDD need not be complex or expensive
✓ Exemptions are judgment calls
✓ Exemptions may be lost
✓ FDDs can be tools against fraud allegations
✓ Regulators may find errors in your offering
Implementing an Exemption Based Franchising Program

Recapping the benefits and challenges of exemption based franchising:

✓ Your franchise offering may be more flexible
✓ Your franchise offering may be confidential
✓ You may avoid “going dark”
✓ Useful to avoid waiting periods
✓ You may be able to be opportunistic in new markets or contexts
Interplay between Federal and State Exemptions

Four key questions:

- Is there a federal exemption?
- Is there a state level exemption?
- Is the exemption only from registration and not disclosure?
- Is there a reason to disclose anyway if current FDD is available?
Jurisdictional Analysis

A franchise statute may be applicable under four circumstances:

1. Franchised business is operated in the State.
2. Offer to sell made in, directed to, received in, or originates from State.
3. Offer to sell accepted in State.
4. Franchisee is a current resident of or a permanent legal resident of or domiciled in State or, if a business entity, has its principal place of business in the State.
Hypothetical

• Franchisor had its headquarters in Bethesda, Maryland.
• The franchised business will be located in Providence, Rhode Island.
• The franchisee is headquartered in Seattle, Washington.
• The franchisor and franchisee meet at the ABA Forum on Franchising in Palm Desert, California, where the franchisor offers to sell the franchisee a franchise, which the franchisee accepts.
Interplay with Business Opportunity Laws

• Biz Op Laws in 26 states encompass franchising
• These laws, which vary by state, by require registration and disclosure
• Exemptions from Biz Op laws:
  • Compliance with state and federal franchise laws; or
  • Offering is made in conjunction with a trademark or service mark
  • FTC Biz Op Rule, 16 CFR §437
Use of Exemptions as Part of a Sales Strategy

• Document the process and maintain records
• Train the sales force on the exemption process and when to use an FDD
• Support exemptions through franchise agreement provisions
• Franchisor losing qualifications for an exemption
Other Legal Considerations

• Penalties for Violating the FTC Exemption Requirements
  • In general vs. exempt franchisors
  • Extensive investigative powers
  • Administrative and civil actions
Other Legal Considerations

• Penalties for Violating the FTC Exemption Requirements
  • Remedies:
    • Injunction
    • Restitution
    • Rescission
    • Receivership
Other Legal Considerations

• FTC Remedies (continued)
  • Asset freeze
  • Suit for damages
  • Consumer refunds
  • Equitable relief

• No private right of action
Other Legal Considerations

- Remedies for State Statute Violations
  - In general vs. exempt franchisors
  - Extensive investigative powers
  - Administrative and civil actions
Other Legal Considerations

• Remedies for State Statute Violations
  • Suspension/Revocation of Exemptions
  • Denial of Registration
  • Injunction
  • Restitution
  • Rescission
Other Legal Considerations

• State Remedies (continued)
  • Receivership
  • Asset freeze
  • Suit for damages
  • Consumer refunds
  • Equitable relief
  • Criminal penalties
Other Legal Considerations

- Individual Private Actions
  - Rescission
  - Damages
  - Costs and attorney fees
  - Equitable relief
Other Legal Considerations

Impact of Business Opportunity Laws

• Exemption under state franchise law may waive exemption under business opportunity law if franchisor is relying on bus op exemption that requires compliance with state franchise law.

• State Business Opportunity Laws’ Remedies:
  • Damages
  • Injunction
Other Legal Considerations

Impact of Business Opportunity Laws (continued)

• Remedies Under State Business Opportunity Laws:
  • Rescission
  • Equitable relief
  • Costs and Attorney Fees
  • Fines
Other Legal Considerations

Impact of Business Opportunity Laws (continued)

• Remedies Under State Business Opportunity Laws:
  • Stop Orders
  • Suspension/Revocation of Registration
  • Criminal Penalties
Other Legal Considerations

Impact of Business Opportunity Laws (continued)

- Individual Private Actions
  - Damages
  - Rescission
  - Damages
  - Costs and Attorney Fees
  - Equitable Relief
Final Thoughts and Questions?
Thank you for attending!

- Martin Cordell, (Washington Department of Financial Institutions)
- Leslie Curran (Plave Koch PLC)
- Beata Krakus, (Greensfelder, Hemker & Gale, P.C.)
- Karen Satterlee (Hilton Worldwide Holdings LLC)
- Charlene York (SMB Shipping Logistics, LLC)