

**American Bar Association
39th Annual Forum on Franchising**

**MY ADDENDA SAY WHAT?
A REVIEW OF STATE MANDATED FDD
AND FRANCHISE AGREEMENT ADDENDA**

**Beata Krakus
Greensfelder, Hemker & Gale, P.C.**

**Halima M. Madjid
Plave Koch PLC**

and

**Diana V. Vilmenay
Gray Plant Mooty**

November 2-4, 2016

Miami, Florida

©2016 American Bar Association

TABLE OF CONTENTS

| | Page |
|---|------|
| I. BACKGROUND | 1 |
| II. SURVEY OF APPLICABLE REGISTRATION STATE FRANCHISE LAWS | 1 |
| A. California | 3 |
| 1. California Differences and Provisions Not Enforceable: | 3 |
| 2. Financial Performance Representations: | 4 |
| 3. Negotiated Changes to Offering:..... | 5 |
| B. Hawaii | 5 |
| 1. Hawaii Differences and Provisions Not Enforceable:..... | 5 |
| C. Illinois | 6 |
| 1. Illinois Differences and Provisions Not Enforceable: | 6 |
| D. Indiana | 6 |
| E. Maryland | 7 |
| 1. Maryland Differences and Provisions Not Enforceable:..... | 7 |
| F. Michigan..... | 8 |
| 1. Michigan Differences and Provisions Not Enforceable: | 8 |
| 2. Notice Provisions: | 9 |
| G. Minnesota..... | 10 |
| 1. Minnesota Differences and Provisions Not Enforceable: | 10 |
| H. New York..... | 10 |
| 1. New York Differences and Provisions Not Enforceable: | 10 |
| 2. Representation of No Untrue Statements:..... | 11 |
| 3. Purpose of Initial Franchise Fee:..... | 11 |
| I. North Dakota | 11 |
| 1. North Dakota Differences and Provisions Not Enforceable: | 12 |
| J. Rhode Island | 12 |
| 1. Rhode Island Differences and Provisions Not Enforceable: | 13 |
| K. South Dakota | 13 |
| L. Virginia | 13 |
| 1. Virginia Differences and Provisions Not Enforceable: | 13 |
| M. Washington | 13 |
| 1. Washington Differences and Provisions Not Enforceable:..... | 14 |

| | | |
|------|---|----|
| N. | Wisconsin..... | 14 |
| 1. | Wisconsin Differences and Provisions Not Enforceable: | 14 |
| O. | General Overview Of Addenda For Business Opportunity States | 15 |
| 1. | Connecticut..... | 16 |
| 2. | Georgia..... | 17 |
| 3. | Maine..... | 17 |
| 4. | North Carolina..... | 17 |
| 5. | South Carolina | 17 |
| III. | MISCELLANEOUS/OTHER STATE REQUIREMENTS INCLUDING RELATIONSHIP LAW STATES | 17 |
| A. | Arkansas | 17 |
| B. | Delaware | 18 |
| C. | Iowa | 18 |
| D. | Mississippi..... | 18 |
| E. | Missouri..... | 19 |
| F. | Nebraska..... | 19 |
| G. | New Jersey | 19 |
| H. | Ohio | 19 |
| IV. | FEE DEFERRAL OR OTHER FINANCIAL CONDITIONS..... | 20 |
| A. | Escrow | 20 |
| B. | Fee Deferral | 21 |
| C. | Surety Bond | 21 |
| D. | Guarantee of Performance | 22 |
| E. | Informal Undertaking | 22 |
| F. | Capital Infusion..... | 22 |
| V. | PRACTICAL STRATEGIES TO PREPARING STATE ADDENDA | 23 |
| A. | Multi-State FDDs vs. State-Specific FDDs..... | 23 |
| B. | Stylistic Choices | 24 |
| C. | What Disclosures Are Not Expressly Required By State Law | 24 |
| D. | The Exemption Mystery – If a Franchisor is Exempt from Registration or Disclosure are the State Addenda Still Required? | 26 |
| 1. | California | 27 |
| 2. | Maryland..... | 27 |
| 3. | Illinois..... | 28 |

| | | |
|------|---|----|
| E. | Suggested Ways to Work with State Examiners on Addenda-Change Requests..... | 28 |
| 1. | The Comment Letter Conundrum..... | 28 |
| 2. | Conflicts Between Examiners and State Law..... | 29 |
| 3. | Addressing Other Substantive Comments in State Riders/Addenda | 30 |
| F. | Best Practices For Maintaining and Administrating State Addenda..... | 31 |
| VI. | TYPICAL FDD ITEMS AND AGREEMENT PROVISIONS AFFECTED AND CONSEQUENCES OF AMENDMENTS | 32 |
| VII. | WHAT ADDENDA TO USE WHEN MULTIPLE STATE FRANCHISE LAWS APPLY TO ONE TRANSACTION | 36 |

MY ADDENDA SAY WHAT? A REVIEW OF STATE MANDATED FDD AND FRANCHISE AGREEMENT ADDENDA

I. BACKGROUND

In the nearly 40 year history of the Forum this is, to the authors' knowledge, the first time a program is devoted solely to state addenda to franchise disclosure documents. Why has this common FDD exhibit garnered so little attention? And why is it that state addenda suddenly were deemed to warrant their own program?

We can only hypothesize about the rationale behind the lack of former programs. Perhaps state addenda to FDDs simply meet with the same treatment as boilerplate language in an agreement: they are summarily reviewed by lawyers and their clients. Partially this is understandable – much of what is in the addenda is required by state law and franchisors have limited ability to change the language. As will be discussed later in this paper, another factor that plays in to the laissez-faire attitude towards state addenda is that they can often be used as a place to address franchise examiner comments out of which the franchisor is unable to negotiate. Similar to statutorily required disclosures this is where franchisors put information over which they don't have control.

The importance of state addenda and their exact wording did however become a topic of interest over the last year when the United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") required Dickey's Barbecue Restaurants ("Dickey's" or "Dickey's Barbecue") and some of its franchisees to resolve claims between the parties in different fora: some through arbitration, and others through state court litigation.¹ The key issue in that case was that while the Franchise Agreements in question required dispute resolution through arbitration, the mandatory Maryland state addenda to Dickey's FDD and franchise agreement required that some disputes be resolved by state courts. The *Dickey's* case put into question the presumption of many franchise lawyers, that the Federal Arbitration Act preempted state laws requiring court litigation or in-state dispute resolution, such as is common in state franchise statutes.

Against that background, this paper will review the state franchise law requirements that go beyond the disclosure obligations imposed by the Federal Trade Commission Act² and the FTC Franchise Rule³, review potential strategies and best practices for preparing state addenda and working with state franchise examiners to address comments, and of course look at the *Dickey's* case and related case law. *Dickey's* was not the first time a court grappled with this particular issue, but the court's analysis and the resulting bifurcation of the actions are noteworthy.

II. SURVEY OF APPLICABLE REGISTRATION STATE FRANCHISE LAWS

Through the national applicability of the FTC Franchise Rule and the efforts of the North American Securities Administrators Association ("NASAA"), the FDD for different states is uniform in most respects. However, some, but not all, of the states with franchise disclosure and registration laws (whether by statute, regulation or otherwise) require certain modifications to the FDD and the agreements, even though those modifications are not required under the FTC Franchise Rule. For example, the franchise registration states may require that certain

¹ *Chorley Enters., Inc. v. Dickey's Barbecue Rests., Inc.*, 807 F.3d 553 (4th Cir. 2015) ("Dickey's Barbecue").

² 15 U.S.C. §§ 41 *et seq.* (LexisNexis, Lexis Advance through PL 114-219, approved 7/29/16).

³ 16 C.F.R. 436 (2007).

provisions in the Franchise Agreements be eliminated or modified if they are or may be unenforceable in that state. Instead of having a separate FDD for each state that requires a change to the FDD or franchise agreement, it is common practice for franchisors to elect to have one FDD, referred to as a “roll up FDD” or “multistate FDD”, with state-specific addenda to address the state-specific changes. The state-specific addenda can be prepared in various ways including, one addenda per document (i.e. the FDD, franchise agreement and any other relevant agreements), or one addendum per state that includes all relevant changes and refers to all documents that need to be modified. As an alternative, franchisors may have state-specific FDDs that include the state-specific changes; however, this practice is not common. As will be discussed later in this paper in Section V. D., use of state-specific FDDs can generate additional administrative burdens and costs as each FDD must be updated and the franchisor’s administrative staff would need to be well-versed on which FDD to provide to each prospect in order to comply with all applicable franchise laws. Regardless of the option elected, franchisors should pay careful attention to the exact state requirements as some states require only changes to the FDD language, some states require only changes to the agreements, and other states require changes to both the FDD and the agreements.

Although the state franchise law in some states will require state-specific language to be in a particular location within the FDD, most allow flexibility on where such language appears. For example, common approaches are to include state-specific addenda in one exhibit to the FDD or to include state-specific amendments to the agreements as exhibits or attachments to the relevant agreement and then, only include the addenda to the FDD as an exhibit to the FDD. The location within the FDD of any state-specific addenda and state-specific amendments to the Franchise Agreement or other documents should be identified in the Table of Contents to the FDD.⁴

The states of California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin have varying franchise laws and each state law is discussed below, including whether a state-specific addendum is required, where to find the state law requirements as applied to the FDD and any provisions in agreements that may not be enforceable in the registration states. Attached to the paper as **Exhibit A** is a summary of state franchise law and state-specific addendum requirements.

There are different approaches to determining exactly what disclosures must be included in the state addenda. Some practitioners take a minimalistic approach and only include the information and statements in the state addenda that are clearly required to be included. Others take a more inclusive approach and include information that may not be strictly required, but that nonetheless would apply to a franchise agreement subject to a state’s franchise law. An example of how these different approaches may manifest themselves is with regard to references to the applicability of state franchise laws. Some states require that such a statement be included in the state addendum. In other instances, the statute may specify that it may not be waived by agreement, but that information is not required in the state addendum. The minimalist approach would be to only include a disclosure about the applicability of state law in the addendum for the state that requires the statement to be made. The inclusive

⁴ NASAA, Commentary on 2008 Franchise Registration and Disclosure Guidelines .04 (2009), http://www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary_final.pdf.

approach would be to include the disclosure independent of an express requirement to do so.⁵ The consequences of these different approaches are discussed in Section V.B.1.

A. California

Because of the requirements of the California Franchise Investment Law (“CFIL”)⁶ and the accompanying regulations,⁷ it is necessary to include a California addendum to the FDD. Typically, a rider or amendment to the Franchise Agreement is not required.

1. California Differences and Provisions Not Enforceable:

CFIL and California disclosure obligations that are usually addressed in the California state addendum to the FDD include:⁸

- (i) disclosure of currently effective orders of any national securities association or national securities exchange, suspending or expelling from membership in such association or exchange entities or individuals whose disputes are subject to disclosure in Item 3 of the FDD;
- (ii) disclosure of franchisees with rights under California law concerning termination, transfer and non-renewal. It must also be disclosed that if the franchisor’s franchise agreement is inconsistent with California law, California law will nonetheless control;
- (iii) a statement that provisions requiring waiver of compliance with the California franchise law is void;
- (iv) a statement that forum selection and choice of law provisions may not be enforceable;
- (v) a statement that termination upon the bankruptcy of the franchisee may not be enforceable;
- (vi) a statement that liquidated damages provisions may be restricted or prohibited;
- (vii) a statement that Section 31125 of the California Corporations Code requires the franchisor to give the franchisee an FDD approved by the Commissioner of Corporations before the franchisor asks the franchisee to consider a material modification of its franchise agreement;
- (viii) a statement that if the Franchise Agreement contains a waiver of punitive damages and jury trial provision, these provisions may not be enforceable;

⁵ See e.g. Ind. Code 23-2-2.7-1 which lists various provisions that may not be included in a franchise agreement subject to the Indiana franchise statute. The statute imposes limitations on approved suppliers, the franchisor’s right to compete with its franchisees and other behavior that the legislature has deemed inappropriate. However, there is no obligation to disclose any of those obligations in the franchisor’s FDD.

⁶ Cal. Corp. Code §§ 31000 through 31516 (West 2006).

⁷ Cal. Code Regs. tit. 10, § 310.000 *et seq.* (2005).

⁸ Many of the disclosure obligations can be found in Cal. Code Regs. tit. 10, § 310.114.1 (2005).

- (ix) a statement that prospective franchisees are encouraged to consult private legal counsel to determine the applicability of California and federal laws⁹ to any provisions of a franchise agreement restricting venue to a forum outside the State of California;
- (x) a statement that if the Franchise Agreement contains a post-term non-compete provision, this provision may not be enforceable;
- (xi) a statement that if the Franchise Agreement requires binding arbitration, this provision may not be enforceable;
- (xii) the following statement: FRANCHISOR'S WEBSITE HAS NOT BEEN REVIEWED OR APPROVED BY THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT. ANY COMPLAINTS CONCERNING THE CONTENTS OF THIS WEBSITE MAY BE DIRECTED TO THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT AT WWW.DBO.CA.GOV;
- (xiii) the following statement: THE CALIFORNIA FRANCHISE INVESTMENT LAW REQUIRES THAT A COPY OF ALL PROPOSED AGREEMENTS RELATING TO THE SALE OF THE FRANCHISE BE DELIVERED TOGETHER WITH THE DISCLOSURE DOCUMENT; and
- (xiv) the following statements: THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF CALIFORNIA. SUCH REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE COMMISSIONER OF BUSINESS OVERSIGHT NOR A FINDING BY THE COMMISSIONER THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.

2. Financial Performance Representations:

If any financial performance representations are made (“earnings claim” is the term still used in the relevant regulation), and the earnings claim figure(s) does (do) not include either costs of sales or operating expenses, then, in addition to the information required by Item 19, the FDD shall contain the following statement prominently set forth in Item 19 or set forth in a preface, exhibit or appendix to the FDD:

"The earnings claims figure(s) does (do) not reflect the costs of sales, operating expenses or other costs or expenses that must be deducted from the gross revenue or gross sales figures to obtain your net income or profit. You should conduct an independent investigation of the costs and expenses you will incur in

⁹ See, e.g., Cal. Bus. & Prof. Code § 20040.5 (Deering, Lexis Advance through Chapter 248 of the 2016 Regular Session and Chapter 8 of the 2015-16 2nd Extraordinary Session, and ballot measures approved by the electorate at the June 7, 2016, Presidential Primary Election); Cal. Civ. Proc. Code § 1281 (Deering, Lexis Advance through Chapter 248 of the 2016 Regular Session and Chapter 8 of the 2015-16 2nd Extraordinary Session, and ballot measures approved by the electorate at the June 7, 2016, Presidential Primary Election); and, the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (LexisNexis, Lexis Advance through PL 114-219, approved 7/29/16).

operating your (franchised business). Franchisees or former franchisees, listed in the offering circular, may be one source of this information."¹⁰

3. Negotiated Changes to Offering:

Under the CFIL, every negotiated sale is an amended offering and as such, the franchisor must register an amended FDD reflecting the negotiated changes, before offering any revised terms to a prospective franchisee. There is an exception to this rule, but it requires that any prospective franchisee in California who requests that changes be made to the franchisor's offer receive a summary of the changes that have been negotiated for a California franchise within the 12 months immediately preceding the offer or sale.¹¹ While the addendum doesn't have to be included in the California addendum to the FDD that is an easy way to ensure compliance with this disclosure requirement.¹²

B. Hawaii

Because of the requirements of the Hawaii Franchise Investment Law ("HFIL")¹³ and the accompanying regulations,¹⁴ it is necessary to include a Hawaii addendum to the FDD. Typically, a rider or amendment to the Franchise Agreement is not required.

HFIL and Hawaii disclosure obligations that are usually addressed in the Hawaii state addendum to the FDD include:¹⁵

1. Hawaii Differences and Provisions Not Enforceable:

- (i) THESE FRANCHISES WILL BE/HAVE BEEN FILED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF HAWAII. FILING DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS OR A FINDING BY THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.
- (ii) THE FRANCHISE INVESTMENT LAW MAKES IT UNLAWFUL TO OFFER OR SELL ANY FRANCHISE IN THIS STATE WITHOUT FIRST PROVIDING TO THE PROSPECTIVE FRANCHISEE, OR SUBFRANCHISOR, AT LEAST SEVEN DAYS PRIOR TO THE EXECUTION BY THE PROSPECTIVE

¹⁰ Cal. Code Regs. tit. 10, § 310.114.1(6) (2005)

¹¹ Cal. Corp. Code § 31109.1 (Deering, Lexis Advance through Chapter 248 of the 2016 Regular Session and Chapter 8 of the 2015-16 2nd Extraordinary Session, and ballot measures approved by the electorate at the June 7, 2016, Presidential Primary Election).

¹² Note that including the disclosure in the FDD addendum for California may not meet the obligations of Section 31109.1. If the franchisor negotiates additional agreements between the effective date of the FDD and the time when the franchisor engages in negotiations with a prospect subject to the CFIL the franchisor would still be required to disclose the additional negotiated terms. Additionally, a franchisor may not wish to disclose negotiated terms in the FDD state addendum so as to avoid putting franchisees in other states on notice of changes it has negotiated in California.

¹³ Haw. Rev. Stat. § 482E-1 through § 482E-12 (LexisNexis, Lexis Advance through the 2016 Second Special Session. Subject to changes by Revisor pursuant to HRS 23G-15).

¹⁴ Haw. Code R. § 16-37 (Lexis Advance through July 27, 2016).

¹⁵ Many of the disclosure obligations can be found in Haw. Code R. § 16-37-4 (Lexis Advance through July 27, 2016).

FRANCHISEE, OF ANY BINDING FRANCHISE OR OTHER AGREEMENT, OR AT LEAST SEVEN DAYS PRIOR TO THE PAYMENT OF ANY CONSIDERATION BY THE FRANCHISEE, OR SUBFRANCHISOR, WHICHEVER OCCURS FIRST, A COPY OF THE DISCLOSURE DOCUMENT, TOGETHER WITH A COPY OF ALL PROPOSED AGREEMENTS RELATING TO THE SALE OF THE FRANCHISE.

- (iii) THIS DISCLOSURE DOCUMENT CONTAINS A SUMMARY ONLY OF CERTAIN MATERIAL PROVISIONS OF THE FRANCHISE AGREEMENT. THE CONTRACT OR AGREEMENT SHOULD BE REFERRED TO FOR A STATEMENT OF ALL RIGHTS, CONDITIONS, RESTRICTIONS AND OBLIGATIONS OF BOTH THE FRANCHISOR AND THE FRANCHISEE.

Hawaii does have a few additional disclosures that may also be required or potentially applicable regarding certain practices by a franchisor that are prohibited, such as language which would release the franchisor from liability imposed by Hawaii law, terminate or refuse to renew or refuse to permit a transfer a franchise except for good cause.

C. Illinois

Because of the requirements of the Illinois Franchise Disclosure Act of 1987 (“IFDA”)¹⁶ and the accompanying regulations,¹⁷ it is necessary to include an Illinois addendum to the FDD and a rider or amendment to the Franchise Agreement.

IFDA and Illinois disclosure obligations that are usually addressed in the Illinois state addendum to the FDD and rider/amendment to the Franchise Agreement include:¹⁸

1. Illinois Differences and Provisions Not Enforceable:

- (i) The IFDA prohibits waiver of certain rights enumerated under that statute. For example, the agreements cannot require a franchisee to waive rights under the IFDA that relate to governing law, venue, and jurisdictional requirements. The addenda must note that any such waivers are deleted or are ineffective. Interestingly, the IFDA does not prohibit arbitration outside Illinois.
- (ii) The IFDA also requires that the addenda reflect that termination and non-renewal rights under the IFDA cannot be waived or modified.¹⁹

D. Indiana

Although Indiana does not require an addendum to the FDD or rider/amendment to the Franchise Agreement, franchisors should keep in mind that the Indiana franchise relationship

¹⁶ 815 Ill. Comp. Stat. 705/1 to 705/44 (LexisNexis, Lexis Advance through P.A. 99-584, except for portions of P.A. 99-556, and P.A. 99-576 of the 2016 Regular Legislative Session).

¹⁷ 815 Ill. Comp. Stat. 705/1 to 705/44 (LexisNexis, Lexis Advance through P.A. 99-584, except for portions of P.A. 99-556, and P.A. 99-576 of the 2016 Regular Legislative Session); Ill. Admin. Code tit. 14, §§ 200 *et seq* (Lexis Advance through April 29, 2016).

¹⁸ Many of the disclosure obligations can be found in 815 Ill. Comp. Stat. 705/1 to 705/44 (2008).

¹⁹ 815 Ill. Comp. Stat. 705/19 to 705/20 (LexisNexis, Lexis Advance through P.A. 99-584, except for portions of P.A. 99-556, and P.A. 99-576 of the 2016 Regular Legislative Session).

law²⁰ imposes certain limitations, including “Forbidden Provisions” in franchise agreements and “Prohibited Practices”, which relate to such issues as the use of designated and approved suppliers, exclusivity/encroachment, the receipt of rebates that are not compensation for services rendered, termination/non-renewal without “good cause,” “limiting litigation brought for breach . . . in any manner whatsoever,” mandatory participation in certain advertising and marketing programs, and discriminating unfairly among franchisees.²¹

E. Maryland

Because of the requirements of the Maryland Franchise Registration and Disclosure Law (“MFRDL”)²² and the accompanying regulations,²³ it is necessary to include a Maryland addendum to the FDD and a rider or amendment to the Franchise Agreement.

1. Maryland Differences and Provisions Not Enforceable:

MFRDL and Maryland disclosure obligations that are usually addressed in the Maryland state addendum to the FDD and rider/amendment to the Franchise Agreement include:

In some instances, franchisors are required to include unaudited financial statements in the FDD. In the event such statements are used, the following disclaimer must be included: These Financial Statements Have Been Prepared Without An Audit. Prospective Franchisees Or Sellers of Franchises Should Be Advised That No Independent Certified Public Accountant Has Audited These Figures Or Expressed An Opinion with Regard to their Content Or Form. It is recommended that this statement appear on the cover page to the unaudited financial statements.

- (i) Franchise agreements sometimes include as a grounds for termination, filing for bankruptcy. The MFRDL requires franchisors to note that this ground for termination may not be enforceable.
- (ii) The MFRDL does not permit franchisors to condition a franchisee’s right to renewal or transfer on a release of claims under the MFRDL. If a release of these claims is required, the addenda must note that a release in these instances cannot apply to claims under the MFRDL.
- (iii) With regard to choice of venue clauses, the MFRDL does not permit franchisors to require franchisees to sue for alleged MFRDL claims outside of the courts in Maryland.
- (iv) While many agreements include provisions which limit the time within which to bring a claim, the MFRDL does not permit franchisees to waive or limit the right to bring alleged MFRDL claims within 3 years after the grant of the franchise.

²⁰ Ind. Code § 23-2-2.7 (Burns, Lexis Advance through the 2016 Second Regular Session of the 119th General Assembly).

²¹ *Id.* at §§1-2.

²² Md. Code Ann., Bus. Reg. §§ 14-201 through 14-233 (LexisNexis, Lexis Advance through July 1, 2016).

²³ Md. Code Ann., Bus. Reg. §§ 14-201 through 14-233 (LexisNexis, Lexis Advance through July 1, 2016); Md. Code Regs. 02.02.08. (Lexis Advance through the 8/19/2016 issue of the Maryland Register).

F. Michigan

Michigan is a notice only state which means that the Michigan Department of Attorney General, Franchise Section, does not review FDDs and only requires that franchisors register a Notice of Intent with the Attorney General once a year if they wish to offer or sell franchises in the state. The Michigan Franchise Investment Law requires, however, the inclusion of a state-specific notice immediately following the cover sheet of the FDD.²⁴

1. Michigan Differences and Provisions Not Enforceable:

Michigan law requires inclusion of the following specific statements in 12 point font:²⁵

The state of Michigan prohibits certain unfair provisions that are sometimes in franchise documents. If any of the following provisions are in these franchise documents, the provisions are void and cannot be enforced against you.

(a) A prohibition on the right of a franchisee to join an association of franchisees.

(b) A requirement that a franchisee assent to a release, assignment, novation, waiver or estoppel which deprives a franchisee of rights and protections provided in this act. This shall not preclude a franchisee, after entering into a franchise agreement, from settling any and all claims.

(c) A provision that permits a franchisor to terminate a franchise prior to the expiration of its term except for good cause. Good cause shall include the failure of the franchisee to comply with any lawful provision of the Franchise Agreement and to cure such failure after being given written notice thereof and a reasonable opportunity, which in no event need be more than thirty (30) days, to cure such failure.

(d) A provision that permits a franchisor to refuse to renew a franchise without fairly compensating the franchisee by repurchase or other means for the fair market value at the time of expiration of the franchisee's inventory, supplies, equipment, fixtures and furnishings. Personalized materials which have no value to the franchisor and inventory, supplies, equipment, fixtures and furnishings not reasonably required in the conduct of the franchise business are not subject to compensation. This subsection applies only if: (i) the term of the franchise is less than five (5) years, and (ii) the franchisee is prohibited by the franchise or other agreement from continuing to conduct substantially the same business under another trademark, service mark, trade name, logotype, advertising or other commercial symbol in the same area subsequent to the expiration of the franchise or the franchisee does not receive at least six (6) months' advance notice of franchisor's intent not to renew the franchise.

(e) A provision that permits the franchisor to refuse to renew a franchise on terms generally available to other franchisees of the same class or type under similar circumstances. This section does not require a renewal provision.

²⁴ Mich. Comp. Laws §445.1527.

²⁵ *Id.* at §445.1508(3).

(f) A provision requiring that arbitration or litigation be conducted outside this state. This shall not preclude the franchisee from entering into an agreement, at the time of arbitration, to conduct arbitration at a location outside this state.

(g) A provision which permits a franchisor to refuse to permit a transfer of ownership of a franchise, except for good cause. This subdivision does not prevent a franchisor from exercising a right of first refusal to purchase the franchise. Good cause shall include, but is not limited to:

(i) Failure of the proposed transferee to meet the franchisor's then-current reasonable qualifications or standards.

(ii) The fact that the proposed transferee is a competitor of the franchisor or subfranchisor.

(iii) The unwillingness of the proposed transferee to agree in writing to comply with all lawful obligations.

(iv) The failure of the franchisee or proposed transferee to pay any sums owing to the franchisor or to cure any default in the Franchise Agreement existing at the time of the proposed transfer.

(h) A provision that requires the franchisee to resell to the franchisor items that are not uniquely identified with the franchisor. This subdivision does not prohibit a provision that grants to a franchisor a right of first refusal to purchase the assets of a franchise on the same terms and conditions as a bona fide third party willing and able to purchase those assets, nor does this subdivision prohibit a provision that grants the franchisor the right to acquire the assets of a franchise for the market or appraised value of such assets if the franchisee has breached the lawful provisions of the Franchise Agreement and has failed to cure the breach in the manner provided in subdivision (c).

(i) A provision which permits the franchisor to directly or indirectly convey, assign or otherwise transfer its obligations to fulfill contractual obligations to the franchisee unless provision has been made for providing the required contractual services.

2. Notice Provisions:

The Michigan addendum to the FDD must also note the following: (1) the fact that the Notice of Intent is on file with the attorney general in Michigan does not constitute approval, recommendation, or endorsement by the attorney general of the franchise offering; and (2) if the franchisor has unaudited financial statements which show a net worth of less than \$100,000, the addendum should state that franchisee can request an escrow of the initial investment and other funds paid. Finally, the Michigan FDD addendum should include a statement that questions regarding the notice should be directed to the Department of Attorney General for Michigan with the current address and telephone number noted.²⁶

²⁶ *Id.*

G. Minnesota

Because of the requirements of the Minnesota franchise law²⁷ and the accompanying regulations,²⁸ it is necessary to include a Minnesota addendum to the FDD and a rider or amendment to the Franchise Agreement.

1. Minnesota Differences and Provisions Not Enforceable:

Minnesota disclosure obligations that are usually addressed in the Minnesota state addendum to the FDD and rider/amendment to the Franchise Agreement include:

- (i) Provisions pertaining to protection of franchisee's rights to use trademarks that are subject to disclosure in Item 13 of the FDD. Additionally, certain provisions included in Item 17 of the FDD must be modified.
- (ii) Contractual choice of law and venue provisions that select law and venue outside of Minnesota may not be enforceable.
- (iii) Minnesota law sets forth certain restrictions that relate to a franchisor's right to terminate or not renew a franchise. In the event of termination, except in certain limited circumstances, the franchisor must provide the franchisee 90 days' advance notice of termination (with 60 days to cure) and, for non-renewal, 180 days' advance notice. If the Franchise Agreement provides for different notice periods, the addenda to the FDD and agreement, must reference the statutorily required notice periods.
- (iv) Other provisions that may not be permitted and should be referenced in the addenda for Minnesota are contractual statutes of limitations; liquidated damages clauses; termination penalties or judgment notes; jury trial waivers; conditioning renewal or assignment on release or waiver of claims under Minnesota franchise law; and if a Minnesota forum is not specified, a statement must be added that the franchisee's rights under the Minnesota statutes to submit matters to a Minnesota court is not abrogated or reduced.

H. New York

Because of the requirements of the New York General Business Law ("NYGBL")²⁹ and the accompanying regulations,³⁰ it is necessary to include a New York addendum to the FDD and a rider or amendment to the Franchise Agreement.

1. New York Differences and Provisions Not Enforceable:

NYGBL and New York disclosure obligations that are usually addressed in the New York state addendum to the FDD and rider/amendment to the Franchise Agreement include:

²⁷ Minn. Stat. §§ 80C.01 through 80C.22 (LexisNexis, Lexis Advance through the end of the 2016 Regular Session).

²⁸ Minn. R. 2860.0100 through 2860.9930 (Lexis Advance through February 1, 2016).

²⁹ N.Y. Gen. Bus. Law §§ 680, *et seq.* (Consol., Lexis Advance through 2016 released chapters 1-286).

³⁰ N.Y. Comp. Codes R. & Regs. tit. 13, §§ 200.1 through 201.16 (Lexis Advance through August 26, 2016).

- (i) The FTC Franchise Rule and many other state franchise disclosure laws limit the time frame for disclosure of criminal actions under Item 3 to a 10 year period.³¹ However, the NYGBL also includes that time frame limitation for misdemeanor and nolo contendere pleas.³² Accordingly, the New York addendum to the FDD should note whether any such criminal actions have been maintained and if none, include a broader negative disclosure that no such actions must be disclosed.
- (ii) For a franchisee that receives an exclusive territory, New York law requires the franchisor to disclose that, if the franchisor establishes another franchise in that exclusive territory that will use the franchisor's trade name or trademark, the franchisee must have the right to rescind or amend the Franchise Agreement.
- (iii) Franchisees must be permitted to terminate the Franchise Agreements on any ground available pursuant to New York law.
- (iv) Despite the fact that most franchise agreements include an unrestricted right for the franchisor to transfer or assign the agreements, New York law places a restriction on that right and requires that the assignee must be willing and able to assume the obligations of franchisor or condition renewal or assignment on release of claims.
- (v) Contractual choice of law provisions that designate law other than New York law may not be enforceable to the extent that the rights of the franchisee or franchisor under New York franchise law are limited.

2. Representation of No Untrue Statements:

New York also requires a separate page in the New York addendum to include the following statements: "The franchisor represents that this prospectus does not knowingly omit any material fact or contain any untrue statement of material fact."

3. Purpose of Initial Franchise Fee:

New York requires Item 5 to be amended to describe the purpose for which the initial franchise fee or payment will be used.

I. North Dakota

Because of the requirements of the North Dakota Franchise Investment Law ("NDFIL") and the accompanying regulations³³, it is necessary to include a North Dakota addendum to the FDD and a rider or amendment to the Franchise Agreement. Typically, the North Dakota addenda will include the following statements required by the NDFIL:

³¹ 16 C.F.R. § 436.5(c) (2007).

³² N.Y. Gen. Bus. Law § 683(e) (Consol., Lexis Advance through 2016 released chapters 1-286).

³³ N.D. Cent. Code §§ 51-19-01 through 51-19-17 (Lexis Advance through all acts signed by the governor through the end of the 2016 Special Legislative Session including changes and corrections made by the North Dakota Code Revisor).

1. North Dakota Differences and Provisions Not Enforceable:

The North Dakota Securities Commissioner has held the following to be unfair, unjust, or inequitable to North Dakota franchisees³⁴:

- A. Restrictive Covenants: Franchise disclosure documents which disclose the existence of covenants restricting competition contrary to Section 9-08-06, N.D.C.C., without further disclosing that such covenants will be subject to this statute.
- B. Situs of Arbitration / Litigation Proceedings: Franchise agreements providing that the parties must agree to arbitrate / litigate disputes at a location that is remote from the site of the franchisee's business.
- C. Restriction on Forum: Requiring North Dakota franchisees to consent to the jurisdiction of courts outside of North Dakota.
- D. Liquidated Damages and Termination Penalties: Requiring North Dakota franchisees to consent to liquidated damages or termination penalties.
- E. Applicable Laws: Franchise agreements which specify that any claims arising under the North Dakota franchise law will be governed by the laws of a state other than North Dakota.
- F. Waiver of Trial by Jury: Requiring North Dakota franchisees to consent to the waiver of a trial by jury.
- G. Waiver of Exemplary and Punitive Damages: Requiring North Dakota franchisees to consent to a waiver of exemplary and punitive damages.
- H. General Release: Requiring North Dakota franchisees to execute a general release of claims as a condition of renewal or transfer of a franchise.
- I. Limitation of Claims: Requiring that North Dakota franchisees to consent to a limitation of claims. The statute of limitations under North Dakota law applies.
- J. Enforcement of Agreement: Requiring that North Dakota franchisees to pay all costs and expenses incurred by the franchisor in enforcing the agreement. The prevailing party in any enforcement action is entitled to recover all costs and expenses including attorney's fees.

J. Rhode Island

Because of the requirements of the Rhode Island Franchise Investment Act ("RIFIA") and the accompanying regulations³⁵, it is necessary to include a Rhode Island addendum to the FDD and a rider or amendment to the Franchise Agreement.

³⁴ N.D. Cent. Code § 51-19-09 (Lexis Advance through all acts signed by the governor through the end of the 2016 Special Legislative Session including changes and corrections made by the North Dakota Code Revisor).

1. Rhode Island Differences and Provisions Not Enforceable:

As compared to other states, the RIFIA and Rhode Island regulations require minimal changes by way of the state addendum. Contractual choice of venue and choice of law provisions that would apply to a claim that is enforceable under the RIFIA are not enforceable and should be noted in the addendum.

K. South Dakota

Although South Dakota does not require an addendum to the FDD or rider/amendment to the Franchise Agreement, franchisors should keep in mind that the South Dakota Franchise Investment Law³⁶ restricts certain “Prohibited Practices”.³⁷ The prohibited practices in large part relate to financial performance representations and non-compliance with timing requirements in the disclosure process.³⁸

L. Virginia

Because of the requirements of the Virginia Retail Franchising Act (“VRFA”) and the accompanying regulations³⁹, it is necessary to include a Virginia addendum to FDD required for any cross default provisions. Typically, a rider or amendment to the Franchise Agreement is not required.

1. Virginia Differences and Provisions Not Enforceable:

The state law protection that must be noted in the Virginia addendum to the FDD, is that it is unlawful for a franchisor to cancel a franchise without reasonable cause. This is usually a modification to Item 17.h.

M. Washington

Because of the requirements of the Washington Franchise Investment Protection Act (“WFIPA”) and the accompanying regulations⁴⁰, it is necessary to include a Washington rider or amendment to the Franchise Agreement. Typically, an addendum to the FDD is not required.

³⁵ R.I. Gen. Laws §§ 19-28.1-1 through 19-28.1-34 (Lexis Advance through Chapter 218 (except 39, 41, 116, 120, 142, 175, 192, 200, 215-217) of the January 2016 Session but not including corrections and changes made by the Director of Law Revision. The final official version of statutes affected by 2016 legislation will appear on lexis.com and Lexis Advance in October 2016).

³⁶ S.D. Codified Laws §§ 37-5B-1 through 37-5B-53 (2009) (LexisNexis, Lexis Advance through all legislation from the 2016 Regular Session of the 91st Legislative Assembly and Supreme Court Rule 16-67).

³⁷ S.D. Codified Laws § 37-5B-26 (LexisNexis, Lexis Advance through all legislation from the 2016 Regular Session of the 91st Legislative Assembly and Supreme Court Rule 16-67).

³⁸ *Id.*

³⁹ Va. Code Ann. §§ 13.1-557 through 13.1-574 (LexisNexis, Lexis Advance through all acts adopted at the 2016 Regular Session of the General Assembly).

⁴⁰ Wash. Rev. Code §§ 19.100.010 through 19.100.940 (LexisNexis, Lexis Advance through 2016 1st Special Session); Wash. Admin. Code §§ 460-80-050 through 460-80-540, §§ 460-82-050 through 460-82-200 (Lexis Advance through the 16-15 Washington State Register dated July 20, 2016).

1. Washington Differences and Provisions Not Enforceable:

WFIPA and Washington disclosure obligations that are usually addressed in the Washington rider/amendment to the Franchise Agreement include:

- (i) The state addenda should reflect that the WFIPA may supersede the Franchise Agreement, including in the areas of termination and renewal of the franchise. The WFIPA includes restrictions on the franchisor's rights to terminate and refuse to renew. To the extent that the agreements offer less protection to the franchisee than the WFIPA, the WFIPA provisions will control.
- (ii) If the Franchise Agreements include a contractual choice of law provision and the application of that law will conflict with the WFIPA, the WFIPA will control.
- (iii) Except in connection with a negotiated settlement during the course of the parties' relationship where the parties are represented by counsel, releases or waivers of claims are not enforceable.
- (iv) Contractual statutes of limitations, jury trial waivers or other attempts to require the franchisee to waive rights specifically granted by the WFIPA are not enforceable.
- (v) Franchisors must assess the reasonableness of transfer fees as the WFIPA requires that all such fees must reflect the franchisor's reasonable estimated or actual costs in effecting a transfer.
- (vi) In any arbitration or litigation matter involving a franchise purchased in Washington, the arbitration or litigation must occur either in the state of Washington, in a place mutually agreed upon by the parties at the time the proceeding is filed, or the location required by the judge or arbitrator.

N. Wisconsin

Wisconsin does not require an addendum to the FDD or a rider/amendment to the Franchise Agreement. However, franchisors should keep in mind that the following provisions under the Wisconsin Franchise Investment Law may impact the franchise relationship⁴¹.

1. Wisconsin Differences and Provisions Not Enforceable:

- (i) For all franchisees residing in the State of Wisconsin, franchisor must provide franchisee at least 90 days' prior written notice of termination, cancellation or substantial change in competitive circumstances. The notice will state all the reasons for termination, cancellation or substantial change in competitive circumstances and will provide that franchisee has 60 days in which to cure any claimed deficiency. If the deficiency is cured within 60 days, the notice will be void. If the reason for termination, cancellation or substantial change in

⁴¹ Wis. Stat. §§ 553.01 through 553.78 (LexisNexis, Lexis Advance through Acts of the 2015 - 2016 Legislative Session); see also Wisconsin Fair Dealership Law, Wis. Stat. §§ 135.01 through 135.07 (LexisNexis, Lexis Advance through Acts of the 2015 - 2016 Legislative Session).

competitive circumstances is nonpayment of sums due under the franchise, franchisee will have 10 days to cure the deficiency.

- (ii) For Wisconsin franchisees, the Wisconsin Fair Dealership Law⁴², supersedes any provisions of the Franchise Agreement or a related contract which is inconsistent with the Law.

O. General Overview Of Addenda For Business Opportunity States

Business opportunity laws are often given little thought by established franchisors. While many business opportunity laws contain exemptions for franchise programs in general, in several state statutes there is no such exemption. Instead, franchisors tend to rely on exemptions for business opportunities that license a registered trademark. In particular start-up franchisors that do not yet have a federally registered trademark and franchisors that are rolling out a new trademark that is not yet registered should understand the requirements of these business opportunity laws.⁴³ However, other franchisors should not ignore the business opportunity laws either. By making certain representations any franchisor may fall within the scope of these business opportunity laws.

The trademark related exemption in these state business opportunity laws, for example, does not always exempt the franchisor from the entire statute. For example, North Carolina's business opportunity statute reads in the typical fashion for this group of business opportunity laws. Under the statute, a business opportunity is defined as:

the sale or lease of any products, equipment, supplies or services for the purpose of enabling the purchaser to start a business, and in which the seller represents:

(1) That the seller will provide locations or assist the purchaser in finding locations for the use or operation of vending machines, racks, display cases or other similar devices, or currency-operated amusement machines or devices, on premises neither owned nor leased by the purchaser or seller; or

(2) That it may, in the ordinary course of business, purchase any or all products made, produced, fabricated, grown, bred or modified by the purchaser using in whole or in part, the supplies, services or chattels sold to the purchaser; or

(3) The seller guarantees that the purchaser will derive income from the business opportunity which exceeds the price paid for the business opportunity; or that the seller will refund all or part of the price paid for the business opportunity, or repurchase any of the products, equipment, supplies or chattels supplied by the seller, if the purchaser is unsatisfied with the business opportunity and pays to the seller an initial, required consideration which exceeds two hundred dollars (\$200.00); or

⁴² Wis. Stat. §§ 135.01 through 135.07 (LexisNexis, Lexis Advance through Acts of the 2015 - 2016 Legislative Session).

⁴³ In particular, the state business opportunity laws of Connecticut, Georgia, Maine, North Carolina and South Carolina, all discussed below.

(4) That it will provide a sales program or marketing program which will enable the purchaser to derive income from the business opportunity which exceeds the price paid for the business opportunity, provided that this subsection shall not apply to the sale of a marketing program made in conjunction with the licensing of a federally registered trademark or a federally registered service mark, or when the purchaser pays less than two hundred dollars (\$200.00).⁴⁴

Franchisors would typically rely on subsection (4) of the above definition because they have a federally registered trade or service mark. However, note that the exception for programs with registered marks only apply to subsection (4). Thus, if the franchisor includes a repurchase provision in its franchise agreement or otherwise falls within the scope of subsections (1) and (3), the franchisor would still be subject to the business opportunity statute in North Carolina and would have to ensure that it complies with the disclosure obligations of the North Carolina business opportunity law.

Connecticut, Georgia, Maine, North Carolina and South Carolina are all states that do not have franchise specific exemptions in their state business opportunity laws. The good news with respect to each of these states is that a franchisor can use its regular FDD, with the appropriate state addenda.⁴⁵

Note that the below requirements would only apply to a franchisor that is licensing a mark that is not registered or that otherwise fall within the business opportunity definition of these business opportunity statutes. Registration, timing of disclosures, rescission rights and other franchisee protective measures can be found in the statutes and should be reviewed by franchisor and its counsel if these statutes may apply.

1. **Connecticut**

In Connecticut, a cross-reference sheet is required to be included with the franchise filing.⁴⁶ It compares where disclosures required under the Connecticut business opportunity law can be found in the FDD. Typically the disclosure requirements in the Connecticut statute do not match up perfectly with the FTC Franchise Rule and some additional disclosures may also be required to be included in a state addendum.

Like the other states listed in this section, Connecticut also requires that a state-specific cover page be added to the FDD disclaiming the state's approval of the content of the FDD.

⁴⁴ N.C. Gen. Stat. Sec. 66-94 (Lexis Advance through Session Laws 2016-3, 2016 2nd Extra Session).

⁴⁵ Business opportunity law compliance can present significant challenges, especially for exempt franchisors. For a more in depth review of the applicability of business opportunity laws to franchisors, see Beata Krakus and Alexander Tuneski, *Caught in the Web of Federal and State Business Opportunity Laws: Managing and Avoiding the Entanglement of Regulations*, 36th Annual ABA Forum on Franchising (2013).

⁴⁶ Conn. Gen. Stat. §36b-63 (2007).

2. Georgia

Compliance with the Georgia business opportunity statute is relatively simple, as all the franchisor has to do is to include a Georgia specific cover page⁴⁷. Note that other obligations, such as escrowing initial fees, may arise under the Georgia statute.

3. Maine

Maine accepts the FDD as the disclosure document under its business opportunity statute, but there is certain additional information that may have to be included in a Maine specific addendum.⁴⁸ For example: the addendum will have to list the names and addresses of required suppliers; the types of permits and licenses that the franchisee must obtain; disclosures about availability of substantiating materials for any FPRs made in the FDD; and information about the statutory rescission right the franchisee has. The franchisor must also disclose information about the bond it is required to keep under the statute.⁴⁹

4. North Carolina

The North Carolina business opportunity law can be complied with simply by including a state-specific cover page.⁵⁰

5. South Carolina

The South Carolina business opportunity law can be complied with simply by including a state-specific cover page.⁵¹

III. MISCELLANEOUS/OTHER STATE REQUIREMENTS INCLUDING RELATIONSHIP LAW STATES

These authors have seen a lot of variation from franchise system to franchise system and from firm to firm in the state addenda that are included in the FDD and/or related agreements. This section highlights certain business opportunity or relationship law states for which the authors have seen addenda disclosures that are not explicitly required by state law. Prior to including them, franchise lawyers and their clients should give some thought as to whether the inclusion of these disclosures are absolutely necessary. In Section V.B.3, we discuss some issues to consider when determining whether to include an addendum that is otherwise not explicitly required.

A. Arkansas

Under the Arkansas Franchise Practices Act, franchisors are required to provide at least ninety days written notice in advance of terminating, cancelling or failing to renew a franchise

⁴⁷ Ga. Code Ann. §10-1-411(b) (2003).

⁴⁸ Me. Rev. Stat. tit. 32, §4693 (1999).

⁴⁹ Me. Rev. Stat. tit. 32, §4693 and § 4695 (1999).

⁵⁰ N.C. Gen. Stat. § 66-95 (Lexis Advance through Session Laws 2016-3, 2016 2nd Extra Session).

⁵¹ S.C. Code Ann. § 39-57-30 (LexisNexis, Lexis Advance through all legislation from the 2016 session).

except for specific instances of good cause set forth in the statute.⁵² It is likely for this reason the authors have seen in the FDDs of older systems, the following type of addenda language:

Arkansas law may supersede certain provisions of the Franchise Agreement, including in the areas of termination or nonrenewal of your franchise.

B. Delaware

The Delaware Franchise Security Law provides that notwithstanding any provision in a franchise agreement which provides otherwise, a franchisor must provide at least ninety days' notice prior to any termination of a franchise or election not to renew a franchise.⁵³ As a likely means to address this relationship law concern, the following addenda language was included in an FDD:

Delaware law may supersede certain provisions of the Franchise Agreement, including in the areas of termination or nonrenewal of your franchise.

C. Iowa

Although franchisors are exempt from the Iowa business opportunity law so long as they comply with federal and Iowa disclosure laws,⁵⁴ the Iowa Code does not explicitly exempt franchisors from complying with a "cooling off period" or limited rescission option contained in the Code. The following addendum could be included:

Pursuant to Iowa's Business Opportunity Promotions, Revised Code Sections 551A.1, *et. seq.* if this offer is made to you in Iowa, if you agree to purchase this offer in Iowa or if you are a resident of Iowa and the franchise is or will be operated in Iowa, this Addendum shall serve as notice to you that you have the right to cancel this transaction within three business days of the date you sign the Franchise Agreement or we accept the Franchise Agreement, whichever is later.⁵⁵

D. Mississippi

The Mississippi Code states that a franchisor may not cancel or otherwise terminate or fail to renew a franchisee without notifying the franchisee of the cancellation, termination or nonrenewal in writing at least 90 days in advance of the cancellation, termination or failure to renew.⁵⁶ It provides an exception to that notice requirement for criminal misconduct, fraud, abandonment, bankruptcy or insolvency of the franchisee, or notably, the "giving of a no account" or insufficient check.⁵⁷ To address this relationship law concern, the following addenda language was included in an FDD:

⁵² Ark. Code. Ann. § 4-72-204(b)(2016).

⁵³ 6 Del. Code § 2554 (Lexis Advance through 80 Del. Laws, ch. 399).

⁵⁴ Iowa Code § 551.A.4 (2007).

⁵⁵ *See id.* at § 551.A.6.

⁵⁶ Miss. Code Ann. § 75-24-53 (1999).

⁵⁷ *Id.*

Mississippi law may supersede certain provisions of the Franchise Agreement, including in the areas of cancellation, termination, or nonrenewal of your franchise.

E. Missouri

The Missouri statute governing pyramid sales schemes and franchise cancellations contains language virtually identical to its equivalent in the Mississippi Code.⁵⁸ It is likely for this reason the authors have seen in the FDDs of older systems, the following type of addenda language:

Missouri law may supersede certain provisions of the Franchise Agreement, including in the areas of cancellation, termination, or nonrenewal of your franchise.

F. Nebraska

For franchise arrangements subject to Nebraska's Franchise Practices Act it is important to note that the statute requires good cause for termination or non-renewal of a franchise and requires, in most circumstances, 60 days' written notice enumerating all of the reasons for termination or non-renewal.⁵⁹ To address this relationship law concern, the following addenda language was included in an FDD:

Nebraska law may supersede certain provisions of the Franchise Agreement, including in the areas of termination or nonrenewal of your franchise.

G. New Jersey

Most franchise lawyers know that New Jersey has a particularly robust Franchise Practices Act requiring good cause for termination and non-renewal, except in certain limited circumstances.⁶⁰ Under the Act, good cause is limited to the failure of a franchisee to substantially comply with requirements imposed by the Franchise Agreement⁶¹. It is likely for this reason the authors have seen in one or more FDDs, the following addenda language:

New Jersey law may supersede certain provisions of the Franchise Agreement, including in the areas of cancellation, termination, or nonrenewal of your franchise.

H. Ohio

Ohio is another one of the business opportunity states that provides an exemption for "any transaction that complies in all material respects" with the FTC Franchise Rule.⁶² Notably, pursuant to Ohio's business opportunity law, a purchaser has the right to cancel an agreement selling or leasing to the purchaser a business opportunity plan.⁶³ That law provides that the

⁵⁸ Mo. Ann. Statutes § 407.405.1 *et seq.*(2001, 2009 pocket part).

⁵⁹ Neb. Rev. Statutes §87-404 (2007).

⁶⁰ N.J. Stat. Ann. 56:10-1 *et seq.* (2001).

⁶¹ *Id.*

⁶² Ohio Rev. Code § 1334.13(A) (2004).

⁶³ If the franchise seller has fully complied with the FTC Franchise Rule, then, in the authors' opinion, the purchaser's cancellation option is moot.

purchaser may cancel the agreement at any time before midnight of the fifth business day after the day on which the purchaser signs the agreement if, the seller has complied with the sections of the statute providing the purchaser of its right to cancel the agreement.⁶⁴ If, on the other hand, the seller has failed to comply with those notice requirements, the purchaser may cancel the agreement at any time within twelve months after the day on which the purchaser signs the agreement.⁶⁵ Franchisors offering franchises to Ohio residents using FTC FDDs may consider including the following language to an addendum to the FDD and/or amendment to the Franchise Agreement if they are concerned that the transaction may not fully comply with the FTC Franchise Rule:

Pursuant to Ohio's Business Opportunity Plan, Revised Code Sections 1334.01, *et. seq.* if you are a resident of Ohio and purchasing a new or renewal franchise, this Addendum shall serve as notice that you have the right to cancel this transaction without penalty or obligation by providing [Franchisor] written notice of cancellation at any time prior to midnight of the fifth business day after you sign the Franchise Agreement.

IV. FEE DEFERRAL OR OTHER FINANCIAL CONDITIONS

All of the registration states that must approve a filing typically condition the approval on the franchisor's demonstration of financial ability to provide pre-opening obligations and services that are promised (e.g., such as real estate, improvements, equipment, inventory, training, or other items included in the offering). If the state's analysis of the franchisor's financial condition concludes that the franchisor lacks the necessary financial strength to do so, the state may issue an impound order for the protection of prospective franchisees. States generally look at three measures of financial strength: (i) a positive net worth; (ii) a ratio of current assets against current liabilities of at least 1:1; and (iii) a profit in the just-concluded fiscal year. Unless the franchisor satisfies all three prerequisites (with some latitude given to start-up franchisors having a strong net worth), it is likely that the state will require one of the financial assurances noted below. State administrators will generally permit franchisors to elect the specific type of financial assurance that will be imposed.

The franchisor's FDD (Item 5 and Item 7), as well as the Franchise Agreement (and possibly other agreements that require pre-opening payments) must also be revised to reflect these conditions. Most states will allow (and some, in fact, require) these changes to be made in the state-specific FDD addendum and in the state rider or amendment to the agreement.

A. Escrow

The franchisor may be required to escrow franchise fees and other funds paid by a franchisee until the franchisor's obligations under the franchise offering have been satisfied (i.e., escrow fees from the date that the franchisee signs until the time when the franchised business opens). The terms of the escrow agreement vary among the states, and some states will negotiate specific terms of the agreement. California, Maryland, Minnesota, New York, and Virginia require that the funds collected from the franchisee be placed in a separate trust account with a bank or trust company located in the state; however, other states permit the

⁶⁴ Ohio Rev. Code § 1334.05(A)(1) (2004).

⁶⁵ *Id.* at (A)(2).

funds to be deposited into accounts that may be located out of the state. Some franchisors may find it difficult to find an out of state bank to serve as escrow agent.

In most cases the franchisor must also file with the franchise examiner an original signed copy of the escrow agreement in a form required by the state. Some states may request a copy of the signed escrow agreement to be included in the FDD as part of the state disclosure addendum. The escrow agreement must include the name and address of the depository and the account number of the escrow account. All checks collected must be made payable to the depository. When the franchisor has satisfied its pre-opening obligations, and the franchisee is able to open for business, the franchisor may apply to the state for authority to direct the escrow agent to release the escrowed funds. In some states the franchisee must sign a statement authorizing the release of funds and the bank must sign a statement noting the funds on deposit for the specific franchisee.

There are clear advantages and disadvantages with using an escrow. A significant advantage over, for example, fee deferral, is that the franchisee must pay the initial fees and payments in advance. There are however significant disadvantages. Setting up an escrow account can be time consuming and expensive. The management can also be problematic, especially if the franchisee never opens its unit. The state regulations of escrowed payments assume that the franchisee will eventually open their unit and when this does not happen ad hoc solutions may be required to get the funds released from escrow.

B. Fee Deferral

The franchisor may be required to defer the collection of franchise fees and other initial payments owed by franchisees until the franchisor has completed its initial obligations under the Franchise Agreement and the franchise is open for business. This requirement is likely to include all fees due to the franchisor prior to opening, such as initial deposits, development fees, training fees, amounts of purchase of product or start up merchandise, regardless of what type of agreement the fees are due under.

Fee deferral has the opposite advantages and disadvantages to escrowing the initial fees. There is no upfront cost involved for the franchisor and no mechanisms to set up. Thus, it is a quick and cheap solution. The downside is that the franchisor must provide the franchisee with initial training and access to its confidential system information before it has received any payment from the franchisee. The franchisor runs the risk of the franchisee walking away from the franchise after it has received crucial information, and without having any financial risk or having made any significant investment into the franchise.

In the authors' experience fee deferral may serve as a temporary solution in a state where the franchisor does not expect to have many sales. If such a state requires a financial assurance the franchisor can elect fee deferral. If a prospective franchisee comes along, the franchisor can then amend its FDD by choosing another form of financial assurance and, thereby defer the cost of the alternative form of assurance until there is a high likelihood that it will sell a franchise. Of course, there is a cost to amend the FDD.

C. Surety Bond

The franchisor may be required to post a surety bond. Typically a state will require that the bond amount be equal to the initial franchise fee (referenced in Item 5) multiplied by the number of franchises estimated to be opened in the state in the next year (referenced in Table 5

in Item 20 of the FDD). Some states require that the bonds be issued by a corporate surety authorized to transact business in the state. The bond must remain in place until any franchisees signed are opened. In subsequent years, if the state requests financial assurances, the franchisor may not only need to maintain the prior year's bond but will be required to obtain an additional bond.

Surety bonds are often obtained through the franchisor's insurance company. For existing, U.S. businesses getting the necessary bond is usually not an issue, beyond the potential expense. As such, it is a relatively hassle free option if financial assurances are required by state franchise examiners. However, for foreign franchisors without prior ties to the U.S. surety bonds often are not a realistic option. Most bond issuers will shy away from foreign parties.

D. Guarantee of Performance

The franchisor may be required to make arrangements with a guarantor (either from a parent or other affiliate) whose financial statements demonstrate an ability to perform the franchisor's obligations in the Franchise Agreement (a few states may permit a non-affiliated party to guarantee the franchisor's obligations). A signed guarantee of performance will be required from the guarantor, as well as the guarantor's audited financial statements, and both must appear in the FDD.

The form of guarantee that must be used is one prepared by NASAA.⁶⁶ One significant difference between using the guarantee of performance and the other options described above in this Section is that the guarantee extends not only to pre-opening obligations of the franchisor. Instead it covers the franchisor's obligations "under its franchise registrations and the Franchise Agreement"⁶⁷, meaning that it does not expire until the Franchise Agreement expires or is otherwise terminated.

E. Informal Undertaking

If a state believes that the franchisor's financial condition is borderline acceptable, it might agree to defer the impound but closely monitor the franchisor's general condition. To do so, the franchisor must submit an undertaking letter certifying that it will file, once a quarter, its unaudited financial statements to the state through the end of its fiscal year.

F. Capital Infusion

A franchisor may be given the opportunity to infuse more capital into the company to provide increased equity. If so, the franchisor must submit an updated unaudited financial statement to demonstrate the change. The state also may require other documents to substantiate the change.

Exhibit B to the paper summarizes the states which have statutes that allow for the various impound condition options. Franchisors should make sure that they comply with any

⁶⁶ Form E to the NASAA 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines).

⁶⁷ *Id.*

escrow or impound requirements and flag their files accordingly, since the failure to comply with such requirements can result in fines or penalties.⁶⁸

V. PRACTICAL STRATEGIES TO PREPARING STATE ADDENDA

A. Multi-State FDDs vs. State-Specific FDDs

The presumption of this paper is that even though state franchise laws may have different disclosure requirements than the FTC Franchise Rule, one disclosure document can be prepared and used throughout the U.S. The FTC Franchise Rule grants express permission to include state addenda with disclosures that are specifically required by state franchise laws.⁶⁹ Even if state statutes are not as explicit as the FTC Franchise Rule, the NASAA Guidelines expressly address this issue as well and permit inclusion of non-preempted state-specific disclosures in state-specific exhibits that can constitute an exhibit to the FDD.⁷⁰ As drafted, the NASAA Guidelines indicate that there can be several state addenda, thus clarifying that it is permissible to include addenda for multiple states in one FDD. This is also the long-time practice of most franchisors offering franchises in different states.

It is of course permissible to create separate FDDs for different states, but it is not something the authors suggest. Administering multiple FDDs is a difficult concept, as the question of what state's laws apply can be complex. For example, imagine a New York based franchisor selling a franchise to two prospective franchisees. One prospect lives in Missouri but wants to open a franchise in Illinois, and one lives in California and is as of yet uncertain where to open his franchised business. In the situation with the Missouri/Illinois prospect we know for certain that New York may claim jurisdiction over the offer and sale. Because of how the applicability provision of the Illinois franchise statutes is drafted it is likely that the Illinois law will not apply. For the California prospect, New York law will apply again and California law will also apply. We don't know if other state laws may also apply as it is possible that they will be triggered by the franchised location being in those states. Without adding complicating factors such as having multiple franchisee owners located in different states and similar factors, the above scenarios show how difficult it may be to discern which state franchise laws apply.⁷¹ Thus, having one FDD for all states creates less of a headache for the sales team and potentially cuts down on the number of FDDs a prospect must receive. There are also situations where franchisors deliberately use separate FDDs. Maybe the most common situation is where during the initial or annual renewal registration process state examiners comment on the content of the FDD.

It should be noted though, that where several state laws may apply to a franchise relationship having one multistate FDD does not resolve all issues. The parties may still be faced with a question of which state law and which state addendum applies to a specific transaction. In our research, we have not come across any cases where the parties had executed multiple state addenda and the court had to determine which one applied. There are, however, multiple franchise cases dealing with choice of law questions. Most courts approach these cases like any other choice of law dispute, often starting with the Restatement (Second)

⁶⁸ Excerpts of this paper are from Leonard Vines, Halima Madjid, Dale Cantone, *Best Practices for State Franchise Registration*, American Bar Association Annual Forum on Franchising, 2009, Toronto, Ontario.

⁶⁹ 16 C.F.R. 436.6(e) (2007).

⁷⁰ NASAA Guidelines pg. 5. The registration states are either members of, or voluntarily follow the NASAA Guidelines.

⁷¹ See Exhibit C to the paper for an overview of the scope of state franchise statutes.

of Conflicts of Law. Under the Restatement, the choice of law provision in a contract should be upheld unless the chosen law has no substantial relationship to the parties to the transaction, or it would be contrary to the public policy of a state which has materially greater interest in the matter than the contractually chosen state.⁷² Were there two addenda, it is possible that a court would adopt a similar analysis, though it may also look at the Franchise Agreement as being ambiguous and start its analysis by resolving the ambiguity.

B. Stylistic Choices

On a stylistic level, different franchisors and franchise counsel take a different approach to the state addenda. Probably the most common approach is to have a separate state addendum to the FDD for each state that requires one, and a separate state addendum to the Franchise Agreement for each relevant state. But examiners appear to accept combined franchise agreement and FDD addenda. Likewise, one running addendum that includes all the state requirements in one, long addendum, also appears to be acceptable. As will be discussed below in Section V. B, while these differences may appear to be purely stylistic, they may in some instances have consequences to a franchisor.

C. What Disclosures Are Not Expressly Required By State Law

One question that arises when drafting state-specific addenda is what language is mandatory. Section II of this paper and Exhibit A addresses disclosure requirements in some detail, but the answer to the question is state and provision specific, and drafters should carefully consider the potential consequences of their choices and the wording of specific addenda.

As discussed above in this paper, some states require FDD addenda and franchise agreement addenda.⁷³ Amongst those states, there are some that require only an FDD addendum and some that require addenda to both the FDD and the Franchise Agreement. Other states do not require any addenda.⁷⁴ Additional state addenda are also required for franchisors that do not have a federally registered trademark or service mark or otherwise fall within the scope of state business opportunity laws.⁷⁵

When not required, determining whether to include an addendum is a decision that should be reviewed carefully. There are two general schools of thought. One is that franchisors should not disclose more information about franchise laws than is required by law. The other is to disclose information about franchise laws as, arguably, they apply whether or not they are disclosed.

The minimalist approach would be to only include those addenda and disclosures that are expressly required. Reasons for not including non-mandated disclosures include taking a literal approach to the state disclosure requirements; not wanting to unnecessarily inform prospective franchisees of legal rights the prospect is unaware of; and not wanting to make an

⁷² See e.g. *Grand Kensington, LLC v. Burger King Corp.*, 81 F.Supp.2d 834, 837 (E.D. Mich. 2000).

⁷³ California, Hawaii, Illinois, Maryland, Michigan, Minnesota, New York, North Dakota Rhode Island, Virginia, and Washington require a state addendum for a multi-state FDD to be used in the state. Illinois, Maryland, Minnesota, New York, Rhode Island, and Washington also require a state addendum to the Franchise Agreement.

⁷⁴ Indiana, South Dakota, Virginia and Wisconsin typically do not require addenda. There may be situations, such as when financial assurances are required, when an addendum may be necessary.

⁷⁵ See e.g. Ga. Code Ann. §36b-63 (2007).

already long FDD even longer. The inclusionary approach would be to include addenda and disclosures even when they are not required. This approach may be based in the view that since the law already grants a franchisee these rights there is no point in hiding them. However, which approach to take is more than a philosophical quandary. It may have a direct impact on the franchisor's and franchisee's rights. The question of whether or not to include state addenda that are not mandated by law or franchise examiners raises warring issues of, on one hand, franchisee expectations and the states' intent to protect the presumed weaker party through anti-waiver provisions in state franchise laws, and on the other hand, federal preemption and freedom of contract.

Many courts will disregard whether a state addendum was executed and enforce state franchise laws on public policy grounds whether there was an addendum to the Franchise Agreement or not. For example, in *Hengel, Inc. v. Hot N' Now, Inc.*⁷⁶ the Michigan-based franchisor argued that the Illinois Franchise Disclosure Act should apply on public policy grounds even though the contract provided for a different state's law. The case does not mention any Illinois addendum to the Franchise Agreement. Yet, the court analyzed whether there were sufficient public policy grounds to deviate from the Illinois preference for enforcement of choice of law provisions, and the relationship between Illinois and the parties to the transaction and found this to be the case.⁷⁷ This is a typical approach in the majority of cases reviewing anti-waiver provisions in state franchise laws. From a drafter's perspective it doesn't really provide guidance to whether to include non-mandatory addenda and disclosures. It simply doesn't matter whether the franchisor included a state addendum specifying that state law may prevail.

However, while the above analysis is common, not all cases follow the *Hengel* logic. Some courts take a literal approach to state addenda and clearly distinguish between addenda to the FDD and the Franchise Agreement. For example, in *Defazio v. Expetec Corp.*⁷⁸ the Rhode Island addendum to the disclosure document provided that Rhode Island law restricts venue to an in-state forum. However, there was no Rhode Island addendum to the Franchise Agreement. The court found that because the addendum was to the disclosure document and not to the Franchise Agreement itself the dispute resolution provision in the Franchise Agreement was not affected by the disclosure document addendum.

Contrary to *Defazio* and *Hengel*, *Great Earth Companies, Inc. v. Simons*⁷⁹ provides incentive to franchisors and their counsel to include franchise agreement addenda even when they may not be strictly required. In *Great Earth*, the franchisor's disclosure document contained the required Michigan addendum, which includes a statement that franchise agreement provisions requiring arbitration outside the state are void as against the franchisee. The franchisor did not have a Michigan addendum to its franchise agreement and the standard dispute resolution provision in the disclosure document provided for arbitration in New York. The Southern District of New York, acknowledging, but apparently disregarding the federal preemption of state statutes limiting the parties' right to arbitrate, found that the franchisor had induced the franchisee by fraud to enter into the arbitration provision in the agreement.⁸⁰ In *Great Earth*, had a Michigan franchise agreement addendum been included, and that

⁷⁶ *Hengel, Inc. v. Hot N' Now, Inc.*, 825 F.Supp. 1311 (N.D. IL 1993).

⁷⁷ *Id.* at 1315.

⁷⁸ *Defazio v. Expetec Corp.*, Nov. Civ..A. 08-180S, 2006 WL 162327 (Jan 20, 2006 D. RI).

⁷⁹ *Great Earth Cos., Inc. v. Simons*, 288 F.3d 878 (6th Cir. 2002).

⁸⁰ *Id.* at 884. In some interesting twists and turns it turned out that the franchisee had nonetheless acknowledged it was aware of the arbitration provision and the case only dealt with the question of venue for the arbitration.

addendum set forth that Michigan law may void the arbitration forum provision, except as that law may be limited in its applicability by the Federal Arbitration Act⁸¹, it is hard to see a fraudulent inducement claim, and the outcome may have been different.

In many instances franchisors have no control over how to draft the state addenda to the FDD or their agreements. Specific disclaimers and statements are required by state laws and regulations. In other instances the requirements for specific disclosures are a result of comments made by state examiners.

With respect to other addenda requirements, however, franchisors have options. In general it is advisable for a franchisor to stay as close to the statutory requirements as possible so as not to overstate the changes to the Franchise Agreement that result from the addendum. There are at least two aspects to not drafting overly broad addenda. The first is who the addendum will apply to. The second is to what rights the addendum entitles the franchisee to.

With respect to applicability of state addenda, it is suggested that drafters consider the applicability generally of the state franchise law. Thus, state addenda should specify that they only apply if the state franchise law is applicable to the transaction.⁸²

With respect to the rights of the franchisee, franchisors should be mindful to avoid any unnecessary expansion of the franchisees rights.

Franchisors should also avoid any inadvertent conflicts with federal law. Federal law is particularly important in states where the franchise law prohibits or otherwise limits the parties' right to arbitrate disputes.⁸³ The Federal Arbitration Act ("FAA")⁸⁴ provides that arbitration provisions in commercial contracts are valid, except on grounds that would invalidate contracts in general.⁸⁵ As such, the FAA preempts state franchise laws that limit the parties' right to arbitrate claims under their franchise agreements.⁸⁶ It also preempts limitations on the parties' right to arbitrate out of state and other restrictions on the parties' right to arbitrate.⁸⁷

Beyond these general suggestions each franchise system will have to take its own circumstances into consideration. Where the franchisor is based, whether it wishes to litigate or arbitrate, where it wishes to litigate or arbitrate will all weigh in on how addenda are drafted.

D. The Exemption Mystery – If a Franchisor is Exempt from Registration or Disclosure are the State Addenda Still Required?

The authors have referred to this section as the exemption mystery for good reason. Ask a practicing franchise attorney whether a franchisor exempt from state registration or

⁸¹ 9 U.S.C. §1 *et seq.* (LexisNexis, Lexis Advance through PL 114-219, approved 7/29/16)

⁸² See Exhibit C to this paper for a review of the applicability of different state laws.

⁸³ For franchisors whose franchise agreements provide for dispute resolution through litigation the references to federal law would not be as important. Currently Maryland, Michigan, Minnesota, Rhode Island and Washington franchise laws contain venue and forum restrictions.

⁸⁴ 9 U.S.C. §1 *et seq.* (LexisNexis, Lexis Advance through PL 114-219, approved 7/29/16).

⁸⁵ 9 U.S.C. §2. (LexisNexis, Lexis Advance through PL 114-219, approved 7/29/16).

⁸⁶ *Southland Corp. v. Keating*, 104 S. Ct. 852 (1984).

⁸⁷ *Alphagraphics Franchising, Inc. v. Whailer Graphics, Inc.*, 840 F.Supp. 708 (D. AZ 1993) (the FAA preempted the Michigan Franchise Investment Law with respect to venue for arbitration); *Doctor's Associates, Inc. v. Casarotto*, 116 S. Ct. 1652 (1996) (Montana state law requirement that arbitration provision be on the first page of franchise agreement and underscored was preempted by the FAA).

disclosure is required to include that state's addendum in the FDD and you may get several different answers. The most prudent course of action is to check that specific state's franchise law and regulations. Drilling down on the precise answer, while frantically paging through the delicate pages of the Business Franchise Guide, may still prove to be a difficult task.

In sum, the authors' opinion is that unless a state explicitly mandates inclusion of the addenda, it is not required. However, even if the addenda is not explicitly required, franchise attorneys must still assess the pros and cons to determine whether exclusion of the addenda would cut against the spirit and purpose of the addenda—to inform the oftentimes less sophisticated investor of its rights under the applicable state law—and lead to potential legal exposure in the future. A review of three states' franchise laws follows:

1. California

Section 31101 of the CFIL exempts from registration under Section 31110 and disclosure,⁸⁸ for example: the offer and sale of a franchise where the franchisor complies with certain minimum net worth, experience, streamlined disclosure, and notice filing requirements,⁸⁹ an offer, sale, other transfer, or any interest in a franchise to an out-of-state franchisee or of an out-of-state franchise,⁹⁰ an offer or sale to an experienced franchisee,⁹¹ or any offer or sale to a large franchisee.⁹² The specific CFIL sections to which the transaction is exempt govern the form and content of the registration application and the FDD.⁹³ For example, Section 31114 states that the registration application must be accompanied by an FDD that contains the “material information set forth in the application, for registration, as specified by rule of the commissioner, and such additional disclosures as the commissioner may require.”⁹⁴ The absence of this specific language from the requirements under the exemptions listed above and the fact that those exemptions do not require compliance with Section 2 of the CFIL suggests that the “additional disclosures as the commissioner may require (i.e. the California state addendum) is not required.

2. Maryland

Section 14-214(b) of the MFRDL exempts from registration any other transaction that the Commissioner exempts by regulation because: “(i) the transaction is not within the purpose of this subtitle; and (ii) the registration of the transaction is not necessary or appropriate in the public interest or for the protection of investors.”⁹⁵ One such example is for seasoned franchisors who have a net equity, according to the most recently audited financial statements, of not less than \$10,000,000 on a consolidated basis, or \$1,000,000 and is at least 80% owned by a corporation or entity that has the higher net equity and guarantees the performance of the franchisor's obligations.⁹⁶ The seasoned franchisor must also have 25 franchisees conducting the same franchised business at all times during the 5-year period immediately preceding the

⁸⁸ See, e.g., Cal. Corp. Code §§ 31111 (Form and Content of Disclosures) and 31114 (Prospectus) (West 2006).

⁸⁹ Cal. Corp. Code §31101 (West 2006).

⁹⁰ *Id.* at §31105.

⁹¹ *Id.* at §31106.

⁹² *Id.* at §31109.

⁹³ *Id.* at §§ 31111 and 31114.

⁹⁴ *Id.*

⁹⁵ Md. Code Ann. § 14-214(b)(3) (LexisNexis, Lexis Advance through July 1, 2016).

⁹⁶ Md. Code Regs. tit. 2 § 2.2.8.10(D) (2009).

offer or sale.⁹⁷ To take advantage of this exemption the franchisor must, among other things, file a notice of exemption, pay a filing fee and one copy of its FDD.⁹⁸ There is no explicit requirement that the FDD filed with the exemption filing include the state addendum and as long as the authors have been filing exemption applications in Maryland, no state examiner has ever asked for one where it was excluded.

3. Illinois

Section 705/8 of the IFDA also contains a seasoned franchisor exemption that exempts the franchisor from the registration requirements of the IFDA. However, an express condition of the Act is that the franchisor is required to “deliver to the prospective franchisee a disclosure statement in accordance with the requirements” of the Act.⁹⁹ That disclosure statement must be prepared according to, the FTC Franchise Rule, the NASAA Guidelines, and “the rules adopted by the Administrator.”¹⁰⁰ One interpretation of the Act is that because the seasoned franchisor exemption contains no explicit requirement to include a state addendum, one is not required, another reasonable interpretation is that inclusion of the state addenda is necessary because the exemption does not exempt franchisors from complying with the requirement that the disclosure statement be prepared according to rules adopted by the administrator.

It is also imperative to remember that even though inclusion of a state addendum may not be clearly required under a state’s franchise and disclosure law, that law may still govern some facet of the parties’ relationship at a later time if a dispute arises. For example, under the IFDA, a waiver of the state law is void with respect to issues such as termination or nonrenewal of the Franchise Agreement.¹⁰¹ Inclusion of a state addendum not only protects the franchisee by providing information about its rights under the applicable state law, it can also serve as a reminder notice to a franchisor that a termination or nonrenewal of that particular franchisee is subject to notice and other requirements when time comes to end the franchise relationship.

E. Suggested Ways to Work with State Examiners on Addenda-Change Requests

1. The Comment Letter Conundrum

Whenever franchisors and their counsel receive a response to an application for a state franchise registration there is a little bit of trepidation. Will there be comments? If so, can they be dealt with quickly or will they require extensive discussions and arguments back and forth with the franchise examiners? Assuming a franchisor wants to maintain one multistate FDD, the comments must be addressed not only in the FDD that is being filed with the state the comment letter originated from, but also in all other states in which the franchisee is seeking registration of its FDD.

The consequences of state comment letters are often aggravated by the fact that the response time from different states can vary widely, including comments received from one state after the FDD has already been approved in other states.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ 815 Ill. Comp. Stat. 705/8 (LexisNexis, Lexis Advance through P.A. 99-584, except for portions of P.A. 99-556, and P.A. 99-576 of the 2016 Regular Legislative Session).

¹⁰⁰ *Id.* at 705/16.

¹⁰¹ *Id.* at 705/41.

This raises the question whether the franchisor can make changes to the FDD that are responsive to the comment letter without refiling the FDD with other state franchise examiners who have already approved.¹⁰² Before delving in to how the need to refile can be minimized it is worth pointing out that the approach of franchise examiners and practitioners alike to making changes to the FDD vary greatly. Empirical research with both groups indicate that some believe it is acceptable to make relatively significant changes to the FDD without having to re-file the FDD with states that have already approved the FDD, while others consider every change to the FDD to require a re-filing. There is no right or wrong approach, though the authors would caution to make overly large changes without re-filing the FDD with the franchise registration states. This is especially the case if the required change could have an impact on a prospective franchisee's decision whether or not to buy a franchise.

The first thing to do when receiving a comment letter is to ascertain whether the examiner has grounds for making the comment. Because most franchisors are on calendar year fiscal year and their annual renewals therefore coincide, state franchise examiners have a significant workload in the spring. Oftentimes, some comments are made due to oversights in reviewing the FDD. If the information requested is already in the FDD, examiners will typically withdraw their comment. Likewise, frequently comments may be due to a misunderstanding of the information disclosed and an explanation of what was intended is sufficient.

Dispensing with comments relating to mistakes on the practitioner's or franchise examiner's side as discussed above, there are still options available to a franchisor who has received comments. For example, if the comment is not with regard to a disclosure that was overlooked by the franchisor, there is still often plenty of room for discussion. It may be a matter of interpretation of the required disclosure. For example, where a franchisor's initial fee is variable and depends on the size of the territory a franchisee receives, different examiners view the level of detail required about the formula differently. Some will permit a franchisor to simply state that the initial fee will vary depending on the size of the territory, while others may require more information about how the initial fee will be determined. There is not necessarily any right or wrong answer and it is a matter for discussion between the franchisor and the franchise examiner what information will be required.

One important point to remember when negotiating with examiners is that it is their job to protect franchisees in their state. Thus, it is often worth discussing with them what impact the required change will have on franchisees. There may be circumstances present in which the required change will not be as important as in the typical case. For example, the level of initial investment in the franchise may be such that the franchise only attracts sophisticated franchisees, or maybe the level of initial investment is so low that the prospective franchisee's risk exposure is very low.

2. Conflicts Between Examiners and State Law

A relatively common area of contention where there should be some room for negotiation are disclosure requirements that are not strictly required by the FTC Franchise Rule or state franchise laws and regulations. For example, in recent years California examiners have commented on the naming convention in franchise programs. Some franchisors refer to themselves as "licensors" and to their franchisees as "licensees." California examiners have claimed the licensor/licensee terminology to be potentially confusing and requested changes to

¹⁰² The issue here should not be overstated. Most of the states that are quick to approve do not require filing of material change amendments, so those registrations are not affected by later changes to an approved FDD.

the FDD. Similarly Maryland examiners have been requiring that franchisors include disclosures about spousal guarantees in the FDD in Item 15. Neither the terminology requirement, nor the spousal guarantee disclosure is expressly required by the FTC Franchise Rule or by the applicable state laws. These are only two examples and there are many additional variations. Sometimes they are consistent amongst the examiners in a state, but it is not infrequent that the requests are more individual. To some extent it may be possible to negotiate out of these types of comments, though it is hard to press the examiners too much.

The issue with being overly persistent when negotiating with state examiners was one raised by the International Franchise Association in its motion for leave to file an *amicus curiae* brief in support of the franchisor's petition for writ of certiorari in *Dickey's Barbecue*.¹⁰³ The motion points out that "franchisors do not want to create any conflict with state franchise regulators because they can significantly impact the franchisor's right to operate in that state."¹⁰⁴ This statement goes to the heart of the problem franchisors face when negotiating with examiners: they can only push back so much as the examiner's approval of their file stands between the franchisor and its ability to offer and sell franchises in the examiner's state. There is rarely any realistic appeals process that will not significantly impede the franchisor's ability to sell franchises. To boot, franchise filings are required at least annually, so the relationship with the examiner is an ongoing one. Much like franchisors and franchisees usually try to retain a good relationship between them due to the longevity of the franchise relationship, franchisors cannot jeopardize their relationship with the state franchise examiners.

Thus, assuming there are comments that a franchisor must address in their FDD, what can be done? As discussed above, making changes in the body of the FDD will according to many franchise examiners and practitioners require the re-filing of the FDD in most states in which the franchisor is registering its offering. For states where the FDD has yet to be approved this is usually easily handled by resending the changed FDD. For states in which the FDD has already been approved it may require that a material change amendment be filed. The examiners' review of that amendment is usually swift, but there is significant cost involved for the franchisor, both with respect to state filing fees and legal fees for preparing the filing. Franchisors are therefore understandably reluctant to file material change amendments.

3. Addressing Other Substantive Comments in State Riders/Addenda

Depending on the type of comment, some examiners will permit a franchisor to address comments that do not directly impact the standard state addenda by including the required changes in the state addendum for the state from which the comment is coming. It is generally accepted that a change to a state addendum to the FDD or franchise agreement does not require a refiling with any other state. A typical example is if a state requires financial assurances. The normal approach is for the franchisor to add the relevant information to the state addendum without re-filing in other states. Similarly, occasionally examiners will permit other disclosures to be placed in the state addendum. Particularly if the comment relates to a disclosure of minor importance this solution may be acceptable to examiners. This is especially the case if the franchisor believes that it is likely to file a material change amendment during the year and can promise to move the required disclosure to the body of the FDD at the time of amendment. In some instances examiners may even agree to delay disclosure completely until the next time the franchisors files its revised FDD.

¹⁰³ 2015 WL 9596024.

¹⁰⁴ *Id.* at 6.

Finally, one option available to franchisors is to create a state-specific FDD for the state whose examiner is making requests for changes to the FDD that the franchisor is unwilling to make. As discussed in this paper, having multiple FDDs is not ideal, but when the request that the examiner makes is such that the franchisor wants to minimize the impact of the comment, it may still be the best available option. This may be a good option when an examiner is in effect requiring the franchisor to somehow tweak their program in order to get registered or when the comments otherwise may have far-reaching consequences. For example, if a start-up/early stage franchisor whose initial fee depends on the size of the franchisee's territory is required to include a formula for calculating the initial fee, the franchisor may be in a bind. It may not have a very precise formula to include. It may come up with a formula for purposes of getting registered in a particular state, but it may not be willing to use that formula everywhere else. Another example is the question of exclusive territories disclosed in Item 12 of the FDD. The FTC guidance on exclusive territories and exceptions to the exclusivity is often not consistent with what franchisors deem to be an exclusive territory. In both those examples, an examiner may be within their right to request a change, yet the franchisor may be unwilling to revise its multistate FDD and a state-specific FDD may be of value.

With respect to state-specific FDDs, it is important to note the FTC guidance with respect to financial performance representations/Item 19. The FTC in its Frequently Asked Questions to the FTC Franchise Rule,¹⁰⁵ FAQ 38, considered what a franchisor should do if a state requests a change or removal of a financial performance representation ("FPR"). The FTC concluded that such a comment puts in question whether the franchisor has a reasonable factual basis for the FPR. As having a reasonable basis is a prerequisite for any FPR,¹⁰⁶ agreeing to the changes required by a state examiner indicates that the FPR lacks such a basis, and thus it should be removed from all FDDs used by the franchisor.¹⁰⁷

F. Best Practices For Maintaining and Administrating State Addenda

It is important for franchisors to maintain and have the proper procedures in place for using any required state addenda. As part of the FDD annual update process and franchise registration filings, franchisors or practitioners should review relevant state franchise registration and disclosure requirements, as well as state relationship laws, before filing to ensure that the FDD, franchise agreement, and all other exhibits comply with the state-specific requirements.¹⁰⁸ There are multiple ways to draft the state addenda. For example, practitioners should consider whether they want to use state addenda that refer to the specific sections of the agreements and items of the FDD that are being modified or, alternatively, whether they want to use state addenda that merely refer to the modifications for each state that need to be made without reference to specific section numbers or items. If the first approach is used, the state addenda should be carefully reviewed each year to ensure consistency with any updated language in the agreements for FDD.

After completion of the state application filings and once a registration is granted by the state administrator, franchisors should keep meticulous records of the current form of FDD and

¹⁰⁵ <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs>

¹⁰⁶ 16 C.F.R. 436.5 (s)(3) (2007).

¹⁰⁷ Minor changes to footnotes and disclaimers are arguably not affected by FAQ 38, and there may be other circumstances in which it can still be possible to make a change to Item 19 in one state without making it so everywhere.

¹⁰⁸ Leslie Curran, et. al., *Franchise Law Compliance Manual: Franchise Disclosure and Sales Compliance* (Jeffrey A. Brimer (ed.) 2d ed., American Bar Association 2011) ch. 2, p. 91.

state-specific addenda to be used in connection with franchise sales in a particular state or multi-state transaction. This is especially true when states request changes to the state addenda. Prior versions of the state addenda should be archived so that they are not inadvertently used. Those individuals working on agreement preparation should understand the significance of the state addenda and when to use the various state addenda, understanding that certain transactions may trigger the franchise laws of more than one state. The FDD and state addenda documents used should be clearly identified and distributed to prospective franchisees and make sure the appropriate state addenda documents are signed for the applicable states involved in the franchise deal. Prior to execution of agreements, a final review should be done to determine overall compliance to include whether the state addenda, if any are required, have been correctly executed.

VI. TYPICAL FDD ITEMS AND AGREEMENT PROVISIONS AFFECTED AND CONSEQUENCES OF AMENDMENTS

Franchisors are required to spell out the most salient franchise relationship terms of the parties' franchise agreement in Item 17 including, those provisions governing termination, renewal, choice of law and dispute resolution.¹⁰⁹ On the other hand, as discussed in Section II of this paper, many of the state franchise laws contain anti-waiver provisions that attempt to render ineffective franchise agreement provisions containing foreign governing law, venue and forum¹¹⁰ clauses. Because many of the states' franchise laws impose their own jurisdictional requirements as a means to protect franchisees and franchise transactions for which the laws may be applicable, it is important for both franchisors and franchisees to understand the potential interplay between the Franchise Agreement obligations summarized in the FDD and set out in the Franchise Agreement with those obligations imposed under state law.

Indeed this was the crux of the problem in *Dickey's*¹¹¹ where the Fourth Circuit bifurcated Dickey's common law claims for breach of contract from the franchisees' Maryland franchise law claims thereby requiring the parties to pursue their claims against each other piecemeal in two different types of dispute resolution: (1) arbitration before the American Arbitration Association in Texas and (2) litigation before a Maryland district court.

Dickey's, a Texas-based franchisor of quick-service barbecue restaurants, operates franchises across the U.S. After alleged franchise agreement violations by two sets of franchisee operators in Maryland and failed attempts at mediation, Dickey's filed separate arbitration proceedings against both sets of plaintiffs (the "Maryland Franchisees") in Texas pursuant to the terms of the parties' franchise agreements.¹¹² In both matters Dickey's asserted common law claims for breach of contract and the Maryland Franchisees, in turn, filed suit in Maryland seeking, among other things, to enjoin the Texas arbitration and asserting affirmative claims for relief under the Maryland franchise law.¹¹³ The Maryland district court

¹⁰⁹ 16 C.F.R. 436.5 (q) (2007).

¹¹⁰ 815 Ill. Comp. Stat. 705/19-20 (LexisNexis, Lexis Advance through P.A. 99-584, except for portions of P.A. 99-556, and P.A. 99-576 of the 2016 Regular Legislative Session).

¹¹¹ *Dickey's Barbecue*, supra note 1.

¹¹² The two sets of plaintiffs were Justin Trouard and Jessica Chelton in one matter and Matthew and Carla Chorley and corporate franchisee Chorley Enterprises, Inc. in the other matter. For ease of reference we refer to the franchisee parties collectively as the "Maryland Franchisees."

¹¹³ *Dickey's Barbecue*, supra note 1, at 559.

consolidated both Maryland lawsuits to decide on the preliminary motions and held the Texas arbitrations in abeyance pending a ruling on preliminary injunction motions.¹¹⁴

The franchise agreements contained a dispute resolution provision (“Article 27”) and “Maryland-specific” provisions (“Article 29”). Article 27 required the parties to proceed to arbitration before the American Arbitration Association nearest to Dickey’s corporate headquarters in Plano, Texas if mediation failed to resolve their dispute.¹¹⁵ Pursuant to Article 27, the parties agreed to arbitrate “all disputes, controversies, claims, causes of action and/or alleged breaches or failures to perform arising out of or relating to this Agreement (and attachments) or the relationship created by this Agreement.”¹¹⁶ On the other hand, the Franchise Agreements provided that the state-specific provisions of Article 29 “control” and that Maryland law would “govern and control any contrary or inconsistent provisions” of the Franchise Agreements.¹¹⁷ It stated that inconsistent provisions were “modified and amended” so that they complied with Maryland law. It also stated that the “provisions of this Agreement shall not require you to waive your right to file a lawsuit alleging a cause of action arising under Maryland Franchise Law in any court of competent jurisdiction in the State of Maryland.”¹¹⁸ The Fourth Circuit observed that Article 29 was similar to Section 02.02.08.16(L)(3) of the Code of Maryland Regulations¹¹⁹ which states that “a franchisor violates the Maryland Franchise Law if it requires a franchisee to [w]aive the franchisee’s right to file a lawsuit alleging a cause of action arising under the Maryland Franchise Law in any court of competent jurisdiction” in Maryland.¹²⁰

The franchisees argued in Maryland district court that the arbitration provision conflicted with the arbitration provision resulting in: (1) the arbitration provision being void and (2) a conclusion that all of the parties’ claims should be resolved in district court. Dickey’s argued that the state provision was not inconsistent---it simply preserved the franchisees’ right to dispute claims under the Maryland law in arbitration or before a court. In the alternative, it argued that if Article 27 and 29 conflicted, the Federal Arbitration Act (“FAA”) would preempt Article 29 as an “invalid prohibition on arbitration.”¹²¹ After the district court determined that the Franchise Agreements were ambiguous since both parties’ interpretation of the contract were plausible, the Fourth Circuit reversed. The Fourth Circuit held that there were no genuine disputes of material facts regarding the parties’ agreement to arbitrate and that the clear language of the parties’ agreement obligated the parties to resolve common law claims in arbitration and the Maryland franchise law claims in state district court.¹²² Notwithstanding its acknowledgement of potentially conflicting results, the court held that the outcome was required under the FAA.¹²³ It noted that if the parties wanted to agree on a single forum for all of their claims, they could have done so.¹²⁴ The U.S. Supreme Court denied a petition for certiorari so, at this time, there is no way to compel a different result.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.* at 559-60.

¹¹⁸ *Id.* at 560.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.* at 560.

¹²² *Id.* at 566.

¹²³ *Id.*

¹²⁴ *Id.*

These franchise agreements contained apparently contradictory provisions in a fashion typical of several franchise agreement that these authors have seen. The franchise agreements provided for arbitration of all claims "arising out of or relating to" the agreements (strongly implicating FAA preemption) but also required, as a result of Maryland requirements, the inclusion of the anti-waiver provision."¹²⁵ The Fourth Circuit opined that had the parties wanted to avoid potentially conflicting results they could have agreed to a single forum for all of their claims.¹²⁶ That rather cursory conclusion begs the questions of whether the Fourth Circuit really understood the rather bureaucratic chess match franchise attorneys engage in with state examiners to get a franchise application approved in a state. Indeed, the court seemed inclined to disregard any arguments that a franchisor in today's registration regime cannot require the parties to agree to a single forum for all of their claims unless that forum is the forum of the franchisee's choosing or is a state court as required by state law.

So what options do franchise attorneys drafting these state addenda and negotiating with state examiners ultimately have to successfully get franchisors registered or renewed? One might argue that a natural result of the Fourth Circuit's decision in *Dickey's* is that the parties might be forced to a settlement table sooner in order to avoid the significant cost and expense of litigating potentially overlapping claims in two different states and two different forums. Another argument is that the outcome in *Dickey's* is an outlier and that other courts will appropriately recognize FAA preemption when they see it. At the drafting stage, the franchise attorney must carefully consider the potential conflicts between the Franchise Agreement's dispute resolution provisions and the anti-waiver provisions of state franchise laws and draft the addenda so that they are consistent as possible with the outcome the franchisor seeks to achieve (and avoid).

Notably, Maryland is alone among the franchise registration states in requiring that the franchise agreement addenda provide for in-state litigation of disputes under the state's franchise statute. But, there are other states that require in-state dispute resolution. Setting aside the presumption of FAA preemption, *Dickey's* illustrates that a franchisor may not be able to enforce an out-of-state arbitration provision in those states. It is also possible that franchisees will try to question the enforceability of the entire dispute resolution provision where a state franchise law puts only the venue of the dispute resolution in question. There really is no fail-safe drafting method to avoid these issues completely, but one approach that has met with some success is to write dispute resolution provisions as permissive as opposed to mandatory. Instead of requiring that disputes be arbitrated in an out-of-state proceeding the dispute resolution provision in the franchise agreement can give the party the right – but not the obligation – to do so.¹²⁷ This approach preserves a franchisee's right to litigate in a state court, while not invalidating the arbitration provision.

¹²⁵ *Id.* at 559-60.

¹²⁶ *Id.* at 566. The Fourth Circuit rejected *Dickey's* Barbecue's argument that *Zaks v. TES Franchising*, No. 3:01CV2266JBA, 2004 WL 1553611 (D. Conn. July 9, 2004) supported its argument that Article 29 preserved the Maryland Franchisees' rights to pursue their Maryland franchise law claim in arbitration or court because "the parties there executed an addendum to their agreement expressly stating that the arbitration provision overrode any provision permitting suit in Maryland." *Id.* citing *Zaks*, 2004 WL 1553611, at *2. As the authors understand it, state examiners do not likely allow that approach.

¹²⁷ See e.g. *Ramada WorldWide, Inc. v. SB Hotel Mgmt. Inc.*, Civ. No. 2:14-02186 (WJM), 2016 WL 758536 (Feb. 23, 2015, D. N.J.). While this case deals with a dispute resolution provision requiring litigation the court's analysis is informative. Because the dispute resolution provision permitted litigation in New Jersey, but did not require it, it was not in violation of the Minnesota franchise statute that prohibits waivers of in-state dispute resolution. Because the

Indeed one wonders whether these types of considerations were factored in when the underlying Franchise Agreement addenda of the next case were prepared. In *Long John Silver's*¹²⁸ a federal court denied several franchisees' motions to dismiss for improper venue and, in the alternative to transfer venue thereby requiring the parties to litigate their dispute in Kentucky federal district court instead of Minnesota. In that case, Long John Silver's and A&W Restaurants, Kentucky-based restaurant franchisors (together, "A&W") terminated their Minnesota-based franchisees and sued them in the Western District of Kentucky.¹²⁹ In turn, the franchisees filed suit in federal district court in Minnesota and filed motions to dismiss and transfer venue in the Kentucky litigation.¹³⁰ The case turned on the court's analysis of whether and to what extent the Minnesota Franchise Act (the "Act") governed the Franchise Agreements among the parties¹³¹ The franchisees argued that the Act governed the Franchise Agreements as a matter of public policy and that Minnesota was the proper forum. A&W countered that the Act did not govern the parties' agreements since the Franchise Agreements did not contain provisions violating the Act or the franchisees' rights.¹³²

The court considered the Act's anti-waiver provisions which prohibit Minnesota franchisees from being bound by foreign choice of law and forum selection clauses that would deny them procedural and substantive due process rights or their ability to claim certain claims and remedies.¹³³ It then looked to the terms of the parties' Franchise Agreements and addenda. The Franchise Agreement addenda deleted provisions requiring the parties to litigate in Kentucky and acknowledged that the Act prohibits franchisors from requiring Minnesota-based franchisees to litigate outside Minnesota.¹³⁴ The court found that the Franchise Agreements did not *explicitly* require that litigation occur outside of Minnesota and was otherwise silent as to the appropriate venue. It opined that the acknowledgment that the franchisees could not be required to litigate outside of Minnesota did not "amount to [an] obligation to litigate all claims in Minnesota."¹³⁵ In sum, the Franchise Agreements did not force the franchisees to submit to a forum or law that would otherwise be improper. The court found that Kentucky had a substantial connection to the parties' claims since the Franchise Agreements were negotiated and executed in Kentucky and payments were tendered there. Accordingly, the Act was not violated and A&W was free to pursue its claim where it opted to.¹³⁶ Moreover, while the court determined that Minnesota would be an "adequate alternative forum," it also noted that a transfer of the litigation to Minnesota would shift some of the inconvenience of litigation from the franchisees to A&W. Thus, by deleting a requirement that the franchisees be required to litigate in Kentucky and including an acknowledgment of the Act's anti-waiver provisions, the litigation was allowed to proceed in the original venue and forum.

franchise agreement permitted the franchisee to bring an action in Minnesota the action brought in New Jersey was not contrary to Minnesota law.

¹²⁸ *Long John Silver's, Inc. et al. v. Nickleson, et al.*, No. 3:11-CV-93-H, 2011 WL 5025347 (W.D. Ky. Oct. 21, 2011).

¹²⁹ *Id.* at *2.

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² *Id.*

¹³³ The court observed that, "in other words, the Act does not command that all franchise agreements with Minnesota franchisees *unquestionably be filed and litigated in Minnesota and decided by Minnesota law.*" *Id.* at 3 (emphasis added).

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

VII. WHAT ADDENDA TO USE WHEN MULTIPLE STATE FRANCHISE LAWS APPLY TO ONE TRANSACTION

The jurisdictional scope of the state registration laws varies. An offer or sale of a franchise can occur under several circumstances, which are defined in the particular state statute, and may be based upon:

- (a) meetings between the franchisor and prospect;
- (b) an offer that originates from the state;
- (c) an offer that is directed to the state;
- (d) acceptance of an offer directed to the state;
- (e) an offer to a prospect who resides in the state;
- (f) an offer to franchisee who resides in the state;
- (g) the state in which the franchise will be located; or
- (h) the state in which a franchisee's territory will be located.¹³⁷

As a result, in some cases a franchisor may be required to register in more than one state for the same transaction. Some states specifically exempt or do not impose registration requirements on out-of-state sales, thus allowing a franchisor located in a registration state to sell to non-residents of other states who are not otherwise subject to the registration state's coverage. Each sales situation involving multistate transactions is unique and should be independently analyzed and reviewed.¹³⁸ Franchisors must also assess if any state-specific addenda must be signed in conjunction with signing the Franchise Agreement or other agreements.

The table attached to the paper as **Exhibit C** summarizes the state jurisdictional requirements.

¹³⁷ Excerpts of this paper are from Leonard Vines, Halima Madjid, Dale Cantone, *Best Practices for State Franchise Registration*, American Bar Association Annual Forum on Franchising, 2009, Toronto, Ontario.

¹³⁸ Leslie Curran, et. al., *Franchise Law Compliance Manual: Franchise Disclosure and Sales Compliance* (Jeffrey A. Brimer (ed.) 2d ed., American Bar Association 2011) ch. 2, p. 97.

Exhibit A

While there is no definitive answer on exactly what language should be used in the state addenda attached to an FDD or what changes might have to be made in a franchise agreement as a result of local state requirements, this chart describes some of the common revisions that may be required and also discusses some other local requirements that should be observed when filing the registration application and preparing the FDD. Usually most of these items can be included in a state-specific addendum, but in a few cases may have to be in the text of the FDD itself.

1. California

- 1.1 The Addendum needs a statement in all caps that states that a copy of all proposed agreements must be delivered together with the FDD. (CA Franchise Reg. §310.114.1(c)(1), and Dept. of Corp. Guidelines for Franchise Registration.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.2 State whether the franchise or any person in Item 2 is subject to any order of a national securities exchange or association expelling that person. (Guidelines.) Bus. Franchise Guide CCH ¶5051.
- 1.3 The FDD should have a statement about rights available to a franchisee concerning termination and nonrenewal under California law (Business & Professions Code §§20000 to 20043.) (CA Franchise Reg. §310.114.1(c)(5)(A), and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.4 If there is a termination on bankruptcy provision, there must be a statement in the FDD that this may not be enforceable under federal bankruptcy law. (CA Franchise Reg. §310.114.1(c)(5)(B)i, and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.5 If there is a post-term non-compete provision, there must be a statement in the FDD that this may not be enforceable under California law (Business & Professions Code §16600). (CA Franchise Reg. §310.114.1(c)(5)(B)ii, and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.6 If there is a liquidated damages clause, there must be a statement in the FDD that certain liquidated damages clauses are unenforceable under California law (Civil Code §1671). (CA Franchise Reg. §310.114.1(c)(5)(B)iii, and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.7 If the agreement requires binding arbitration, there must be a statement in the FDD that the arbitration provision may not be enforceable under California law. (CA Franchise Reg. s 310.114.1(c)(5)(B)iv, and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.
- 1.8 If California law is not chosen, there must be a statement in the FDD that the foreign choice of law provision may not be enforceable. (CA Franchise Reg.

310.114.1(c)(5)(B)v, and Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶¶5050.23 and 5051.

- 1.9 The FDD must recite in bold-face type of not less than 10 point type that registration does not constitute approval, recommendation or endorsement by the commissioner. (CFIL §31114.) Bus. Franchise Guide CCH ¶3050.33.
- 1.10 If any earnings claim is made and the earnings claim does not include costs of sales or operating expenses, a prescribed statement must be included. (Guidelines.) **[Use state-specific language]** Bus. Franchise Guide CCH ¶5051.
- 1.11 A statement should be added to the Addendum that the franchisor's website has not been reviewed or approved by the Department of Corporations.
- 1.12 Registration must be accompanied by the Customer Authorization of Financial Records form. (Guidelines.) Bus. Franchise Guide CCH ¶5051.
- 1.13 If the franchisor sells a franchise on terms different from the terms registered, the prospective franchisee must receive in a separate written appendix to the FDD a summary description of such material negotiated terms during the 12-month period ending in the calendar month preceding the month in which the negotiated sale was. (CFIL §31109.1) **[See statute for complete disclosure requirements.]** Bus. Franchise Guide CCH ¶3050.287. **[Note: The CA Franchise Reg. §310.100.2 still contain an old, unmodified and inconsistent disclosure requirement. Bus. Franchise Guide CCH ¶5050.071.]**
- 1.14 Any advertisement which refers to the registration of franchises under the California Franchise Investment Law must have a certain legend in not less than 10 point type. (CA Franchise Reg. §310.156.1(c) and Guidelines.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶¶5050.34 and 5051.

2. Hawaii

- 2.1 A required statement must appear in bold-faced type in the Addendum. (HI Franchise Reg. §16-37-4(c)(7).) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶5110.04.
- 2.2 The Addendum must disclose that certain practices by a franchisor are prohibited by Hawaii law, such as release language which would relieve the franchisor from liability imposed by Hawaii law. (HI FIL §482E-6(2)(F).) See Bus. Franchise Guide CCH ¶4110.01.

3. Illinois

- 3.1 Item 17 of the FDD must be amended to disclose that termination and non-renewal is governed by Illinois law. (IFDA §§705/19 and 705/20.) Bus. Franchise Guide CCH ¶3130.19.
- 3.2 If the Franchise Agreement provides for jurisdiction or venue outside Illinois, or has a non-Illinois choice of law provision, the Franchise Agreement must be amended to that provide that the IFDA governs the parties' rights. (IFDA §705/4

and IL Franchise Reg. §200.608.) Bus. Franchise Guide CCH ¶¶3130.04, 5130.50.

- 3.3 The FDD should be amended to provide that the provisions of the IFDA will supersede any provisions in conflict with the IFDA.

4. **Indiana**

No requirements.

5. **Maryland**

- 5.1 Unaudited financial statements need a specific legend. (MD Franchise Reg., §02.02.08.13.D.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶5200.13.
- 5.2 Item 11 of the FDD must disclose how advertising fees are to be raised and spent, and how the franchisee may obtain an accounting of advertising expenditures. (MD Franchise Reg. §02.02.08.04.B(2).) Bus. Franchise Guide CCH ¶5200.04.
- 5.3 If the Franchise Agreement provides for termination on bankruptcy, Item 17 of the FDD must state that the provision may not be enforceable under federal bankruptcy law. (MD Franchise Reg. §02.02.08.04.B(3).) Bus. Franchise Guide CCH ¶5200.04.
- 5.4 In addition to the FDD financial statement requirements, the additional financial statements required by the Maryland Reg. must be included in the FDD. (MD Franchise Reg. §§02.02.08.04.B(4) and 2.02.08.13.) Bus. Franchise Guide CCH ¶¶5200.04, 5200.13.
- 5.5 The FDD should provide that any general release will not apply to liability against the franchisor created by Maryland Franchise Registration and Disclosure Law. MD FRDL §14-226.) Bus. Franchise Guide CCH ¶¶3200.26.

6. **Michigan**

- 6.1 On a separate page immediately following the cover sheet, there must be (i) a 12-point boldface statement that the state prohibits certain unfair practices, (ii) an exact copy of the void and unenforceable provisions in §445.1527 of the Act, and (iii) a legend in 12-point boldface type that the Attorney General has not approved the offering. (MI FIL §§445.1508(3) and 445.1527, and Letter of Explanation.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶¶3220.08, 3220.27, 5220.01.
- 6.2 If the franchisor has unaudited financial statements which show a net worth of less than \$100,000, the separate statement in 6.1 above should state that franchisee can request an escrow of the initial investment and other funds paid. This right should be described in the Addendum. (MI FIL §445.1512.) Bus. Franchise Guide CCH ¶3220.12.

7. Minnesota

- 7.1 Franchise agreements must conform to the declaration that it is unfair and inequitable to engage in certain acts spelled out in the MN Rules. (MN Franchise Law §80C.14 and MN Franchise Reg. §2860.4400.) Bus. Franchise Guide CCH ¶¶5230.31, 3230.14.
- 7.2 Item 17 of the FDD must include a reference to the MN termination, nonrenewal and transfer provisions. (MN Franchise Law §80C.14. Subds. 3, 4 and 5.) Bus. Franchise Guide CCH ¶3230.14.
- 7.3 If a MN forum is not specified, a statement must be added to the FDD that the franchisee's rights under the MN statutes to submit matters to a MN court is not abrogated or reduced. (MN Franchise Law §80C.21 and MN Franchise Reg. letter.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶¶3230.21 and 5230.61.
- 7.4 The franchisor must state in FDD and in a franchise agreement rider that it will protect the franchisee's right to use franchisor's trademark.
- 7.5 A required statement must appear in bold-face type in the Addendum (MN Franchise Reg. §2860.3300) **[Use state-specific language.]**
- 7.6 Advertisements used in MN must contain the franchisor's name, address and commercial symbol and franchise registration number. (MN Franchise Reg. §2860.1440, Subd.2.) Bus. Franchise Guide CCH ¶5230.28.

8. New York

- 8.1 The FDD has to be amended to reflect NY's different disclosure obligations for FDD Items 3, 4, 5 and 17. (NY Franchise Reg. §200.2(c).) Bus. Franchise Guide CCH ¶5320.02.
- 8.2 NY Regs. require the use of specific statements in bold-face type on the cover page relating to available information and that the state does not recommend it or verify the information. (NY Franchise Reg. 200.2(a)(7).) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶5320.04.
- 8.3 The FDD should be amended to state that the choice of law should not be considered a waiver of any right conferred on either party by NY Franchise Law.
- 8.4 Advertising must contain a specific legend. (NY Franchise Law §681.12 and NY Franchise Reg. §200.0(d) and (e).) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶¶3320.04, 5320.09.
- 8.5 Franchise brokers must register one time using a Franchise Broker Registration Form. (NY Franchise Law §681.13, NY Franchise Regs. §200.11, and Franchise Registration Information Sheet.) Bus. Franchise Guide CCH ¶¶3320.04, 5320.11, 5321.10 and 5321.17.

8.6 On a separate page in the Addendum add: **“THE FRANCHISOR REPRESENTS THAT THIS PROSPECTUS DOES NOT KNOWINGLY OMIT ANY MATERIAL FACT OR CONTAIN ANY UNTRUE STATEMENT OF MATERIAL FACT.”**

9. North Dakota

9.1 The FDD should state ND Securities Commissioner has found certain practices to be unfair, unjust or inequitable to ND franchisees. (ND Administrative Policy.) Bus. Franchise Guide CCH ¶5340.05.

9.2 Item 3 of FDD must disclose if any person in Item 2 is subject to a currently effective SEC order. (ND FIL §51-19-06.5(3).) Bus. Franchise Guide CCH ¶3340.06.

9.3 A statement should be added to the FDD that the laws of North Dakota will supersede any conflicting provisions of the franchise or other agreements.

10. Oregon

No requirements.

11. Rhode Island

11.1 The FDD should state that a provision in a franchise agreement restricting jurisdiction or venue to a forum outside the state or requiring the application of the laws of another state is void with respect to a claim enforceable under the Act. (RI FIA §19.28.1-14.) **[Repeat statutory language]** Bus. Franchise Guide CCH ¶3390.14.

12. South Dakota

12.1 Use the South Dakota specific application form (rather than the NASAA application form).

13. Virginia

13.1 Add a statement that it is unlawful to cancel a franchise without reasonable cause. (VA Retail Franchising Act §13.1-564.) Bus. Franchise Guide CCH ¶3460.08.

13.2 If the franchisee has to sign a release or waiver as a condition to transfer or assignment, a sample copy of the release should be attached to the FDD. (VA Franchise Regs. §5-110-80.D.1.) Bus. Franchise Guide CCH ¶5460.08.

14. Washington

14.1 There must be a rider stating that if the Franchise Agreement is inconsistent with the relationship provisions of the WA FIPA, the provisions of the Act will prevail over the inconsistent provisions of the FDD and franchise agreement. (WA Policy Statement for Franchisor/Franchisee Relationship Disclosure

Requirements, Rider Number One.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶5470.85.

- 14.2 There must be a second rider stating that (i) some states have laws or court decisions which may supersede the termination and renewal provisions, and (ii) if disputes are to be resolved by arbitration, the arbitration must be held in WA or in a place mutually agreed upon. (WA Policy Statement, Rider Number Two.) **[Use state-specific language.]** Bus. Franchise Guide CCH ¶¶5470.78, 5470.85.
- 14.3 Washington prohibits use of general releases. There must be a statement in the FDD that the release does not include a release of claims under the WA FIPA. (WA FIPA §19.100.180 and WA Interpretive Statement FIS-2.) Bus. Franchise Guide CCH ¶¶4470.01, 5470.76.
- 14.4 Franchise brokers have to register annually. (WA FIPA §19.100.140, WA Franchise Regs. WAC 460-82.200, WA Interpretive Statement FIS-6, and WA Policy Statement FPS-4.) Bus. Franchise Guide CCH ¶¶3470.14, 5470.51, 5470.80, 5470.88.

15. Wisconsin

- 15.1 The Wisconsin Fair Dealership Law provides that its effect may not be varied by contract or agreement and any contract or agreement doing so is void and unenforceable to that extent. (WI FDL §135.025(3).) Bus. Franchise Guide CCH ¶4490.03. Some franchisors still add that statement to an Addendum.

Exhibit B

| State** | Escrow* | Fee Deferral | Surety Bond | Certificate of Deposit | Guarantee of Performance | Informal Undertaking | Capital Infusion |
|----------------|----------------|---------------------|--------------------|-------------------------------|---------------------------------|-----------------------------|-------------------------|
| California | X* | X | X | | X | | X |
| Hawaii | X | X | X | | X | | |
| Illinois | X | X | X | X | X | | |
| Maryland | X* | X | X | | X | X | |
| Minnesota | X* | X | X | | X | | |
| New York | X* | X | X | | X | | |
| North Dakota | X | X | X | | X | | |
| Rhode Island | X | X | X | | X | | |
| South Dakota | X | X | X | | X | | |
| Virginia | X* | X | X | | X | X | |
| Washington | X | X | X | | X | | |

*Escrow must be in a bank located in the state.

**Certain state statutes do not provide for deferral of fees, informal undertaking, or capital infusion, but it has been the practice of state regulators to allow the use of such options, including unused lines of credit or other options available to franchisors.

Exhibit C

| State | Franchisee Domiciled in the State | Franchised Business to Be Located in the State | Offer to Sell Franchise Made in the State | Offer to Sell Franchise Directed to State and Received in State | Offer to Buy Franchise Accepted in the State |
|---------------------|--|--|--|--|---|
| California | X (and Franchised Business to be located in state) | X (and Franchisee domiciled in state) | X | X | X |
| Hawaii | X | X | X | X | |
| Illinois | X | X (and offer to sell franchise is made or accepted in Illinois if they are not a resident of Illinois) | X | X | X |
| Indiana | X | X | | | |
| Maryland | X | X | X | X | X |
| Minnesota | | X | X | X | X |
| Michigan | X | X | X | X | X |
| New York | X (and Franchised Business to be located in State) | X (and Franchisee domiciled in state) | X | X | X |
| North Dakota | X (and Franchised Business to be located in State) | X (and Franchisee domiciled in state) | X | X | X |
| Oregon | X | X | X | X | X |

| State | Franchisee Domiciled in the State | Franchised Business to Be Located in the State | Offer to Sell Franchise Made in the State | Offer to Sell Franchise Directed to State and Received in State | Offer to Buy Franchise Accepted in the State |
|---------------------|--|---|--|--|---|
| Rhode Island | X (and Franchised Business to be located in State) | X (and Franchisee domiciled in state) | X | X | X |
| South Dakota | X (and Franchised Business to be located in State) | X (and Franchisee domiciled in state) | X | X | X |
| Virginia | | X | | | |
| Washington | X | X | X (and the offer violates the franchise law of the state to which the offer is directed) | X | X |
| Wisconsin | | | X | X | X |

Beata Krakus

Beata Krakus is an officer in the Chicago office of Greensfelder, Hemker & Gale, P.C., and part of the firm's Franchising & Distribution Practice Group. She works with franchisor clients in domestic and international franchise transactional matters, as well as related areas such as distribution and sales representative arrangements, and other commercial contracts. She has advised, structured, and prepared franchise programs for many different franchise concepts including real estate brokerages, hotels, restaurants, and fitness and personal health systems.

Prior to joining Greensfelder, Ms. Krakus was an associate with Sonnenschein Nath & Rosenthal LLP. She also practiced in Warsaw, Poland with the Swedish law firm of Magnusson Wahlin.

Ms. Krakus is a member of the Governing Committee of the ABA Forum on Franchising and also serves on the Women's Caucus Steering Committee for that organization. She has served as an Associate Editor for *The Franchise Lawyer*, has herself written articles for the *Franchise Law Journal* and other franchise law publications, and has spoken repeatedly at the ABA Forum on Franchising and International Franchise Association Legal Symposium. She is recognized by International's Who's Who of Franchise Lawyers and by Chambers USA and Chambers Global.

Halima M. Madjid

Halima Madjid is the senior franchise paralegal at Plave Koch PLC. She has extensive experience in providing legal support to franchise clients since 2000. Halima works closely with the lawyers in her firm as well as clients in connection with all aspects of federal and state regulation, such as preparing franchise disclosure documents, and securing and maintaining franchise registrations with various state authorities. She also has experience processing domestic and international trademark registration filings. Halima has spoken at the program "Best Practices for State Franchise Registrations" in 2009 in Toronto, Canada and "Best Practices for Managing Your Franchise Disclosure and Registration Practice" in 2011 in Baltimore, Maryland sponsored by the American Bar Association Forum on Franchising.

Diana V. Vilmenay

Diana Vilmenay is an attorney at Gray Plant Mooty in Washington, D.C. She counsels clients on domestic and international franchise matters. She works with start-up and established franchisors to expand their franchise systems here and abroad including in Africa, Asia, the Caribbean, Europe, the Middle East, and South America. Diana supports clients in the preparation of their FTC, state-specific and international franchise disclosure documents. She also assists them with domestic and foreign franchise registrations. She advises clients on many franchise transactions including the drafting, negotiating, and review of their franchise agreements.

Ms. Vilmenay enhances her franchise experience by writing and co-editing articles on a wide range of franchise matters. She coordinated the review of and preparation of country chapters for the second edition of *International Franchise Sales Laws* published by the ABA Forum on Franchising. She has written for the Forum and is an editor for the "*Franchising In*" international series, published by the LexNoir Foundation.