UNIQUE AND OFTEN OVERLOOKED PROVISIONS OF STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS

Joe Fittante
Larkin Hoffman Daly & Lindgren Ltd.
Minneapolis, Minnesota

Theresa Leets*
California Department of Corporations
Los Angeles, California

Rebekah Prince
Snell and Wilmer L.L.P.
Los Angeles, California

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*The opinions expressed by Ms. Leets in this paper and during the oral presentation are her own and do not necessarily represent the views of the California Department of Corporation or NASAA.
# TABLE OF CONTENTS

I. INTRODUCTION .................................................................................................................. 1

II. UNIQUE STATE PROVISIONS IMPACTING THE REGISTRATION PROCESS ........................................... 1

   A. Unique State Exemptions .................................................................................................. 1

      1. Recent Changes Under the Illinois Franchise Disclosure Act Make Exemption Based Franchising Relatively Painless for Large Franchisors ......................................................... 2

      2. New York’s Exemption Maze ...................................................................................... 3

         a. Bigger is Better not only in Texas but also in New York ..................................... 3

         b. Limited Offering .................................................................................................. 3

      3. North Dakota ............................................................................................................. 3

      4. Washington ............................................................................................................. 4

         a. Net Worth and Experience ................................................................................. 4

         b. Limited Offering ................................................................................................ 4

   B. Initial Applications and Renewals ................................................................................. 4

      1. Hawaii and New York .................................................................................................. 4

      2. Illinois ...................................................................................................................... 5

      3. Rhode Island ............................................................................................................ 5

      4. The 90 Day Problem .................................................................................................. 5

      5. Financial Assurance Requirements and Going Concern Opinions ...................... 6

III. UNIQUE STATE PROVISIONS IMPACTING THE SALES PROCESS .............................................. 8

   A. Waiting Periods ............................................................................................................. 8

   B. Sales While Applications are Pending ......................................................................... 9

   C. Limitations on the “Hard Sell” .................................................................................. 11

   D. Beware the Franchisee Sale in New York ................................................................. 11
E. Material Modifications and Negotiated Sales – Understanding California’s often Overlooked and most Misunderstood Provisions ............................................ 12
   1. Material Modifications to existing Franchise Agreements ............................. 12
   2. Two Approaches to Negotiated Sales in California ...................................... 13
      a. California’s Statutory Negotiated Sale Procedure ................................. 13
      b. California’s Regulatory Negotiated Sales Procedure ............................. 13

F. Provisions Impacting Disclosures in the Franchise Disclosure Document ....... 14
   1. Sourcing and Payment Disclosure Obligations Under Maryland Law ............ 14
      a. Additional Disclosure Obligations Related to Sourcing ....................... 15
      b. Additional Disclosure Obligations related to Fees ............................... 15
   2. Michigan’s Hidden Escrow Obligation ..................................................... 16
   3. The Land of 10,000 Disclosure Obligations ............................................. 17
   4. Illinois Advertising .................................................................................. 18

IV. UNWRITTEN RULES OF THE REGISTRATION ROAD ................................. 18
   A. Beware Cesar Chavez ............................................................................ 18
   B. Risk Based Review in California ............................................................ 19
   C. Gaining Priority in Cal-Easi ................................................................. 19
   D. Advertising Standards in California ....................................................... 19
   E. Illinois’ Jumbo Exemption ....................................................................... 20
   F. Virginia’s Type and Facsimile Requirements .......................................... 20
   G. Indiana Effectiveness ............................................................................. 20
   H. Indiana Goes Green and Means It .......................................................... 20
   I. Maryland Communications ...................................................................... 21
   J. Accounting for Furloughs and Closures ............................................... 21
   K. When an Initial Filing Is Not Really an Initial Filing ................................. 21
   L. The Texas Two Step - Illinois Style ....................................................... 21
M. What’s in a Name? That Which We Call A Development Agent Would Smell as Sweet .................................................................................................. 22

1. California ................................................................................................ 22
2. Washington ........................................................................................... 22
3. Illinois ..................................................................................................... 23

N. Florida Filing Requirements ........................................................................ 23

V. CONCLUSION ................................................................................................... 23
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I. INTRODUCTION

With only 14 state franchise registration and disclosure laws, one would think that the provisions of those laws would be relatively well known among practitioners in the franchise registration and disclosure area. For the majority of those provisions this is the case. However, provisions buried deep in these statutes and their accompanying regulations can be overlooked by even the most seasoned practitioners in this area. Depending upon the provision, the failure to comply may result in a comment letter from a state examiner delaying franchise registration, form the basis for an enforcement action or be cited in a complaint by a disgruntled franchisee. This paper highlights many of those provisions, analyzes their impact and discusses some of the “unwritten rules of the road” in franchise registration.

II. UNIQUE STATE PROVISIONS IMPACTING THE REGISTRATION PROCESS

A. Unique State Exemptions

The threshold question for any franchisor hoping to sell franchises in a registration state without actually going through the registration process is whether the franchisor, the prospect or the transaction falls within an exemption from registration provided by the applicable registration and disclosure law. While several new exemptions were added under the amended FTC Franchise Rule (the “Amended Rule”), these exemptions have not, for the most part, been adopted at the state level, leaving a regulatory patchwork for those franchisors who regularly engage in exemption based franchising.

Nevertheless, there are certain states with exemptions that, if applicable, can be used by a franchisor to its competitive advantage.


3 Although the original FTC Rule did not provide for “Sophisticated Investor” exemptions, several state franchise laws contain such exemptions. Under the Amended Rule, the “Sophisticated Investor” exemptions cover three types of investments (a) an exemption based on the size of the investment (Federal Trade Commission, Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. 436 (2007) (the “Amended Rule”), at 436.8 (a)(5)(i); (b) an exemption based on the net worth of the investor (Amended Rule at 436.8(a)(5)(ii); and (c) an exemption based on the franchisee’s involvement with the franchisor (Amended rule at 436.(a)(5)(iii). See Susan Grueneberg & Ann Hurwitz, The FTC Franchise Rule, (ABA 2008).
1. Recent Changes Under the Illinois Franchise Disclosure Act Make Exemption Based Franchising Relatively Painless for Large Franchisors

In Illinois, several important changes to the Franchise Disclosure Act went into effect in October 2009, including changes to the exemption provisions (the "Illinois Act"). Applications for the large franchisor exemption for franchisors with a net worth of more than $5 million now receive a cursory review to ensure the application meets certain basic requirements, and if it does, the application is declared effective immediately; provided, however, that a substantive review may follow later with comments.

Arguably even more important is the addition of an exemption for those franchisors with a net worth in excess of $15 million. Like the exemption under the New York Franchise Act, the Illinois exemption is self executing in that the franchisor is automatically exempt from registration. Unlike New York, however, the franchisor must still provide a Franchise Disclosure Document to a franchise prospect.

More interesting, and an area where many franchisors can trip up, especially in this economic climate, is the Illinois regulation that provides that an exempt franchisor relying on the net worth requirement automatically loses the exemption if the “franchisor’s net worth requirement is no longer met.” This would require a franchisor to file a new application or an initial application, depending upon the exemption, immediately if the franchisor’s net worth drops below the required threshold. Moreover, if the franchisor continues to sell franchises and the net worth has dropped below the threshold, the franchisor would arguably be selling franchises in violation of the Illinois Act, giving a franchisee the right to rescind the transaction. However, an argument could be made that an accurate determination of a company’s net worth is only made with the annual audit of the franchisor’s financial statements and that the franchisor does not know the true net worth until the completion of such audit each year. Furthermore, the net worth of a company can fluctuate during the course of the year, and a small dip below the threshold could arguably be immaterial and not require an amendment or any filing with the state.

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5 See http://www.illinoisattorneygeneral.gov/consumers/franchise.html. Also new as of October 2009, the application for the large franchisor exemption requires a filing fee of $500 for initial applications and $100 for renewal filings. Previously there was no fee for exemption filings.

6 Per the Illinois Attorney General’s office, the Illinois Regulations are being updated to reflect the new $15 million exemption from any filing with the state. Although there is no required filing, the examiners recommend providing the office with some form of written notice that a franchisor plans to rely on the exemption.

7 Illinois Regulations, §200.202(e)(4)(A). California law is much like Illinois law on this point providing that if a franchisor becomes ineligible at any time for an exemption, the exemption is immediately lost and a registration must be filed before any further offers or sales can be made in California.
2. New York’s Exemption Maze

a. Bigger is Better not only in Texas but also in New York

Other than Illinois, New York is the only state that provides more than one net worth exemption. However, if the franchisor meets the larger of the two net worth tests under New York law, the franchisor not only has no registration obligation but, unlike Illinois, has a very minimal disclosure obligation. This disclosure obligation is limited to providing the prospect with the franchisor’s principal business address along with the name and address of the franchisor’s agent authorized to receive service of process on behalf of the franchisor in New York.8

The franchisor who meets this exemption, as well as an exemption under the Amended Rule, has a significant advantage over its competitors when it comes to financial information the franchisor could provide to a prospect in New York. Because there is no federal or state law limiting or proscribing such information, the franchisor would be free to provide any type of financial information that it sees fit, subject always to potential claims of fraud. In contrast, the competitor who cannot qualify for this state exemption, as well as a federal exemption, would be limited in the financial information it could provide the same prospect.

b. Limited Offering

Even if the franchisor cannot qualify for the net worth exemption discussed above, all is not lost as the New York statute provides a unique “limited offering” exemption whereby offers to not more than two people are exempt from registration in New York; provided, however: (i) the franchisor cannot offer the prospect the right to franchise to others, (ii) the franchisor cannot pay any kind of commission (directly or indirectly) for soliciting franchises in New York, and (iii) the franchisor is domiciled in New York or has filed its consent to service of process in New York.9 Unlike the “jumbo exemption” discussed above, the franchisor must still provide the prospect with a disclosure document that complies with New York law and the Amended Rule, assuming no other exemption applies under the Amended Rule.

3. North Dakota

Although the large franchisor exemption provisions of the North Dakota franchise law are not in themselves unique, the obligations imposed on a franchisor relying on the exemption may result in liability to the franchisor if overlooked. For example, the large franchisor exemption statute in North Dakota specifically requires an exempt franchisor to disclose a material modification to the Franchise Agreement10, whereas the general provisions of the North Dakota

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9 NY Regs. §684.3.
10 ND Regs. §73-03-01-01.
franchise laws have no such requirement.\textsuperscript{11} As a result, an exempt franchisor arguably has a greater disclosure obligation than a non-exempt franchisor who has registered in North Dakota.

4. \textbf{Washington}

a. \textbf{Net Worth and Experience}

Washington, like several other states, provides for a franchisor “net worth” exemption from registration. However, in addition to the franchisor meeting a net worth and experience requirement, the prospective franchisee must also make a minimum “initial investment” of \$100,000 in order for the franchisor to utilize the exemption. Additionally, the franchisor must deliver a disclosure document that complies with the Amended Rule ten business days prior to the execution of an agreement or receipt of any consideration.\textsuperscript{12}

b. \textbf{Limited Offering}

Similar to New York, if a franchisor cannot utilize the net worth exemption, Washington also has a “limited offering” intrastate exemption whereby offers of not more than three franchises for franchise businesses in Washington are exempt from registration. To qualify for the exemption (i) the franchisor must not have any outstanding franchises granted for businesses located outside the State of Washington, (ii) the franchisor must not have granted more than three franchises within the State of Washington, (iii) the franchisor does not advertise or engage in general solicitation for the franchise offering, and (iv) the franchisee must be represented by a CPA or independent legal counsel.\textsuperscript{13}

B. \textbf{Initial Applications and Renewals}

Every registration state has its own unique procedure for renewal of a franchise registration. Generally most registration states require a renewal application or annual report (including an updated Franchise Disclosure Document), be filed within a certain number of days following the end of the franchisor’s fiscal year. As discussed below, there are, however, several states with unusual and often overlooked requirements in the registration process.

1. \textbf{Hawaii and New York}

Hawaii and New York like most other registration states, require the filing of an annual report with each respective state. What makes these states unique is the additional information requested by each state in connection with the annual report. For example, under Hawaii’s law a franchisor must, at the time it files its annual report, also provide the state with information on franchises sold in Hawaii and the dollar amount of the proceeds derived from such sales.\textsuperscript{14}

\begin{itemize}
  
\item \textsuperscript{11} California was the first state to pass a franchise law and as a result many states copied the language in their statutes from California. This inconsistency may be a result of carryover language from California.

\item \textsuperscript{12} See \textit{WASH. REV. CODE} §19.100.030.

\item \textsuperscript{13} \textit{Id.}

\item \textsuperscript{14} Section 16-37-8 of Hawaii Regulations.
\end{itemize}
Under New York’s law, in addition to disclosing the franchises sold and amounts received for such sales, New York requires the credit terms for each sale to be included. Failure by a franchisor to provide this information may not prove fatal but it will delay the approval process in each of these states.  

2. Illinois

Although Illinois is not unique in the information it requires to be filed in connection with a renewal filing, its review practices can leave a franchisor who is unfamiliar with such practices in a precarious position. In Illinois, a franchise renewal application is automatically deemed effective upon the state’s receipt of the Annual Report. However, franchisors that sell in reliance on that automatic effectiveness should be careful since it is not unusual for the state to later comment on the application and require changes to the Franchise Disclosure Document. The franchisor who finds itself in this position is left with a Hobson’s choice, offer rescission to the franchisee or do nothing and risk a later claim for rescission by the franchisee.

3. Rhode Island

Rhode Island’s franchise law is unique as it provides the state with the power to deny an application or revoke the effectiveness of a registration if an officer or director of a franchisor is found guilty of an Item 3 offense and his or her involvement in the franchise creates an “unreasonable risk” to franchisees or offerees.

4. The 90 Day Problem

Pre-Amended Rule, if the franchisor’s financial statements were of a date more than 90 days before the application for registration/renewal was filed, the franchisor was required to include unaudited financial statements dated within 90 days of its application date in its Franchise Disclosure Document. The states of California, New York, Minnesota and Maryland mirrored this requirement. However, under the Amended Rule, a franchisor has 120 days after the close of its fiscal year to complete an annual update of its franchise documents. Unfortunately, none of the states above have updated their laws. Accordingly, a franchisor who files a franchise application with these states more than 90 (but less than 120) days after its fiscal year end, would be required to include unaudited financial statements in its Franchise Disclosure Document to comply with these laws, even though it is in compliance with federal law. Failure to comply with this requirement will undoubtedly draw a comment letter from the applicable state.

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15 NY Regs. §5320.08.
16 Similarly, and as discussed earlier in this paper, in Hawaii renewals are effective after seven days but might be subject to subsequent comments.
18 UFOC Guidelines, Item 21.
In addition to the issue lurking above, the length of franchise registration in Hawaii poses a separate and distinct problem. As discussed above, the Amended Rule has extended the time within which a franchisor is required to renew its disclosure document to no later than 120 days after the franchisor’s fiscal year end. A franchisor’s franchise registration under each registration state’s law will terminate, depending upon the state, 120 days after the franchisor’s fiscal year end, or upon the one year anniversary date of the registration. Most franchisors attempt to have the anniversary date of the registration coincide as closely as possible with the date that is 120 days from the franchisor’s fiscal year end. This strategy works in all states, subject to the issues discussed above, with the exception of Hawaii.

Under Hawaii’s law, a franchisor’s registration expires 90 days after the franchisor’s fiscal year end unless the franchisor files a renewal application within that time period. Accordingly, those franchisors who wait to renew in Hawaii until they are renewing in the other registration states (at the end of April for those franchisors with a December 31 fiscal year end) will find out that their registration has expired and the renewal will actually be an initial application subject to review and comment by Hawaii examiners. Further, and arguably even more important, any sales made after the 90 day date will have been made at a time when the franchisor was not registered to offer or sell franchises in Hawaii, and the franchisor will be subject to penalties imposed by the State as well as claims for rescission by any purchasers of franchises in Hawaii after the registration had expired.

5. Financial Assurance Requirements and Going Concern Opinions

Often when a new franchisor files an initial application for registration in a state or if a franchisor’s financial condition deteriorates, the state will require some evidence of “financial assurance” that the franchisor can perform all of its pre-opening obligations for franchisees. Depending upon the state as well as the franchisor’s financial situation, the franchisor may be required to post a bond, find a guarantor, provide additional capital, set up an escrow or defer certain initial fees from franchisees. Much has been written about the different types of financial assurances states may impose and the processes a franchisor must go through to satisfy a financial assurance request by a state. However, the more ambiguous issue in this area relates to the actual test each state uses to determine whether a financial assurance is required in the first place.

Each franchise registration statute contains authorizing language allowing the examiner in that state to require financial assurances under certain conditions. Typical language provides that the examiner may require financial assurances if the franchisor has failed to demonstrate adequate financial arrangements have been made to provide pre-opening obligations to franchisees. Some states set forth a specific test of the financial condition of the franchisor, while others contain general guidelines that the examiner must consider. Some state statutes and regulations do not contain any additional guidance as to when a financial assurance is required, other than the general authorizing statute. The information in this section of the paper comes from a survey of the applicable statutes and regulations, as well as discussions with state regulators as to what their office considers when examining the financial wherewithal of a franchisor during the franchise registration process.

The Virginia Retail Franchising Act provides a specific test for determining whether financial assurances will be required, providing that if a franchisor’s liabilities exceed assets, the examiner may require an escrow condition.\(^{20}\) Practitioners should also be aware of Virginia’s blanket prohibition on registering franchisees whose financial statements contain a going concern opinion. Although many states will still allow a franchisor with a going concern opinion to register after satisfying a financial assurance requirement, the State of Virginia does not. Under the Virginia statute, a franchisor that “cannot meet its obligations as they mature” (the basis for a going concern opinion) will be prohibited from registering in Virginia.\(^{21}\)

In Minnesota, it is common knowledge that the examiners in Minnesota analyze the current assets of a franchisor as compared to the franchisor’s current liabilities. Unlike Virginia, neither the Minnesota Franchise Act nor its regulations provide for a specific test to be used by the state in determining if a financial assurance is required.

Under the Illinois Franchise Disclosure Act, if the examiner determines that adequate financial resources are not available to the franchisor, or if the franchisor will be relying primarily on initial franchise fees for the capital to perform its pre-opening obligations, the examiner may require financial assurances.\(^{22}\) The Illinois regulations indicate that several factors should be considered, including the current ratio, quick ratio, the debt to equity ratio, amount of working capital, proportion of tangible assets to intangible assets, the amount and multitude of debts, the amount of equity, earnings history, the proportion of receivables compared to other assets, and the quality of receivables (including financial statements that indicate bad debt, debt discharged in bankruptcy, or the failure to allow for aged receivables).\(^{23}\) In addition, the State of Illinois has indicated that red flags are raised if financial statements show a debt to equity ratio of 6 or above, or less than $100,000 in equity. The test imposed will vary based on the amount of the initial franchise fee, and the type and value of assets of the franchisor. For example, if a large component of the assets of the franchisor is allocated to intangible assets (such as intellectual property or goodwill), the examiner may require the franchisor to have a lower debt to equity ratio.

The remaining registration states’ laws and regulations do not include any specific guidance as to what factors are considered in determining whether financial assurances will be required. However, the State of Washington indicated that financial assurances may be required when the financial statements show less than $100,000 in equity. The State of North Dakota indicated that although no set standard is used when reviewing a franchisor’s financial statements, the state will consider two major factors. The first is whether the franchisor has a negative liability to asset ratio, and the second is whether the franchisor has negative stockholders’ equity. New York for the most part takes a hands off approach when it comes to

\(^{20}\) **VIRGINIA REGS.** §5-110-65.


\(^{22}\) **ILL. COMP. STAT.** §705/15.

\(^{23}\) **ILL. REGS.** §200.500.
assessing the financial wherewithal of a franchisor, indicating that while the state has the authority to require financial assurances, it does not do so.\textsuperscript{24}

California does not have a bright line test for determining whether a franchisor will be required to satisfy a financial assurance as a condition to registration. Although this allows flexibility, it may appear that California applies assurances inconsistently as different examiners take different approaches. Some of the factors that the examiners review are capitalization, operating history, working capital in relation to the amount the franchisor will spend for each franchise before opening, and liquidity, the ratio of current assets to current liabilities of the franchisor.

Much like California, Rhode Island examiners do not have a specific test that they use in determining if a financial assurance should be imposed upon a franchisor. Generally speaking, however, Rhode Island analyzes the balance sheet of the franchisor including cash flow, and takes into account the number of states in which a franchisor is registering, the amount of the franchise fee, and the source of funds information disclosed by the franchisor. Hawaii is much like California and Rhode Island in that it does not have a specific test. Hawaii will review various factors, including the current assets and current liabilities of the franchisor.

III. UNIQUE STATE PROVISIONS IMPACTING THE SALES PROCESS

A. Waiting Periods

With the abandonment of the first personal meeting rule and modification of the waiting period prior to sale from 10 business days to 14 calendar days under the Amended Rule\textsuperscript{25}, many practitioners were hopeful that these changes would be uniformly adopted at the state level. Unfortunately, that has not been the case and what currently exists is a minefield for franchisor sales teams, depending upon the state law applicable to the sale.

The good news is that most franchisors\textsuperscript{26} only need worry about this issue in four registration states: New York, Rhode Island, Michigan and Washington. Unfortunately, these states have not yet conformed their laws to that of the Amended Rule. Specifically, Michigan and Washington still require the Franchise Disclosure Document be provided to the prospect at least 10 business days before the earlier of the payment of any consideration to the franchisor or its affiliate, or the signing of an agreement with the franchisor or an affiliate.\textsuperscript{27} Additionally,

\begin{footnotesize}
\begin{enumerate}
\item Because the states of Wisconsin, Indiana and South Dakota do not formally review the Franchise Disclosure Document of a franchisor, these states do not commonly review the financial statements of the franchisor.
\item See Footnote 27 below.
\end{enumerate}
\end{footnotesize}
New York and Rhode Island continue to maintain the first personal meeting rule requiring disclosure at the earlier of the first personal meeting or the time period discussed above.\textsuperscript{28}

Although not a franchise registration law, the Iowa Business Opportunity Promotions Law requires a franchisor seeking exemption from the Law to provide a prospect with a disclosure document at the earlier of the first personal meeting or 14 days before the earlier of the execution of an agreement or payment of consideration to the franchisor.\textsuperscript{29} Much like the Iowa law, the Oklahoma Business Opportunity Sales Act exempts sales of franchises pursuant to disclosure documents that meet the UFOC Guidelines or the FTC Rule, as long as the seller provides the prospect with a disclosure document at the earlier of the first personal meeting or 10 business days before the earlier of the execution of an agreement or the payment of any consideration.\textsuperscript{30}

Because of the variance in laws discussed above, if a franchisor finds itself involved in a transaction where there may be more than one applicable state law, the franchisor should determine the law most favorable to the prospect and comply with that law, thereby countering any argument that the prospect was denied any applicable rights under the various applicable state laws.

**B. Sales While Applications are Pending**

Although there are many areas of the franchise registration and disclosure laws upon which there is relative agreement with respect to statutory interpretation of the provisions of the laws, one area where there is not is a franchisor’s ability to make a sale while an application for renewal or amendment is pending in the affected state. The most conservative approach is to advise the franchisor that it must go dark with respect to its sales efforts until the amendment or renewal application has been approved by the applicable registration state. However, this approach is not expressly required in all states. In fact, there are certain states which actually provide a franchisor with a mechanism by which the franchisor can continue to make offers, and in some instances close sales (albeit with a right of rescission).\textsuperscript{31}

New York is one of the states that provides the practitioner with a roadmap to the franchisor’s ability to make sales during this period. Under the New York law, a franchisor can advise the prospect that an event has occurred requiring amendment and that an amendment

\textsuperscript{28} See N.Y. GEN. BUS. LAW §683.8 and R.I. GEN. LAWS §19-28.1-8. In addition, the Maryland Franchise Registration and Disclosure Law historically has included the “first personal meeting” rule, however an amendment to the Maryland law was recently adopted to conform the delivery requirements under the statute to the Amended Rule. This new legislation will go into effect October 1, 2010.

\textsuperscript{29} Iowa Business Opportunity Promotions, IOWA CODE §523B.1 et seq.

\textsuperscript{30} Oklahoma Business Opportunity Sales Act, OKLA. STAT., tit. 71, §801 et seq.

\textsuperscript{31} The discussion above is based solely on the state statutes and does not consider the relative exposure to a misrepresentation or fraud claim based upon information that may have changed in the new Franchise Disclosure Document. Further, the discussion above assumes that, if the franchisor made a financial performance representation in its Franchise Disclosure Document, that information was still accurate at all relevant times.
application has been or will be filed with the state, and provide the prospect with a copy of the registered Franchise Disclosure Document along with a disclaimer that a copy of the amended disclosure document will be provided after the state has approved it. The franchisor may actually close a sale using the registered disclosure document so long as the franchisor deposits all initial fees in a separate bank account. Once the amended document is approved, the franchisor must then provide it to the prospect. The prospect has the right to rescind the sale and obtain its initial fees at any time prior to the prospect’s receipt of the amended Franchise Disclosure Document or ten business days thereafter. The franchisor can obtain the escrowed fees if no request for rescission is made during such time period.

Like New York, Rhode Island provides the practitioner with guidance on sales activities during the amendment or renewal period. Unlike New York, a franchisor making an offer in Rhode Island after submission of the new Franchise Disclosure Document to the state cannot close the sale until the new Franchise Disclosure Document has been approved, 10 days have lapsed and the franchisor has provided the prospect with a blackline document showing the changes from the prior Franchise Disclosure Document.

California also includes specific provisions that a franchisor must comply with while it has an application for renewal or amendment pending with the state. Under the California Franchise Investment Law, while an application is pending, the franchisor can provide a prospect with the pending disclosure document if the Franchisor also provides the prospect with a statement that the information therein has not been reviewed by the state, and the filing is pending but not yet effective. The franchisor must deliver the effective disclosure document to the prospect once it has been approved, blacklined to show all changes from the unapproved document that was previously provided, at least 10 business days prior to the signing of any agreement or receipt of any consideration. Note for timing purposes that California provides a provision for automatic effectiveness if the renewal filing reaches one of its 4 offices (San Diego, Los Angeles, San Francisco or Sacramento) no later than 15 business days before the expiration of the registration and no comment letters have been issued to toll automatic effectiveness.

Because the States of Illinois, Wisconsin, South Dakota and Indiana declare the Franchise Disclosure Document effective upon receipt by the state, the franchisor may not continue to make offers or sales in these states using the old disclosure document because it will be superseded by the new disclosure document upon receipt by the state. This leaves the States of Maryland, Minnesota, North Dakota, Virginia and Washington as those states in which

32 N.Y. Regs. §200.3(h)(3).
35 Id. at §31121.
36 Although Hawaii does not technically provide that the disclosure document is effective upon receipt it does provide that the amended disclosure document must be filed with the state at least seven days prior to the sale of a franchise. Therefore, in practice, the old document is superseded upon the filing of the new disclosure document. See Haw. Rev. Stat. §482E-3.
the franchisor can arguably continue to make sales using the old document until the earlier of expiration of the franchisor's registration in the applicable state, or approval of the amendment application by the state, so long as no material change has occurred.

C. **Limitations on the “Hard Sell”**

The States of Maryland and Minnesota impose unique limitations on what a franchisor may communicate to a prospect regarding other prospects who may be interested in the same franchise. Both Minnesota and Maryland prohibit a franchisor from indicating to a prospect that a third party is willing to enter into a franchise agreement for the franchise under consideration without at the same time providing the prospect with the name and contact information of the other interested party.37 This provision of the Minnesota law was at issue in *Randall et al. v. Lady of America Franchise Corporation.*38 In this case, a representative of the franchisor allegedly indicated that another prospect was interested in the location that the plaintiffs were pursuing. The defendant argued that even if it did make the claim, as long as it was true there was no violation of the law. The court disagreed, holding that “. . . the rule forbids making any claims about third-party interest - true or false - . . . .” without making the appropriate disclosure regarding the third party interest.

The disclosures required under Minnesota and Maryland law, coupled with the ruling discussed above, should give franchisors pause. This sales technique is probably more common than one would think, and one would assume that most franchisors may not be making the required disclosures as they are probably not aware of these laws. However, ignorance is no defense.

D. **Beware the Franchisee Sale in New York**

Although New York is known as one of the more progressive states when it comes to its exemptions from registration and in certain situations disclosure, New York’s exemption for a franchisee sale is like no other state and can result in significant liability for those who fail to heed its requirements.

Generally speaking the registration states exempt from their registration and disclosure laws, the sale by a franchisee for its own account of its franchise so long as the franchisor is not involved in the transaction other than to approve the purchaser of the franchisee’s business. The New York provision (in addition to requiring that the sale is for the franchisee’s own account, not part of a plan of distribution of franchises and not effected by or through the franchisor), however, requires that the seller franchisee provide the prospective purchaser with a copy of the franchisor’s Franchise Disclosure Document.39 This requirement raises a number

37 See MD. REGS. CODE tit. 2, §02.02.08.16(C) and MINN. R. §2860.4300.


39 NY Regs. §684.5(c) provides that one week prior to the execution of any contract or purchase agreement or at least one week prior to the receipt of any consideration, whichever occurs first, the franchisee must provide the prospective purchaser with a copy of the offering prospectus of the franchisor (including any amendments) currently registered with the department of law.
of issues and questions: what if the franchisee does not provide the most recent Franchise Disclosure Document? What is the prospect’s recourse against the franchisee or the franchisor? How can the franchisor be certain that the franchisee has followed the appropriate protocols? Who is liable to whom?

E. Material Modifications and Negotiated Sales – Understanding California’s often Overlooked and most Misunderstood Provisions

For purposes of this paper, the material modification and negotiated sale provisions under California’s law are a hybrid in that they can affect the registration process as well as the sales process, depending upon the circumstances. Regardless, one thing is certain; they are arguably the most misunderstood provisions under not only California’s law, but any provision of any state franchise registration and disclosure law.

1. Material Modifications to existing Franchise Agreements

In all registration and disclosure states other than California, franchisors and franchisees are free to modify the terms of existing agreements without having to make any public filings. However, under California’s law a franchisor who seeks to negotiate a proposed modification to an existing franchise agreement must provide the franchisee with a written disclosure describing the proposed modification, and allow 5 business days to elapse before an agreement evidencing the modification is signed or alternatively allow the franchisee to rescind a signed modification within 5 days. Further, the franchisor must register the material modification with California unless an exemption from the requirement can be found under the California statute. To that end, a filing is not required if timely disclosure is made and the modification agreement is executed at least 12 months after the date the franchise agreement was signed, and does not waive any right of the franchisee under the California Franchise Relations Act and one of the following is met:

a) The proposed modification is in connection with the resolution of a bona fide dispute between the franchisor and the franchisee and is not applied on a system wide basis;  

b) The proposed modification is offered on a voluntary basis to fewer than 25% of the franchisor’s California franchises within any 12-month period, provided each franchisee is given a right to rescind the modification agreement if the modification is not made in compliance with Section 31125(c)(1); or

c) The modification is offered on a voluntary basis and does not substantially and adversely impact the franchisee’s rights, benefits, privileges, duties, obligations, or responsibilities under the franchise agreement.

40 CAL. CORP. CODE §31125.

41 Cal. Regs. §310.125.

42 A modification is not made on a system wide basis if it is offered on a voluntary basis to fewer than 25% of the franchisor’s California franchises within any 12-month period.
2. Two Approaches to Negotiated Sales in California\(^{43}\)

One would assume that the provisions of California's law related to negotiated sales were passed in an effort to give prospects more information related to a franchisor's negotiating practices in connection with its sale of franchises by requiring franchisors to make certain disclosures in connection with negotiated sales. The law, however, may have had a different effect arguably hindering a franchisee's ability to negotiate a franchise agreement because franchisors who do not want to disclose any negotiated franchise agreements would simply refuse to negotiate the agreement.

In any event, in 2008 California amended its negotiated sales law to provide a method by which a franchisor could negotiate provisions of its franchise agreement with a prospect without having to make a filing with the state related to those negotiations. At the same time, California maintained its original filing requirements in the Regulations related to negotiated sales. Each of these methods is discussed below.

a. California’s Statutory Negotiated Sale Procedure\(^{44}\)

Changes to the Franchise Agreement which are negotiated in the sales process do not have to be registered with California so long as the initial offer is the offer registered in California, the negotiated terms confer additional benefits on the prospect and the prospect receives all of the following in a separate written appendix to the disclosure document: (i) a summary description of each material\(^{45}\) negotiated term for a California franchise during the 12-month period ending in the calendar month immediately before which the negotiated offer or sale is made;\(^{46}\) (ii) a statement indicating that copies of the negotiated terms are available upon written request; and (iii) the franchisor contact information to whom requests for a copy of the negotiated terms may be obtained. The franchisor must also certify or declare in an appendix to its application for renewal that it has complied with all of the requirements of this section, if this exemption is claimed.

b. California’s Regulatory Negotiated Sales Procedure

The regulatory requirements for California’s negotiated sales exemption are considerably more onerous than the requirements included in the California Corporations Code. The regulations require a franchisor to amend its Franchise Disclosure Document and file notices with the Commissioner. Not surprisingly, most franchisors choose to comply with the less burdensome requirements of the Code set forth in Section (a) above. Practitioners should

\(^{43}\) Cal. Corp. Code §31109.1; Cal. Regs. §310.100.2; 310.100.4.

\(^{44}\) Cal. Corp. Code §31109.1.

\(^{45}\) Material is defined in this section to mean “that a reasonable franchisee would view the terms as important in negotiating the franchise. The franchisor must maintain copies of all material negotiated terms for which this exemption is claimed a period of 5 years from the effective date of the first agreement containing the relevant negotiated term.

\(^{46}\) The franchisor must provide a copy of the negotiated terms described above to the prospective franchisee within 5 business days following the request of the franchisee.
be mindful, however, of the specific requirement in the Code that requires that “the negotiated terms, on the whole, confer additional benefits on the franchisee.”\(^{47}\) Although negotiated agreements typically favor the franchisee, there may be instances where the negotiated changes might not confer additional benefits. For instance, in the case of a prospective franchisee that might not otherwise qualify for a franchise program, the franchisee could suggest taking a smaller territory for the same fee, or putting more stringent payment terms in the agreement in order to get the deal. In these instances, the franchisor will be limited to the regulatory exemption in California. Under those regulations, the offer or sale of a franchise on terms different from the terms of the offer registered with California is exempt from the registration requirements if all of the following conditions are met:

1. The initial offer is the offer most recently registered, renewed or amended in California.
2. The prospective franchisee receives the Franchise Disclosure Document and all copies of all Notices of Negotiated Sales of Franchises filed with California within the last 12 months, if any.
3. Before selling another franchise, the franchisor amends its Franchise Disclosure Document to provide that:
   
   “The terms of Items(s) _____ of this disclosure document have been negotiated with other franchisees. A copy of all Negotiated Sales Notices filed in California in the last 12 months is attached as Exhibit ____.”
   
   This disclosure should be made in the disclosure document Item that was negotiated or in an appendix to the document. This disclosure must be made if the negotiated sale occurred with 12 months of the offering being made. An amendment making only this disclosure is effective when filed.
4. The Notice of Negotiated Sale of Franchise must be filed with the Commissioner within 15 business days after the negotiated sale is consummated.
5. The franchisor certified or declares in an appendix to its application for renewal that all notices have been filed with the Commissioner.\(^{48}\)

F. Provisions Impacting Disclosures in the Franchise Disclosure Document

1. Sourcing and Payment Disclosure Obligations Under Maryland Law

Of all the state franchise registration and disclosure laws, Maryland arguably imposes on a franchisor the most unique state disclosure obligations. These obligations are found deep within the Maryland regulations and can be broken into two categories: those disclosures that relate to sourcing restrictions, and those that relate to payments by the franchisee.


\(^{48}\) Cal. Regs. §310.122.
a. **Additional Disclosure Obligations Related to Sourcing**

Under the Maryland regulations, a franchisor is prohibited from making a disclosure related to the sources from which a franchisee is required to purchase goods, services, equipment, inventory or other items without making certain additional disclosures. Based upon the Amended Rule, a franchisor is required to make certain disclosures related to sole or limited sources of supply for items to be purchased by the franchisee in connection with the franchise. Accordingly, it is arguable that the franchisor would be required to comply with the Maryland regulations when making these disclosures related to required suppliers. The Maryland regulations require the following disclosures in this regard: First, a disclosure of any affiliation between the franchisor and these sources of supply; Second, if the source is affiliated with the franchisor, the cost to the seller of the items; Third, the prevailing market price for the goods, and if none an explanation as to why market price cannot be determined; and Finally, the manner, if any, in which the franchisor or its affiliate under the terms of the franchise agreement ensures the availability of the goods.

Unfortunately it is unclear whether these disclosures are exclusive or inclusive of one another and there is no further guidance in the statute or regulations related to these disclosures. For example, it is unclear if the disclosure related to market price applies to market price only in Maryland, as the market price may be different in Maryland than it is in other parts of the country. Additionally, it is unclear how cost should be calculated. This is relatively easy if the seller is buying the goods and reselling them as the cost for the goods is the price paid for them by the seller. However, how is cost determined if the seller is actually manufacturing the goods?

b. **Additional Disclosure Obligations related to Fees**

The Maryland regulations also require unique disclosures related to the fees the franchisee must pay the franchisor. Pursuant to the regulations, a franchisor is required to disclose the “significance” of each fee in the franchise sales transaction. Unfortunately, the regulations do not provide any additional guidance as to what this disclosure requires.

The regulations also give a franchisee the right to obtain an accounting of the advertising expenditures by the franchisor. The regulations, however, do not provide whether the franchisor satisfies this disclosure obligation by making the percentage disclosure of expenditures of monies in the advertising fund in the prior fiscal year as required by the Amended Rule.

49 See Md. Regs. Code tit. 2, §02.02.08.16(J).

50 Id.

51 Id.

52 See Md. Regs. Code tit. 2, §02.02.08.16(F)(2).

53 See Md. Regs. Code tit. 2, §02.02.08.16(G)(1)(b).
Many franchisors provide a refund of the franchise fee if the franchise agreement is terminated based upon a failure to successfully complete training. Further, in an attempt to stimulate franchise sales in the current economic climate, many franchisors are offering to prospects “money back guarantees” if exercised in a certain period of time. Under the Maryland regulations, either of these scenarios arguably trigger additional disclosure obligations by the franchisor. To that end, the franchisor must disclose whether the franchise fee is secured or guaranteed and, if so, in what manner.54

2. Michigan’s Hidden Escrow Obligation

As discussed in this paper, there are still certain states that require the inclusion of unaudited financial statements in a franchisor’s Franchise Disclosure Document if the application date of that disclosure document with the affected state is more than 90 days from the franchisor’s fiscal year end.55 Pre-Amended Rule, these state laws were never an issue because the UFOC Guidelines required renewal of the UFOC within 90 days of the franchisor’s fiscal year end.56 With the passage of the Amended Rule, and the change to this requirement from 90 to 120 days at the federal level,57 one would have hoped that these states would have changed their laws to only require unaudited financial statements in those situations where the application was more than 120 days from the franchisor’s fiscal year end. However, that has not been the case and even though the federal law requires renewal within 120 days, these states require the inclusion of unaudited financial statements if the renewal amendment is later than 90 days from the franchisor’s fiscal year end.

Other than the administrative headache of having to produce these financial statements for a limited number of states, there really is no substantive issue encountered by the franchisor in connection with this obligation. That is, unless you are a franchisor selling franchises in Michigan and your unaudited financial statements provide for a negative or minimal net worth. Under the Michigan law, any franchisor whose most recent financial statements in its disclosure document are unaudited and that show a net worth of less than $100,000 must, at the request of the franchisee, place all initial fees into escrow with an escrow agent that is a bank authorized to do business in Michigan.58 These funds must stay in escrow until the franchisee signs an affidavit providing that the franchisor’s initial obligations have been satisfied or partly satisfied, in which case, only that portion of the fees attributable to the satisfied obligations are released.

54 See MD. REGS. CODE tit. 2, §02.02.08.16(F)(4). Based upon the language of the regulations it is arguable that this disclosure was intended to only apply to those franchisors who made a representation about how quickly the franchisee could make enough money from the opportunity to cover their initial investment. For example, if there is no guarantee or security the franchisor is required to disclose the period of time over which other franchisees were able to recover their initial investment. Nevertheless, the plain language of the regulations would encompass the situations above.

55 See Section 2.B.4 above.


57 Amended Rule, at 436.5(u).

58 MICH. COMP. LAWS §445.1512.
One can imagine the surprise of the franchisor selling a franchise in Michigan when it learns that it must escrow franchise fees because it had disclosed unaudited financial statements in its Franchise Disclosure Document that do not show the minimum net worth discussed above. The franchisor that faces this prospect could, to avoid the issue, create a separate Franchise Disclosure Document for use in Michigan that contains only the audited financial statements of the franchisor as there is no obligation that the franchisor disclose the unaudited financial statements to a Michigan prospect.

3. **The Land of 10,000 Disclosure Obligations**

If Maryland leads the registration and disclosure states with peculiar additional disclosure obligations, Minnesota is a close runner-up, and in some cases, these obligations are even more confounding than those found under Maryland law.

Consistent with the Amended Rule, the Minnesota Franchise Act requires the Franchise Disclosure Document to provide whether the franchisee receives an exclusive territory. However, the Minnesota Franchise Act departs radically from the Amended Rule by providing that if an exclusive territory is granted, the Franchise Disclosure Document is required to include a map of the territory. This requirement leaves many unanswered questions. First, where is the map to be provided? If in the disclosure document, where does it go in the document? Does the franchisor have to amend its Franchise Disclosure Document when it provides the map? Finally, does the provision of the map start a new waiting period that must run prior to closure of the sale? All of these questions revolve around whether the map must be provided in the disclosure document. Although the statute requires the provision of a map, and this language is included in the portion of the statute related to the information to be disclosed in the Franchise Disclosure Document, the statute does not specifically indicate that the map must be provided in the disclosure document. Accordingly, one could argue that although a map is required, it can be provided outside of the disclosure document either in the franchise agreement or otherwise. This reading of the statute is consistent with common practice in the franchise context and allows one to avoid some of the issues discussed above.

Minnesota also requires an additional bankruptcy disclosure. Under the Amended Rule, the Item 4 bankruptcy disclosure is limited to 10 years. Under Minnesota law, the bankruptcy disclosure is 5 years longer than that required by the Amended Rule, requiring disclosure for 15 years from the date of the Franchise Disclosure Document. The unknowing franchisor who deletes a bankruptcy disclosure after 10 years will be opening itself up to liability from those Minnesota franchisees who purchased franchises during the 5 year period after deletion of the disclosure.

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59. **Minn. Stat. §80C.04(t).**

60. *Id.*

61. Amended Rule, at 436.5(d).

62. **Minn. R. §2860.3500(4)(D).**
The franchisor who provides a refund of the initial fee is subject to the same obligations under Minnesota law as those discussed above with respect to Maryland law. Finally, Minnesota arguably imposes upon a franchisor the obligation to ascertain whether a prospect has the qualifications and experience necessary for the operation of the franchised business. Under a little known Minnesota regulation, a franchisor must state in writing the qualifications and experience the prospect should possess in order to successfully operate the business, and if the prospect does not have the appropriate qualifications or experience, the additional personnel that will be required for the operation of the business.64

4. Illinois Advertising

Although this paper spends a considerable amount of time discussing provisions which limit a franchisor’s rights or which place additional obligations on the franchisor, we would be remiss if we failed to mention a provision under Illinois law arguably providing the franchisor with some flexibility when it comes to its advertising. Certain states prohibit or at best take a dim view of franchisee advertising that uses the words “success” or “profits”, regardless of qualification. Illinois on the other hand takes the opposite approach. Under the Illinois regulations, the text of an advertisement may use words like "success," "profits," "profit potential" and words of similar import, so long as such terms are reasonably qualified in the advertisement.65

IV. UNWRITTEN RULES OF THE REGISTRATION ROAD

As discussed in this paper, there are numerous hidden and often overlooked state provisions impacting franchise sales, disclosure and registration requirements. In addition to the provisions discussed above, there are some “unwritten rules" that franchisors would be wise to follow in each of the registration states. This information comes from the authors, collective experiences in either reviewing or filing franchise registration applications over the last number of years.

A. Beware Cesar Chavez

As discussed above, California requires that any Franchise Disclosure Document filed more than 90 days after the franchisor’s fiscal year end contain unaudited financial statements of the franchisor. When filing a document in California it is imperative that the franchisor take into account Cesar Chavez day, a California holiday which is celebrated on March 31 of each year. Filings made on Cesar Chavez day are not accepted until the next business day, which may result in the franchisor being required to file unaudited financial statements with its Franchise Disclosure Document because the filing may now be more than 90 days after the franchisor’s fiscal year end. Further, no automatic effectiveness will be possible.

63 Minn. R. §2860.4500(B)(E).

64 Minn. R. §2860.4500(C)(2). This obligation is arguably also imposed under Maryland’s regulations. See Md. Regs. Code tit. 2, §02.02.08.16 (J).

B.  **Risk Based Review in California**

California’s stated purpose of franchise registration is to maintain a risk-based process of reviewing franchise applications to enhance the uniform and efficient administration and effective enforcement of the Franchise Investment Law. To that end, regulators are to focus on franchisors posing the most risk to prospective franchisees. Although subject to an examiner’s discretion, the areas examiners focus on include, but are not limited to, the following: (i) risks associated with financial condition; (ii) past compliance record; and (iii) significant deficiencies in filing.

C.  **Gaining Priority in Cal-Easi**

The following best practices will expedite a franchisor’s file being scanned into the Cal-Easi database. Failure to follow the guidelines below will result in staff setting the file aside and taking one they can scan faster. The sooner a franchisor’s file is scanned into the database the sooner it can be reviewed. Delays of up to 7 – 14 days can be attributed to problems with scanning a file into the Cal-Easi database.

   a) Avoid double sided documents
   b) Never bind any documents
   c) Use paper clips instead of staples
   d) Do not use plastic covers or document protectors
   e) Do not use exhibit separators, instead print the exhibit and page number on the exhibit itself
   f) Use rubber bands instead of large binder clips
   g) Only use the file numbers (package numbers will be assigned by Cal-Easi for each filing)
   h) Do not send pages of deleted text. Just provide the new text underlined.
   i) Use NASAA Sales Agent disclosure forms
   j) Only include Sales Agents actually selling in California
   k) Do not send copies of the filing fee check
   l) Make the checks payable to the California Department of Corporations

D.  **Advertising Standards in California**

Franchise advertising is a trouble spot that California takes a keen interest in. To that end, the Department discourages the use of rankings, but if they are used they need to be
substantiated within the advertisement. Further, and although not an unwritten rule, if the franchisor is required to file a copy of the advertisement with the Department they must wait 3 business days after filing before they publish their advertisement.  

E. **Illinois’ Jumbo Exemption**

As discussed above, Illinois has adopted a self executing “jumbo” franchise exemption for those franchisors with a net worth in excess of $15,000,000. While there is no statutory requirement that a franchisor meeting the exemption file anything with the state, and there is no penalty for failure to file, the examiners appreciate some form of written notice from franchisors that they will be relying on the exemption.

F. **Virginia’s Type and Facsimile Requirements**

Although NASAA specified that the Franchise Disclosure Document must be written in at least 11 point type, states have traditionally provided franchisors certain leeway in this regard, allowing for smaller type in many circumstances. However, Virginia has recently taken a strict stance when it comes to this requirement requiring that franchisors use at least 11 point type in their Franchise Disclosure Documents and only allowing for smaller type in the tables, but only if, in the opinion of the examiner, the table is clearly readable.

Additionally, Virginia does not acknowledge facsimiles. Accordingly, comment letter responses must be sent by mail as a facsimile will not be accepted as a response.

G. **Indiana Effectiveness**

Although Indiana has moved away from formally reviewing the Franchise Disclosure Document in connection with franchise applications, it still imposes certain unique requirements in the registration process that can trip up even the most experienced franchise practitioners. For example, with the move away from the formal review process to a process more akin to Wisconsin’s process, many practitioners assumed that a Franchise Disclosure Document filed in connection with a renewal application would be effective upon receipt by Indiana much the way the document is effective in Wisconsin. This, however, is not the case unless the franchisor makes a special request in its application cover letter for effectiveness upon receipt by the state. In the absence of this request, Indiana treats a renewal application to be effective upon expiration of the prior filing.

H. **Indiana Goes Green and Means It**

Additionally, Indiana is the only state that has gone totally “green”. While many states require both a hard copy and a CD-Rom of the Franchise Disclosure Document and application materials in connection with a filing, Indiana does not accept hard copies, but only accepts CD-Rom’s.

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66 CAL. CORP. CODE §31156; Cal. Regs. §310.156-310.156.2.

I. **Maryland Communications**

Counsel must make sure that emails from the State of Maryland are not blocked by counsel’s spam filter as Maryland is issuing comment and approval letters via email only. However, when it comes to responses to comment letters, Maryland is the anti-Indiana, requiring all responses to be sent by hard copy. Even if the response is sent via email, the practitioner must follow-up via mail. Further, as a condition to renewal after the expiration of a filing, the franchisor must provide the state with a representation that it has made no offers or sales in the state since the expiration date of the prior filing. Failure to provide this representation will delay the approval.

J. **Accounting for Furloughs and Closures**

Due to various state budget issues, certain states have imposed furloughs and as a result many state offices are no longer open 5-days a week. For example, the Utah Department of Commerce is closed every Friday and the Hawaii Department of Commerce and Consumer Affairs is closed two Fridays of each month. Unfortunately, this seems to be only the beginning of this trend and many states are sure to follow. This becomes an issue for franchisors when an expiration date of a franchise registration falls on the day that a state office is closed due to furlough. As many states have not provided definitive guidance on whether the registration extends to the next business day, franchisors would be well advised to make their filings on the immediately preceding business day to ensure that the filing is timely.

K. **When an Initial Filing Is Not Really an Initial Filing**

Minnesota and New York have taken unusual positions with respect to filings made after the expiration of a prior franchise registration. Because the prior registration has lapsed, one would intuitively assume that the next filing would again be considered an initial filing. However, if the filing is made within six months in New York, and one-year in Minnesota, of the expiration of the prior filing, each state considers the filing to be a renewal filing.

L. **The Texas Two Step - Illinois Style**

Illinois is really a “de facto” two step process for initial registration. The first comment letter from the state is usually an “Order of Denial of Registration” regarding the financial condition. In addition, often Illinois will include clients on the distribution of comment letters. The first “Order of Denial of Registration” letter can scare clients if they have not been briefed on the process in Illinois. The order is really just an assessment of the applicant’s financial conditions and the order makes clear that the disclosure document has not been reviewed for compliance with the Amended Rule. Once the state is comfortable with an applicant’s financial condition, either through discussions with the regulator or the imposition of a fee deferral, escrow or impound, the state will then come back with substantive comments. From a “best practices” standpoint, practitioners with clients filing in Illinois should let the client know up front about the process in Illinois to eliminate any surprises. Managing expectations and letting clients know that the process for registration in Illinois may take longer than other registration states may prevent or at least reduce the chances for an unpleasant “Why aren’t we registered in Illinois yet?” phone call from an anxious client.
M. What's in a Name? That Which We Call A Development Agent Would Smell as Sweet...

There has been significant discussion and uncertainty among the registration states regarding the treatment of “Development Agents” (aka “Area Representatives”, “Area Developers” or “Regional Developers”), in part, at least because there is no uniform term used to describe them, and no uniform set of services they provide. As franchise systems become more sophisticated, increasingly more and more franchisors use the services of “Development Agents”. The responsibilities of a Development Agent may vary, but often a Development Agent is a person (or entity) who agrees to market and help sell franchises on behalf of a franchisor and sometimes assumes certain post-sale support obligations for the franchisor. The main distinction between a Development Agent and a subfranchisor is that the Development Agent does not actually enter into any contractual arrangement with the franchisee.

1. California

The California Franchise Investment Law does not define or contemplate the use of the term “Development Agent”. Until the Department of Corporations issued an interpretive release in 2008, it was unclear whether development agents were considered “subfranchisors” and as a result, required to prepare their own disclosure document and audited financial statements. The 2008 Release clarified that the current policy of the California Department of Corporations is that (similar to the Amended Rule), the term ‘subfranchisor’ is limited to circumstances where the subfranchisor steps into the shoes of the franchisor by selling franchises and performing post-sale obligations. To be a subfranchisor, a development agent must have the authority to enter into a franchise agreement and be obligated to perform franchise obligations.

2. Washington

Although a recent case held to the contrary, the general position in Washington, consistent with California, is that a development agent is not considered a “subfranchisor” (and therefore required to separately register), unless the Development Agent is authorized to enter into, sell, grant or alter any franchises with any franchisees. In Pinchin v. Nick-N-Willy’s Franchise Pizza Company, LLC a franchisee claimed rescission of its franchise agreement due to the franchisor’s failure to disclose an area representative involved in recruiting the franchisee into the system. The Nick-N-Willy’s Franchise Disclosure Document did not include the area representative, and the area representative did not prepare its own Franchise Disclosure Document. The court held that the area representative should have been disclosed in the franchisor’s Franchise Disclosure Document and the area representative should have independently registered as a “subfranchisor” in Washington. Franchisors should take some comfort, however, that the case is not binding authority, since it was not a full appellate decision, but just a commissioners’ denial of discretionary review. Moreover, the ruling is wholly


inconsistent with prior cases\textsuperscript{71}, and turned on the Commissioner’s broad interpretation of the term “negotiate”.

3. Illinois

One of the changes to the Illinois statutes that became effective in October 2009 was a change to the definition of “subfranchise”. The definition has been modified to no longer include those who only provide services to franchisees. The definition continues to include those who “sell or negotiate” the sale of franchises. The revised definition eliminates some confusion regarding what constitutes a “subfranchise”. Since subfranchisors are required to comply with all of the Illinois registration and disclosure requirements, the distinction can be quite significant. Notwithstanding the revised definition, similar to California and Washington, the treatment of “area developers” or “area representatives” or “development agents” and whether they should be considered “subfranchisors” remains a very hot issue. Practitioners should be mindful of the various states’ positions as well as the case law regarding registration and disclosure for such parties.

N. Florida Filing Requirements

Although Florida is not considered a franchise registration state, a franchisor attempting to avoid Florida’s business opportunity law must file a notice prior to making offers and sales in Florida. The filing is relatively easy. However, the franchisor must be sure to submit the notice on the original form provided by the state (as opposed to a photocopy or scanned copy) because the form contains a barcode that the state then scans for purposes of cataloging filings. Any photocopied or scanned notices will be rejected.

V. CONCLUSION

This paper has spent a considerable amount of time identifying provisions of various state franchise registration and disclosure laws, which if overlooked, may create significant liability for the franchisor and ultimately the franchisor’s counsel. However, one should not rely on this paper alone as a guide, as there is no substitute for a thorough reading of the applicable statute and accompanying regulations, if any, to determine those provisions that may be lurking to trip your client up, or provide your client with unexpected grounds for relief.

JOSEPH J. FITTANTE, JR.

Joe is a shareholder in the Larkin Hoffman Daly & Lindgren Ltd. law firm where he is a member of Larkin Hoffman’s Franchise and Distribution Practice Group. He advises franchisors on all aspects of the franchise relationship, including structuring the franchise relationship, drafting franchise documents, and terminating the franchise relationship. Joe is a frequent author and presenter on various franchise topics.

He was recently nominated as the Chair of the Franchise Forum. He has served as a member of the Forum Governing Committee since 2007 and co-chaired the Forum’s 2008 Annual Meeting held in Austin, Texas. He has also served as the Forum’s Diversity Officer and currently serves as the Program Officer. He was the ABA YLD liaison to the Governing Committee from 2003 to 2004.

He is listed in Best lawyers in America, the oldest peer-review publication in the legal profession and in Chambers USA – Franchise Law. He has been selected numerous times as a Rising Star and as a Super Lawyer by Minnesota Law and Politics.
THERESA LEETS

Theresa Leets is a Senior Corporations Counsel for the California Department of Corporations’ Securities Regulation Division. She is 1 of 8 lawyers that regulate the offer and sale of franchises and securities in California. She is a member of the NASAA Corporation Finance Franchise and Business Opportunities Project Group. Ms. Leets received her BA at UC Santa Barbara and her JD at UC Davis.
Rebekah Prince is an associate in the law firm of Snell & Wilmer L.L.P. in Los Angeles, California. She practices in the areas of franchise and distribution law, as well as business and finance with an emphasis on mergers and acquisitions and debt/equity financing. Ms. Prince is currently the Young Lawyers’ Division Liaison to the Governing Committee of the ABA Forum on Franchising. She also serves as Secretary of the California State Bar Franchise Law Committee. A graduate of the University Of Texas School of Law, Ms. Prince also worked as a tax consultant for PricewaterhouseCoopers prior to attending law school. As an undergraduate at Washington and Lee University in Virginia, Ms. Prince earned NCAA All American swimming honors all four years and served as the team’s captain her junior and senior year.