



Franchise Compliance Handbook

Best Practices for Awarding Franchises In Compliance with Federal and State Franchise and Business Opportunity Laws

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TABLE OF CONTENTS

| | Page |
|-------------------------------------------------------------------------|-------------|
| CHAPTER ONE MANEUVERING THE LEGAL LANDSCAPE | 1 |
| CHAPTER TWO FEDERAL FRANCHISE SALES LAW | 3 |
| CHAPTER THREE STATE FRANCHISE SALES LAWS | 7 |
| CHAPTER FOUR BUSINESS OPPORTUNITY LAWS..... | 16 |
| CHAPTER FIVE DELIVERING THE FDD: WHAT TO DO WITH THE RECEIPT PAGE | 17 |
| CHAPTER SIX FINANCIAL PERFORMANCE REPRESENTATIONS | 19 |
| CHAPTER SEVEN NEGOTIATING THE SALE | 23 |
| CHAPTER EIGHT STATE RELATIONSHIP LAWS | 24 |

CHAPTER ONE MANEUVERING THE LEGAL LANDSCAPE

The act of offering and selling franchises is governed by the Federal Trade Commission's trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising; Final Rule," 16 C.F.R. Part 436 (the "**Amended FTC Rule**"), and various states' laws governing the offer and sale of franchises and business opportunities.

For the most part, these laws require franchise sellers to deliver a franchise disclosure document and prohibit certain types of sales practices and representations. Most state franchise laws require registration or that a filing be made before a franchise is awarded in the state.

Overview of Federal Law

The Amended FTC Rule applies to the sale of franchises that will be located in the United States of America and its territories and possessions (but not to the sale of franchises to be located in foreign countries - see Chapter Two).

The Amended FTC Rule (1) requires the pre-sale delivery of a franchise disclosure document ("**FDD**") and the final franchise contracts, (2) prohibits sharing any financial information with prospective franchisees (orally or in writing) except to the extent that Item 19 of the FDD contains a formal financial performance representation, and (3) prohibits certain trade practices which have been determined to be deceptive to prospective franchisees.

Overview of States' Registration and Business Opportunity Laws

In addition to the Federal disclosure requirement, the offer and sale of franchises is regulated by the "franchise sales laws" of 15 states and potentially by the business opportunity laws of 25 states.

The states with franchise sales laws are: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. These laws potentially apply to a franchise sale if the offer is made in the state, the offer is accepted in the state, the franchisee is domiciled in the state, and/or the franchised business will operate in the state. See Chapter Three for more information about state franchise sales laws.

The states with business opportunity laws are: Alabama, Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, and Washington.

Most business opportunity laws exclude or exempt from their application the offer and sale of franchises made in full compliance with Federal law. A federal trademark registration is needed, however, to claim the exemption in Connecticut, Georgia, Louisiana, Maine, North Carolina and South Carolina. Franchisors without a registered trademark desiring to offer and sell franchises in these states either must register and comply with applicable business opportunity laws, or look for a different exemption. A one-time exemption filing is needed to claim exemption from the business opportunity laws of Kentucky, Nebraska, and Texas, and annual exemption filings are needed to claim exemption from the business opportunity laws of Florida and Utah. See Chapter Four for more information about state business opportunity laws.

Overview of Franchise Relationship Laws

Once a franchise is sold, a different set of laws and regulations apply. These laws are commonly known as “franchise relationship laws” because they govern important aspects of the franchise relationship, such as the franchisee’s right to sell or transfer the franchise to a third party, and the franchisor’s right to terminate or refuse to renew the franchise relationship. See Chapter Eight for more information about state relationship laws.

CHAPTER TWO FEDERAL FRANCHISE SALES LAW

Application of Federal Law

The Amended FTC Rule applies to the offer and sale of franchises to be located in the United States of America and its territories and possessions (but does not apply to the offer or sale of franchises to be located in foreign countries).¹

Certain exemptions to the Amended FTC Rule apply for **(1)** franchise sales under \$615, **(2)** fractional franchises,² **(3)** leased departments,³ **(4)** oral contracts, **(5)** franchise sales involving petroleum marketers, and **(6)** three categories of “sophisticated investors.”

Pre-Sale Disclosure Requirements

Among other things, the Amended FTC Rule requires delivery of a franchise disclosure document (“FDD”) at least 14 full calendar days (the “**14-Day Rule**”) before the earlier of: **(1)** execution by the prospective franchisee of any franchise or other agreement (such as an area development agreement or option agreement) which imposes a binding, legal obligation on the prospective franchisee, or **(2)** the payment of any consideration for a franchise by the prospective franchisee.⁴

It is generally up to the franchisor when in the sales process the FDD will be delivered. Some franchisors choose to provide it early in the sales process; some franchisors provide it closer to discovery day or closer to the anticipated signing date. If the prospective franchisee asks for the FDD earlier in the sales process, however, the Amended FTC Rule requires the franchisor to provide it “upon reasonable request.”⁵

Once the prospective franchisee receives the FDD, the 14 calendar day time period begins to run. The following example illustrates how to comply with the 14-Day Rule:

- (1)** If the prospective franchisee receives the FDD on May 15, 2020, the 14 days begins to run on May 16, 2020 (because you don’t count the day on which the prospective

¹ While Federal law does not apply to the sale of franchises which will be located in foreign countries, depending on where the offer and acceptance occurred, a state’s franchise sale law may apply.

² A fractional franchise is a franchise relationship in which, at the time of its creation, (1) the franchisee, any of the franchisee’s current directors or officers, or any of the current directors or officers of a parent or affiliate of the franchisee has more than two years of experience in the same type of business and (2) there is a reasonable basis to anticipate that the sales arising from the franchise relationship will not exceed 20% of the franchisee’s total dollar volume in sales during the first year of operation. 16 C.F.R. § 436.1(g)

³ A leased department is an arrangement in which a retailer permits a seller to conduct business from the retailer’s location, but the seller does not purchase items from the retailer, any person the retailer requires the seller to do business with, or an affiliate of the retailer. 16 C.F.R. § 436.1(l)

⁴ Contrary to common misconception, the FDD is not filed with the Federal government and is not reviewed by any Federal government agency. It merely creates an obligation to disclose certain information to prospective franchisees. Failure to make the disclosures violates Federal law, and also serves as a basis for state and common law fraud claims.

⁵ New York however requires that a franchisor deliver a disclosure document at the earlier of the first personal meeting or 10 business days before the execution of the franchise or other agreement or the payment of any consideration that relates to the franchise relationship. Michigan requires that a franchisor deliver a disclosure document at least 10 business days before the execution of any binding franchise or other agreement or the payment of any consideration, whichever occurs first. See Chapter Two for more information about state franchise sales laws.

franchisee receives the FDD).

- (2) The full 14 calendar day period ends on May 30, 2020.
- (3) The prospect may sign the agreement and pay money on the following day, May 31, 2020.

Therefore, the 14-Day Rule is in reality the 16-day rule.

Historically, FDDs were professionally printed and physically handed or mailed to a prospective franchisee. Today, a pdf version of the FDD is typically delivered to a prospective franchisee via email (with the receipt page sometimes signed via DocuSign), or the FDD is delivered via a franchise sales CRM (such as FranConnect) which maintains electronic receipt records. Regardless of how delivery is accomplished, the actual Receipt page attached to the FDD must be completed and signed by the prospective franchisee, and the franchisor must maintain a copy of completed and sign Receipt page for its records. See Chapter Five for more information regarding the process for delivering and documenting delivery of the FDD.

Redisclosure Requirements After a Material Change Occurs

The question invariably arises as to whether a prospective franchise, who has already been disclosed with an FDD, must be “redisclosed” after a material change requiring amendment has occurred. Federal law does not impose a duty to redisclose, but other factors may weigh in favor of redisclosure, including relevant states’ laws and the nature of the material change.

Annual Updates and Quarterly Revisions

The FDD must be updated annually, *within 120 days after the close of the franchisor’s fiscal year end*, with current information as of its fiscal year end, including the franchisor’s audited, year-end financial statements. Some states, such as Hawaii, may effectively reduce this time period by requiring the submission of state filings at an earlier time. See Chapter Three for more information about state franchise sales laws.

Advance Delivery of Franchise Agreements

In situations where the franchisor has materially altered the terms and conditions of the standard agreements attached to the FDD, except where the change was initiated at the request of the franchisee, the Amended FTC Rule mandates a contract review period of 7 full calendar days (the “**7-Day Rule**”).

The 7-Day Rule is accounted for in the same manner as the 14-Day Rule.

- (1) You may not count the day the prospective franchisee first receives the completed agreements.
- (2) If the prospective franchisee receives the completed agreements on May 24, 2020, the 7-Day Rule begins on May 25, 2020.
- (3) The full 7 calendar day period ends on June 1, 2020.
- (4) However, the prospect may not sign the completed agreements nor pay any consideration to the franchisor until the following day, June 2, 2020.
- (5) Hence the 7-Day Rule is in reality the 9-day rule.

The advance delivery requirement does not apply, however, where the only differences between

the standard agreements and the completed agreements are non-substantive “fill-in-the-blank” provisions, such as the date, name, and address of the franchisee. The addition of substantive terms will trigger the seven-calendar day review period. Examples of substantive provision triggering this requirement includes the addition of a specific radius or geographic area comprising a protected territory,⁶ the actual number of stores to be opened pursuant to an area development agreement, the specific interest rate payable by the franchisee, or other contractual terms that were not previously disclosed in the basic disclosure document or its attachments.

In this author’s opinion, whether certain terms (and, particularly, territorial-related terms) are fill-in-the-blank or substantive is often times clear as mud. Best practices, therefore, dictates allowing the prospective franchisee a full seven calendar days to review the final agreements before signing.

No Representations of Financial Performance

The Amended FTC Rule prohibits the dissemination of any financial performance representations to prospective franchisees *unless (1)* the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, *and (2)* the representation is included in Item 19 of the franchisor’s FDD. See Chapter Six for more information about a franchisor’s ability to share financial performance information.

Prohibited Practices

The Amended FTC Rule prohibits nine acts or practices which are considered deceptive to prospective franchisees, including those described above.

The Amended FTC Rule prohibits franchise sellers from:

- (1) making statements that contradict the franchisor’s disclosures;
- (2) making financial performance representations without a reasonable basis and without written substantiation for the representation at the time the representation is made;
- (3) failing to make available written substantiation for any financial performance representation;
- (4) failing to make promised refunds;
- (5) failing to furnish a copy of the FDD to prospective franchisees early in the sales process, upon reasonable request;

⁶ With respect to protected territories, the Federal Trade Commission’s answers to Frequently Asked Questions explains “a franchisor may fill in a term in a franchise agreement without triggering the seven-day review period, provided the territory previously has been identified, but the exact name or circumstance was unknown at the time of disclosure. For example, if it is a franchisor’s practice to grant protected territories on a county-wide basis, the franchisor may include a statement in its disclosure document to the effect that: ‘We assign protected territories by county. Your protected territory will be [name of county], in [state].’ This sufficiently details the scope of the protected territory – an entire county – to enable the prospect to apply the statement to his or her specific proposed outlet without any further explanation. In the opinion of FTC staff, filling in the exact name of the county at a later date would not necessarily constitute a substantive change. Nevertheless, a vague description of a protected territory – such as a statement that the protected territory will range from 1 to 10 miles from the prospective franchisee’s outlet – is insufficiently detailed to give a prospective franchisee notice of the likely scope of his or her territory; filling in the exact number of miles at a later date, therefore, would be a substantive modification of the franchise agreement triggering the seven-day waiting period.”

- (6) failing to furnish a prospect in the sales process who has already received the FDD with a copy of any updated FDD or quarterly update to an existing FDD, upon reasonable request, before the prospective franchisee signs a franchise agreement;
- (7) materially altering the terms and conditions of any franchise agreement presented to a prospective franchisee for signing unless the seller informs the prospective franchisee of the changes seven days before execution of the agreement;
- (8) disclaiming or requiring a franchisee to waive reliance on any representation made in its FDD or its exhibits or attachments; and
- (9) misrepresenting that any person has purchased a similar franchise or operated a similar franchise from the franchisor, or that any person can provide an independent and reliable report about the franchise or the experiences of any current or former franchisees.

CHAPTER THREE STATE FRANCHISE SALES LAWS

Fourteen states require registration or filing before a franchisor may offer or sell franchises in the state. These states' laws potentially apply if the offer of the franchise originates in the state, the offer to sell is directed by the franchisor to the state and received at the place to which it was directed, the offer to buy is accepted in the state, the offer or sale is made to a franchisee who is domiciled in the state, or if the franchised business will be located or operated in the state. Sometimes the offer and sale of a franchise may trigger the franchise sales laws of more than one state, for example, if the franchisor and franchisee are in different states, each with its own franchise sales law.

Determining Whether a State Law Applies

Before offering or selling a franchise in these states, a franchisor must determine whether it is necessary to register the franchise or make a filing under any state franchise sales law. Most state franchise statutes apply to sales activity taking place within the borders of a given state. Most often, a single state's law will apply. If the franchisor is located in a state with registration or filing requirements and the franchisee resides or is domiciled in a different state, and/or the franchised business will be located in a different, more than one state's franchise sales laws may apply.

A state's registration or filing requirements will often apply when:

- (1) the offer of a franchise or the acceptance of the offer by the franchisee is communicated in or from the regulating state, such as the state in which verbal negotiations take place (in person or on the telephone); faxes, correspondence or proposed agreements are sent or received; or, in which the franchisee executes the franchise agreement;
- (2) the prospective franchisee is domiciled in the regulating state, or, if a business entity, is headquartered in the regulating state; and
- (3) the prospective franchisee is domiciled in or plans to operate the franchised business in the regulating state.

State laws generally define the "offer" of a franchise to include "every attempt to offer or dispose of, or solicitation of an offer to buy, a franchise or interest in a franchise for value." This broad definition of "offer" will generally include oral or written contact with a prospective franchisee. Administrative interpretations suggest that any communications concerning a specific franchise opportunity may constitute an "offer." Offers also may include telephone communications to or from a registration/disclosure state, newspaper, magazine, radio or television advertising offering a franchise. Most states, however, exempt from the definition of offer the circulation of an advertisement in a publication which has two-thirds of its circulation outside of the state, and sending promotional brochures and other franchise sales literature. In contrast, the "sale" of a franchise generally refers to the execution of a franchise agreement or other binding contract (such as an area development agreement, option agreement or letter of intent), or the payment of consideration by the prospective franchisee for the purchase of franchise rights.

The following chart is intended as a guide to determine whether the registration provisions of a state's franchise sales law may apply. The state's franchise sales law will apply if any one of the applicable conditions is met. Reference to this chart alone does not rule out application of a particular state's law. If there is any question about whether a state's law may apply, counsel

should be consulted *before* an offer is made.

| State | Offer to sell originates in state | Offer to sell directed by franchisor to state and received at place to which it was directed | Offer to buy accepted in state | Offer or sale made to domicile or resident and franchise is or will be operated in state (regardless of site of offer/ acceptance) | Offer or sale made or accepted in state and the franchise is or will be operated in state | Franchise will be operated in state (regardless of site of offer/ acceptance) | Offer/sale made to domicile or resident (regardless of offer/ acceptance/ operation) |
|---------------------------|-----------------------------------|----------------------------------------------------------------------------------------------|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|
| California ¹ | X | X | X | X | | | |
| Hawaii ¹ | X | X | X | | X | | |
| Illinois ² | | | | | X | | X |
| Indiana | | | | | | X | X |
| Maryland ¹ | X | X | X | | | X | X |
| Michigan ¹ | X | X | X | X | | | |
| Minnesota ¹ | X | X | X | | | | |
| New York | X | X | X | X | | | |
| North Dakota | X | X | X | X | | | |
| Rhode Island ¹ | X | X | X | X | | | |
| South Dakota | X | X | X | X | | | |
| Virginia | | | | | X | | |
| Washington ³ | X | X | X | | | X | X |
| Wisconsin ¹ | X | X | X | | | | |

Note 1. California, Hawaii, Maryland, Michigan, Minnesota, Rhode Island, and Wisconsin each have some form of exemption applicable to sales made to out-of-state franchisees, where the franchised business also will be operated out-of-state. See page 7 for more information about applicable exemptions.

Note 2. Illinois law provides that “no franchisor may sell or offer to sell a franchise in this State if **(1)** the franchisee is domiciled in this State or **(2)** the offer of the franchise is made or accepted in this State and the franchise business is or will be located in this State, unless the franchisor has registered the franchise with the Administrator...” The anti-fraud provisions of the Illinois law apply to all offers and sales made within the state.

Note 3. Washington law provides that “an offer to sell a franchise is made in this state when: (a) the offer is directed by the offeror into the state from within or outside this state and is received where it is directed, (b) the offer originates

from this state *and* violates the franchise or business opportunity law of the state or foreign jurisdiction into which it is directed, (c) the prospective franchisee is a resident of this state, or (d) the franchise business that is the subject of the offer is to be located or operated, wholly or partly, in this state.” (RCW § 19.100.020, emphasis added)

Note 4. Many states have some form of an exemption for (1) information circulated in a newspaper and other general, regular, and paid circulations when a certain percentage of its circulation is out-of-state, (2) radio or television programs originating out of the state, and (3) internet-based information when certain disclosures or statements are made.

Determining Whether an Exemption Applies

Although most state laws are written broadly enough to capture all sales activity occurring within the state, most states provide an exemption for franchisee-to-franchisee sales accomplished without the franchisor’s participation. Several states also exempt outbound sales, *i.e.*, sales where both the franchisee and the franchised business are located out of state. A number of states also provide exemptions for experienced and high net worth franchisors, or sales to sophisticated purchasers. These exemptions vary greatly by state, and many are conditioned on the franchisor making a filing and providing pre-sale disclosures. The following chart identifies some of the more commonly used exemptions. It should not be relied on alone to determine the availability or application of any particular exemption. If you desire to claim a particular exemption, you should consult legal counsel and/or consult the actual state law for further guidance.

| State ¹ | High Net Worth Franchisor ² | Experienced Franchisor ² | High Net Worth Franchisee/Substantial Investment | Experienced Franchisee | Isolated Sale | Fractional Franchise | Out of State Sale | Sale to Existing Franchisee | Franchisee to Franchisee Sale |
|--------------------|----------------------------------------|-------------------------------------|--------------------------------------------------|------------------------|---------------|----------------------|-------------------|-----------------------------|-------------------------------|
| California | X | X | X | X | | X | X | X | X |
| Hawaii | | | | | X | | X | X | X |
| Illinois | X | X ² | X ³ | X ³ | X | X | | | X |
| Indiana | X | X | | | X | | | | X |
| Maryland | X | X | X ⁴ | X | | | X | X | X |
| Michigan | | | | | X | X | X | X | X |
| Minnesota | | | X ⁴ | | X | X | X | | X |
| New York | X | X | | | X | X | | X | X |
| North Dakota | X | X | | | | | | | X |
| Oregon | | | X | | X | X | | X | X |
| Rhode Island | X | X | X ³ | X ³ | | X | X | X | X |
| South Dakota | | | X ⁴ | | | X | | X | |
| Virginia | X | X | X | | | | | X | X |
| Washington | X | X | X | | X | | | X | X |
| Wisconsin | | | X | X | | X | X | X | X |

Note 1. These exemptions are subject to various limitations and conditioned on additional disclosures and filings. The actual state law should be consulted before relying on any exemption identified here.

Note 2. To qualify for the franchisor net worth/experience exemption in these states, a franchisor must meet certain net worth requirements, have had a minimum number of franchisees, and satisfy certain disclosure and/or exemption filing requirements. Other conditions or limitations may apply.

Note 3. To qualify for the franchisee net worth/experience exemption in Illinois, the franchisee must meet certain net worth requirements and have no less than five years business experience. To qualify for the franchisee net worth/experience exemption in Rhode Island, the franchisee must meet certain net worth requirements and have knowledge and experience in financial and business matters that such person is capable of evaluating the merits and risks of the franchise.

Note 4. Maryland exemption applies to investments of more than \$750,000. Minnesota exemption applies to unfinanced initial investment of at least \$200,000. South Dakota exemption applies to investments of more than \$1,000,000, excluding financing by franchisor and cost of real estate.

Registration and Disclosure Requirements

The fourteen states identified in the chart below require that a franchise be registered, or that a filing be made, before franchises are offered or sold in the state. Several of these states also impose their own pre-sale disclosure requirements, which may differ slightly from Federal law. Where a state law requires delivery of the FDD earlier in the sales process than required by Federal law, state law disclosure requirements should be followed. For example, New York law requires franchise sellers to deliver the FDD at the earlier of the first personal meeting with the prospective franchisee held for the purpose of discussing the proposed franchise sale or 10 business days before the buyer signs a binding agreement or pays any consideration for the franchise.

See the following chart for a summary of each state law’s registration, filing, and disclosure requirements.

| State | Type of Filing | When Effective | Period of Effectiveness | Renewal/Annual Report | Disclosure |
|------------|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|---------------------------------------------------------------|------------------------------------------------------------------------------------|
| California | Registration | 30 th business day at 12:00pm PST following the filing of a complete application and resolution of all issues raised of the last pre-effective amendment (when an application is filed, however, the franchisor will be asked (required) to waive application of the automatic effectiveness provision). | Expires 110 days after fiscal year end | 15 business days before expiration | 14 calendar days before execution of binding agreement or receipt of consideration |
| Hawaii | Filing | 7 calendar days following receipt of filing | Expires 90 days after fiscal year end | 90 days after fiscal year end | 7 days prior to franchise sale |
| Illinois | Registration | 21 st day after filing the application, unless the Administrator denies registration | Expires 120 days after fiscal year end | Annually, but not later than 1 business day before expiration | 14 calendar days before execution of binding agreement or receipt of consideration |
| Indiana | Notification | Upon receipt of notification | Anniversary date | Annually | 14 calendar days before execution of binding agreement or receipt of consideration |

| State | Type of Filing | When Effective | Period of Effectiveness | Renewal/Annual Report | Disclosure |
|--------------|--------------------|---------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|--------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|
| Maryland | Registration | When registered by the Commissioner | Anniversary date | 15 business days before expiration | 14 calendar days before execution of binding agreement or receipt of consideration |
| Michigan | Notification | Upon receipt by the state | Anniversary date | Annual filing | 10 business days before execution of binding agreement or receipt of consideration |
| Minnesota | Registration | When registered by the Commissioner | 120 days after fiscal year end | Annual report due 120 after fiscal year end | 7 days before execution of binding agreement or receipt of consideration |
| New York | Registration | When registered by the Department | 120 days after fiscal year end | Annual report due 120 days after fiscal year end | Earlier of the first personal meeting or 10 business days before execution of binding agreement or receipt of consideration |
| North Dakota | Registration | When registered by the Commissioner | Anniversary date | 15 business days before expiration | 7 days before execution of binding agreement or receipt of consideration |
| Oregon | No filing required | Not applicable | Not applicable | Not applicable | 14 calendar days before execution of binding agreement or receipt of consideration |
| Rhode Island | Registration | 30th business day after filing the application and all requested information or earlier date ordered by the Director | 365 calendar days from the effective date | 30 days before expiration | 14 calendar days before execution of binding agreement or receipt of consideration |
| South Dakota | Notification | Upon receipt by the state | Anniversary date | Annual filing | 14 calendar days before execution of binding agreement or receipt of consideration |
| Virginia | Registration | When registered by the Commissioner | Anniversary Date | 30 days prior to expiration | No state requirement, follow Federal Law. |
| Washington | Registration | 15 th business day after filing the application and all requested information or earlier date as Director determines | Anniversary Date | 15 calendar days before expiration | 14 calendar days before execution of binding agreement or receipt of consideration |
| Wisconsin | Notification | Upon receipt by the state | Anniversary Date | Annual filing | 14 calendar days before execution of binding agreement or receipt of |

| State | Type of Filing | When Effective | Period of Effectiveness | Renewal/Annual Report | Disclosure |
|-------|----------------|----------------|-------------------------|-----------------------|---------------|
| | | | | | consideration |

Amendment of Registration

Like the Amended FTC Rule, most states' franchise sales laws (Indiana, Michigan and South Dakota excepted), require that the FDD be updated, and the state registration amended, after a material change⁷ occurs in the information contained in the registration. California, Maryland, New York, North Dakota, Rhode Island require that an amendment be filed "promptly" after the material change occurs. Minnesota and Wisconsin require that the amendment be filed within 30 days after the material change; Illinois requires that the amendment be filed within 90 days of the material change. Hawaii merely requires that the amendment be filed before further sales are made; Virginia requires amendment "upon the occurrence of any material change"; and Washington requires amendment "as soon as reasonably possible after a material change and, in any case, before the further sale of any franchise."

Pending amendments do not affect a franchisor's registration in a particular state and, subject to any re-disclosure obligations,⁸ should not affect a franchisor's ability to sell a franchise to a buyer who received disclosures before the material change occurred. If a prospective franchisee has not yet received disclosures, the franchisor may provide the updated FDD to the buyer for informational purposes, but the buyer should be told that the FDD is on file but has not yet been accepted for use in the state.

It also must be revised *within a reasonable time after the close of each of its fiscal quarters* to reflect any material change that may have occurred during the quarter. Quarterly revisions may be prepared as an addendum to the standard FDD. Once prepared, each prospective franchisee must receive the disclosure document and the quarterly revisions for the most recent period available at the time of disclosure.

Unless otherwise provided by state law, delivery of an FDD while an amendment is pending will not satisfy the franchisor's disclosure requirements. Instead, to satisfy disclosure requirements, the buyer must receive the amended FDD after the amendment is accepted, and the franchisor must wait for the disclosure period to end before closing on the sale. California, New York and Rhode Island franchise sales laws exempt the offer of a franchise while a renewal application is pending if certain procedures are followed. The California Franchise Investment Law requires, for example, that the buyer be provided: **(1)** a copy of the FDD on file with the Department, **(2)** a written statement that the filing has been made but is not effective, and **(3)** a commitment to deliver a copy of the effective FDD marked to show all material differences between the effective FDD and the FDD previously delivered. New York requires the franchisor to **(1)** inform the buyer, in writing, that an amended filing has been, or will soon be, submitted to the Department, **(2)** once the

⁷ The original FTC Rule defined "material," "material fact, and "material change" to include any fact, circumstance, or set of conditions which has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or which has any significant impact on a franchisee or prospective franchisee.

⁸ Illinois, for example, requires delivery of the amended FDD to any prospective franchisee "including prospective franchisees to whom a disclosure statement was previously delivered if the material change relates to or affect the franchisor or the franchise offered to such prospective franchisees."

amendment is accepted and registered, re-disclose the buyer, and (3) deposit any funds paid to franchisor in a separate bank account to be held in trust until ten business days following the date the buyer was re-disclosed. At any time during the period prior to buyer's receipt of the new FDD and the following ten business day time period the buyer may rescind the sale, at which time the funds must be immediately returned.

Redisclosure Requirements After a Material Change Occurs

The question invariably arises as to whether a prospective franchise, who has already been disclosed with an FDD, must be “rediscovered” after a material change requiring amendment has occurred. The answer to this is “it depends.” It depends on the state in which the franchisee resides or is domiciled and the state in which the franchised business will operate. It also depends, as a matter of judgment and best practices, on whether the material change is relevant to a particular franchisee.

As reflected in the chart below, four states’ laws require redisclosure after a material change has occurred. An additional handful of states’ laws contain anti-fraud provisions, which could imply a redisclosure requirement depending on the nature of the change. Federal law and the remainder of state laws impose no statutory obligation, but best practices may weigh in favor of redisclosure, depending on the circumstances.

The following chart summarizes a franchisor’s legal duty to redisclose prospects who have already been properly disclosed after a material change has occurred. If there is any question about whether redisclosure should be made, counsel should be consulted *before* an offer is made.

| State | May Close on Pending Sale prior to State Approval? | Re-Disclosure Requirement |
|---------------------------|----------------------------------------------------|-------------------------------------------------------|
| California ¹ | No | Must re-disclose |
| Florida | Yes | No duty to redisclose |
| Hawaii ¹ | No | Must re-disclose |
| Illinois ¹ | No | Must re-disclose |
| Indiana | Yes | No duty to redisclose |
| Maryland ² | No | Anti-fraud provisions may imply a duty to redisclose |
| Michigan | Yes | No duty to redisclose |
| Minnesota ² | No | Anti-fraud provisions may imply a duty to redisclose |
| New York ¹ | No | Must re-disclose |
| North Dakota ³ | Yes | No duty to redisclose |
| Rhode Island ² | No | Anti-fraud provisions may imply a duty to re-disclose |

| State | May Close on Pending Sale prior to State Approval? | Re-Disclosure Requirement |
|-------------------------|----------------------------------------------------|-------------------------------------------------------|
| South Dakota | Yes | No duty to redisclose |
| Utah | Yes | No duty to redisclose |
| Virginia ² | No | Anti-fraud provisions may imply a duty to re-disclose |
| Washington ³ | Yes | No duty to redisclose |
| All Other States | Yes | No duty to redisclose |

Note 1. California, Hawaii, Illinois, and New York require re-disclosure and you must wait a full 14 calendar days after state approval prior to closing the pending sale.

Note 2. Maryland, Minnesota, Rhode Island, and Virginia strongly recommend re-disclosure and that you wait a full 14 calendar days after state approval prior to closing the pending sale, in order to avoid violating any anti-fraud provisions.

Note 3. North Dakota and Washington will permit you to close on a pending sale while awaiting approval of the amendment (provided that registration has not expired). Best practices dictate that you provide the prospect with a copy of the new FDD submitted to each state – “for informational purposes only” – and that you inform the prospect that this document is pending approval with the state.

Additional Requirements for Franchise Brokers

New York and Washington impose registration requirements for franchise brokers or sales agents. These requirements are summarized below.

New York

The New York Franchises Act defines a “franchise sales agent” as any person who directly or indirectly engages in the offer or sale of any franchises on behalf of another. Franchisors, sub-franchisors, and their employees are not considered franchise sales agents.

Each sales agent offering or selling franchises in New York must file a Franchise Sales Agent Statement with the New York State Department of Law. Every person who has filed a Franchise Sales Agent Statement must file a Supplemental Franchise Sales Agent Statement whenever there has been any material change in the information contained in the statement.

Washington

The Washington Franchise Investment Protection Act defines a “franchise broker” as “a person who directly or indirectly engages in the business of the offer or sale of franchises,” except a franchisor, subfranchisor, or the officers, directors or employees of either.

The Act requires that every franchise broker apply for a “franchise broker license” by submitting the appropriate application containing, among other things, payment of the application fee and disclosure concerning the broker’s principals. Franchise brokers also must comply with certain recordkeeping requirements.

Sales Literature

Many franchise sales laws require that copies of advertising and sales literature be filed with the state before first publication or use, and some require that advertising contain certain information about the franchisor or prescribed cautionary language. The following chart summarizes these requirements.

| State | Copies to File | Time to File Before Use | Selected Restrictions |
|--------------|-----------------------|--------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| California | 2 | 3 business days | Any ad which refers to the registration of the franchise in California shall contain the franchisor's name and address and, in capital letters of not less than 10-point type, the following: "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." Internet advertisements must be filed under a notice of exemption |
| Maryland | 1 | 7 business days | Must state the name and address of Franchisor |
| Minnesota | 1 | 5 business days | Must state name, address, and primary commercial symbol of Franchisor, and the state registration number |
| New York | 2 | 7-Days | Required language: "This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law." |
| North Dakota | 1 | 5 business days | |
| Washington | 1 | 7-Days | Must state the name and address of Franchisor |

Note 1. No advertising filing is required to be made in any state in which the franchisor is exempt.

Note 2. Of the seven states that require the filing of advertising, California, Maryland, New York, North Dakota, and Washington provide that the franchisor does not need to pre-file advertising that is published in a newspaper or other publication that has had more than two-thirds of its circulation outside of the state during the past year. Minnesota contains no comparable exemption from filing.

CHAPTER FOUR BUSINESS OPPORTUNITY LAWS

In addition to the Amended FTC Rule and the state franchise laws, certain states' business opportunity laws may apply to the offer and sale of franchises. Business opportunity laws are typically broad in scope, and apply to the offer and sale of franchises unless such sales are expressly excluded or exempted from coverage. Business opportunity laws typically impose registration and disclosure requirements, and may impose bonding and/or escrow requirements on the franchise seller.

Twenty-five states have one of a variety of business opportunity statutes. These states are: Alabama, Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, and Washington.

Exemptions from State Business Opportunity Laws

Some business opportunity laws, such as California, Illinois, Indiana, Maryland, South Dakota, Virginia and Washington do not apply to franchises registered according to the state's franchise laws.

Some business opportunity laws, such as Connecticut, Maine and North Carolina, do not apply to the offer and sale of a franchise if the franchisor's marketing plan is associated with a federally registered trademark. A franchisor without a federally registered trademark – even if it has applied for registration – must register its franchise as a business opportunity under the laws of these states.

The business opportunity laws of Ohio and Oklahoma exempt the offer and sale of franchises made in compliance with the Amended FTC Rule. The business opportunity laws of Kentucky, Nebraska, Texas and Utah exempt the offer and sale of business opportunities meeting the FTC Rule definition of a franchise; so long as the franchisor has complied with presale disclosure requirements and has filed the appropriate exemption notice (see registration/filing requirements, below).

Other state business opportunity laws, such as Florida, Georgia, Louisiana and South Carolina, generally will not apply to the offer and sale of a franchise if the franchisor's marketing plan is associated with a registered trademark. In these states, a franchisor without a federally registered trademark may claim exemption from the state business opportunity law by registering its trademark on the state trademark registry. Alternatively, the franchisor may choose to comply with the requirements of these laws which may include complying with advertising requirements and/or escrowing a significant portion of the initial franchise fee.

Even if the offer or sale of a franchise otherwise would be exempt by virtue of the franchisor's compliance with the Amended FTC Rule or state filing requirements, however, it still may fall within a state's business opportunity law if the franchisor makes certain promises or representations in connection with the sale, such as offering to refund the franchisee's money if the franchisee is dissatisfied with his or her purchase.

Florida, Kentucky, Nebraska, Texas and Utah require the filing of form notices of exemption under their state business opportunity laws. In Nebraska, Texas and Kentucky (which also requires submission of the disclosure document), this is a one-time filing.

CHAPTER FIVE DELIVERING THE FDD: WHAT TO DO WITH THE RECEIPT PAGE

Delivering the FDD

The Amended FTC Rule specifically permits disclosure in electronic format and by electronic communication. Specifically, it states that a franchisor will be considered to have furnished a disclosure document if:

- (1) a copy of the document was hand-delivered, faxed, emailed, or otherwise delivered to the prospective franchisee by the required date;
- (2) directions for accessing the document on the Internet were provided to the prospective franchisee by the required date; or
- (3) a paper or tangible electronic copy (for example, computer disk or CD-ROM) was sent to the address specified by the prospective franchisee by first-class United States mail at least three calendar days before the required date.

The Receipt Page

Documenting franchise sales compliance is accomplished through the proper completion, signing and retention of the Item 23 Receipt page (which is the last page of the FDD).

Each prospective franchisee (including each owner of a prospective franchisee) should sign, date and return the Receipt page to the franchisor. The Amended FTC Rule specifically permits electronic acknowledgments of receipt by defining “signature” to include not only written signatures, but electronic signatures, passwords, security codes, and other devices that enable a prospective franchisee to easily acknowledge receipt, confirm his or her identity, and submit the information to the franchisor.

At the time the FDD is delivered, it should be completed with the names of all franchise sellers who have or will participate in the sales process with respect to the particular franchisee.⁹ So, for example, if a franchisor is working with multiple franchise brokers, the Receipt page should reflect the name of the broker working with the particular franchisee.

Once completed and signed, a copy of the Receipt page should be maintained in each franchisee’s file for no less than three years.

⁹ The Amended FTC Rule defines a “franchise seller” to mean a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, sub-franchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

RECEIPT

This disclosure document summarizes certain provisions of the franchise agreement and other information in plain language. Read this disclosure document and all agreements carefully.

If ABC Franchise Corp. offers you a franchise, it must provide this disclosure document to you 14 calendar days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

New York requires that we give you this disclosure document at the earlier of the first personal meeting or 10 business days before the execution of the franchise or other agreement or the payment of any consideration that relates to the franchise relationship. Michigan requires that we give you this disclosure document at least 10 business days before the execution of any binding franchise or other agreement or the payment of any consideration, whichever occurs first.

If ABC Franchise Corp. does not deliver this disclosure document on time or if it contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred and should be reported to the Federal Trade Commission, Washington, D.C. 20580 and the state agency listed in Exhibit A.

The franchisor is ABC Franchise Corp, 123 Rosy Lane, Anytown, Texas 75080. Its telephone number is 972-123-4567.

Issuance Date: April 25, 2020

The franchise seller for this offering is: _____, _____, _____ c/o ABC Franchise Corp., 123 Rosy Lane, Anytown, Texas 75080, 972-123-4567.

I acknowledge receiving this disclosure document dated April 25, 2020 (or the date reflected on the States Effective Dates page in this disclosure document), including the following Exhibits:

- EXHIBIT A Franchise Agreement
- EXHIBIT B Financial Statements
- EXHIBIT C List of State Administrators
- EXHIBIT D List of Agents for Service of Process
- EXHIBIT E List of Franchisees
- EXHIBIT F List of Franchisees Who Left the System
- EXHIBIT G Receipts

Date (do not leave blank)

Signature of Prospective Franchisee

Print Name

If signing on behalf of a corporation or other entity, please also complete the following:

Name of Entity

Title

Please return the completed receipt either by signing, dating, and mailing it to ABC Franchise Corp. at 123 Rosy Lane, Anytown, Texas 75080, or by faxing a copy of the signed and dated receipt to ABC Franchise Corp. at 972-123-4568.

CHAPTER SIX FINANCIAL PERFORMANCE REPRESENTATIONS

Federal and state franchise sales laws prohibit franchisors from providing financial performance representations to prospective franchisees unless Item 19 of the franchisor's FDD contains a formal "financial performance representation."

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

Requirements for an Item 19 Financial Performance Representation

To make an Item 19 financial performance representation, the franchisor must have a reasonable basis and written substantiation for the representation at the time the representation is made. The franchisor also must disclose the following:

- (1) whether the representation is an historic financial performance representation about the franchise system's existing outlets, or a subset of those outlets, or is a forecast of the prospective franchisee's future financial performance;
- (2) if the representation relates to past performance of the franchise system's existing outlets, the material bases for the representation including:
 - (a) whether the representation relates to the performance of all of the franchise system's existing outlets or only to a subset of outlets that share a particular set of characteristics (for example, geographic location, type of location such as free standing vs. shopping center), degree of competition, length of time the outlets have operated, services or goods sold, services supplied by the franchisor, and whether the outlets are franchised or franchisor-owned or operated;
 - (b) the dates when the reported level of financial performance was achieved;
 - (c) the total number of outlets that existed in the relevant period and, if different, the number of outlets that had the described characteristics;
 - (d) the number of outlets with the described characteristics whose actual financial performance data were used in arriving at the representation;
 - (e) of those outlets whose data were used in arriving at the representation, the number and percent that actually attained or surpassed the stated results; and
 - (f) characteristics of the included outlets, such as those characteristics noted above, that may differ materially from those of the outlet that may be offered to a prospective franchisee.
- (3) if the representation is a forecast of future financial performance, the franchisor must state the material bases and assumptions on which the projection is based. The material assumptions underlying a forecast include significant facts upon which a franchisee's future results are expected to depend. These factors include, for example, economic or market conditions that are basic to a franchisee's operation encompass matters affecting,

among other things, a franchisee's sales, the cost of goods or services sold, operating expenses, royalties and ad fund contributions, if any.

Exception for Actual Operating Results of Outlet Offered for Sale

If a franchisor wishes to disclose only the actual operating results for a specific outlet being offered for sale, it may do so without a formal Item 19 financial performance representation, provided the information is given only to potential purchasers for the outlet.

Supplemental Earnings Claim

If a franchisor makes a formal Item 19 financial performance representation, the franchisor may deliver to a prospective franchisee a supplemental financial performance representation about a particular location or variation, apart from the disclosure document. The supplemental representation must:

- (1) be in writing;
- (2) explain the departure from the financial performance representation in the disclosure document;
- (3) be prepared in accordance with the requirements described above; and
- (4) be furnished to the prospective franchisee.

General Media Representations

According to the FTC Franchise Compliance Guide published in May 2008 (“**Guide**”), “financial performance representations” include representations made in the general media, where they are likely to attract members of the public interested in purchasing a franchise system. According to the Guide:

The term ‘general media’ is to be read broadly to include all forms of advertising, including radio, television, magazines, newspapers, and billboards. It also includes electronic advertisements such as those placed on a franchisor’s website or on a web site operated by a broker or some other third party. Electronic advertisements include both static advertisements, as well as pop-up screen and banner advertisements.

Unsolicited bulk email sent to the public sometimes referred to as ‘spam’ is also a form of general media advertising since these messages are widely disseminated to create interest in the franchisor, possibly leading to franchise sales. This is true even if the messages are sent to members of the public who have expressed an interest in receiving franchise information. There is no material difference between sending email messages to members of the public who happen to have expressed some interest in the area of franchising and including financial performance representations in advertisements in franchise-related magazines or newspapers distributed to subscribers. In both scenarios, the financial performance message contained in the ad constitutes a general media claim and triggers the Rule’s disclosure and substantiation requirements.

With respect to statements in speeches and press releases, the Guide further states:

Ordinarily, company statements in speeches, press releases, and the like will not be considered, ‘general media representations,’ unless they are specifically directed at members of the public interested in purchasing a franchise. For example, financial

performance information appearing in a franchisor's press release or in the investors section of the franchisor's website ordinarily would not be deemed a general media representation because such information is not necessarily directed at, or intended for, potential franchisees. The mere fact that those interested in purchasing a franchise can find such information in a newspaper or online does not make it a general media claim. However, where a franchisor utilizes financial performance information disseminated, or intended to be disseminated, to the public generally in its franchise promotional materials (e.g., in a brochure or franchisee section of a website), and includes in its franchise promotional materials a reference to general financial information on its website, or otherwise repeats the general financial information to lure potential franchisees (such as in a face-to-face meeting with an audience of prospective purchasers), such information will be deemed general media financial performance representations.

Publicly filed financial performance information submitted to the Securities and Exchange Commission, on the other hand, are not considered general media representations.

Specific Requirements Applicable to General Media Claims

Financial performance representations made in the general media are subject to the requirements that apply to all financial performance representations, *i.e.*, that they be truthful and reasonable backed by substantiating written information the franchisor possesses when the representations are made. In addition, general media financial performance representations must state:

- (1) the number and percentage of outlets from which supporting data for the representation were gathered that actually attained or surpassed the represented level of financial performance;
- (2) the time period when the performance results were achieved; and
- (3) a clear and conspicuous admonition that a new franchisee's results may differ from the represented performance.

Relationship Between General Media Financial Performance Representations and Item 19 Disclosures

The following excerpt from the Guide explains the relationship between general media claims and the Item 19 Financial Performance Representation:

The [Amended FTC Rule] requires that a franchise seller making a financial performance representation in the general media ensure that a full disclosure of the financial performance representation including the material bases and assumptions appears in Item 19 of the franchisor's disclosure document. A franchisor running an advertisement containing financial performance information at the very least must furnish any prospective franchisees with the required Item 19 disclosures while the advertisement is running. If a franchisor stops running the advertisement and makes no additional financial performance representations in the general media, it nonetheless must continue to disclose information required by Item 19 for a reasonable period of time thereafter. A reasonable period of time is not less than six months.

If a franchisor replaces one advertisement containing a financial performance representation with a new one containing updated financial information, the [Amended FTC Rule] requires that the updated information not the information used in the initial version of the advertisement be included in the franchisor's Item 19 disclosures. Updated information is clearly more material to a prospective franchisee than older, perhaps stale, and possibly misleading information. Finally,

where a franchisor runs multiple advertisements containing different types of financial performance claims, the franchisor must disclose and provide information for each type of claim in Item 19 of its disclosure document.

CHAPTER SEVEN NEGOTIATING THE SALE

Franchisors are legally permitted to negotiate the terms of their standard franchise offering provided that they do not use the negotiation process to discriminate in favor of or against similarly situated franchisees. See Chapter Eight regarding state anti-discrimination laws.

As a practical matter, however, most franchisors are reluctant to negotiate with prospective franchisees for fear that offering a better deal to one franchisee, if discovered by other franchisees, will “open the floodgate” to future requests, with each new candidate wanting the same or a better deal than offered to previous franchisees.

Perhaps more importantly, however: **(1)** reduced fees reduce the revenue stream, and may impact the franchisor’s ability to provide franchise support services, **(2)** non-uniform fees can result in “free riding” and raise discrimination concerns among franchisees, **(3)** deviations from the standard franchise agreement create administrative challenges with tracking each franchisee’s “deal.”

Bottom line is it is best to create a balanced franchise agreement that serves the needs of the franchisor, and stick to it. If fee concessions are made, they should be limited to the start up phase of the business, and caution should be used to reduce their impact on other franchisees.

To the extent the parties agree on negotiated changes, however, best practices dictate that the changes be reflected in an amendment to, rather than be incorporated into the body of, the franchise agreement. This practice ensures that departures from the franchisor’s standard agreement are readily identifiable by personnel of the franchisor and, in the event of a sale of or investment in the franchise system, potential buyers or investors engaged in due diligence.

CHAPTER EIGHT STATE RELATIONSHIP LAWS

Many states have enacted franchise “relationship” legislation to deal with perceived abuses in franchisor practices in its business dealings with franchisees (e.g., termination and nonrenewal).

Relationship laws establish numerous “prohibited practices,” ranging from terminating or failing to renew a franchise without “good cause” to unfairly competing against a franchisee in his/her own territory. To the extent that these laws provide a franchisee greater protection than the franchise agreement, the terms of the state law will supersede applicable provisions in the franchise agreement. For example, if the franchise agreement provides for termination without notice and the applicable state statute provides for 30 days’ notice, the terms of the statute will prevail. See the appended chart for a summary of these laws’ provisions.

Franchisee Transfers

A few state relationship laws protect a franchisee’s right to transfer the franchised business. For example, the Hawaii Franchise Rights and Prohibitions Act prohibits a franchisor from refusing to permit a transfer of ownership of a franchise, except for good cause. The Iowa Franchises Act permits a franchisee to transfer the franchised business and franchise to a transferee, provided that the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees. Similarly, the Michigan Franchise Investment Law declares void any provision in a franchise agreement which permits a franchisor to refuse to permit a transfer of ownership of a franchise, except for good cause.

Termination and Nonrenewal

Most state relationship statutes prohibit a franchisor from terminating or failing to renew a franchise without “good cause,” “just cause” or “reasonable cause.” Definitions of these terms vary from state to state and, in some states, the terms are not defined at all. Some relationship laws specifically state that some practices will be deemed to be “good cause,” including the franchisee’s voluntary abandonment of the franchised business, conviction of a crime, impairment of the franchisor’s trademarks, bankruptcy, repetitive breaches of the same event, seizure or foreclosure by a government authority, and failure to pay monies owed. Best practice is to consult counsel before terminating a franchise agreement or issuing a notice of nonrenewal.

Other Prohibited Practices

Other “prohibited practices” may include requiring or prohibiting any change in the management of the franchisee, unless the franchisor can show “reasonable cause,” prohibiting franchisees from associating with one another. See the appended chart for a summary of these prohibitions.

The Iowa Franchise Act also regulates numerous other aspects of the franchise relationship. The two most intrusive aspects of such regulation relate to encroachment and independent sourcing.

The Iowa Act provides that if a franchisor develops or grants to a franchisee the right to develop a new outlet or location which sells essentially the same goods or services under the same marks as an existing franchisee and the new outlet has an adverse effect on the gross sales of the existing franchisee’s location, the existing adversely affected franchisee has a cause of action for monetary damages. There are a few exceptions, such as if the franchisor has first offered the new location to the existing franchisee on the same basic terms and conditions available to the other potential franchisee; or if the adverse impact on the existing franchisee’s annual gross sales is determined

to be less than five percent during the first twelve months of operation of the new location. A third exception to the general rule requires the franchisor to establish a formal procedure for both hearing and acting on claims by existing franchisees regarding a decision by the franchisor to develop new locations prior to the opening of the location, and awarding compensation to offset the existing franchisees' lost profits.

The Iowa Act also permits franchisees to obtain equipment, fixtures, supplies and services used in the franchised business from sources chosen by the franchisee provided that such goods and services satisfy the franchisor's standards for such items. This does not apply to reasonable quantities of inventory goods or services that a franchisee must buy from the franchisor or an affiliate if such items are "central" to the franchised business and are produced by or incorporate the trade secrets of the franchisor or its affiliate.

Discrimination Among Franchisees

Five states – four by statute (Hawaii, Illinois, Indiana and Washington) and one by rule (Minnesota) – generally prohibit unfair or unreasonable discrimination between franchisees in, among other things, the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealings. While the statutes do not define discrimination, it can be construed to mean differences in treatment between similarly situated franchisees concerning any material aspect of the business and, in some circumstances, between similarly situated prospective franchisees concerning any material terms of the franchise offering. However, there are certain exceptions to the prohibition, for example, if the discrimination or classification is based on franchises granted at different times, or if franchisees are to be located in different geographic markets, if there are volume or size differences, or if there are differences in costs incurred by the franchisor in entering into the franchise agreement. Each state's requirements should be reviewed carefully before any decision to differentiate between franchisees is finalized.

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|----------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Arkansas Franchise Practices Act | <p>Termination – good cause required, which includes failure to comply substantially with franchisor's nondiscriminatory practices; to act in good faith and in a commercially reasonable manner; to pay within 10 days after receipt of notice of sums past due.</p> <p>Nonrenewal – good cause (including above) or in accordance with current policies, practices, standards of the franchisor which are not arbitrary or capricious.</p> <p>As of July 15, 1991, the Act no longer applies to business relations subject to Amended FTC Rule.</p> | 90 days written notice setting forth the reasons for termination, cancellation and nonrenewal with 30 days to cure deficiency; if multiple deficiencies within 12-month period 10 days period required to cure. | <ol style="list-style-type: none"> 1) Refusal to deal in commercially reasonable manner. 2) Not using advertising fee collected for advertising franchisee's business. 3) Requiring/prohibiting change in management unless reasonable cause stated in writing. 4) Termination without good cause – must repurchase inventory, supplies, equipment furnishings obtained from franchisor. 5) Franchisee harmed by violation entitled to treble damages. |

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|----------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| California Franchise Relations Act | <p>Termination – good cause required, which includes failure to comply with lawful requirements of franchise agreement.</p> <p>Nonrenewal – prohibits nonrenewal for purposes of converting to operation by employees or agents of franchisor; and prohibits enforcement of covenants not to compete.</p> | <p>Termination – notice plus reasonable (at least 60 days) to cure failure. Some exceptions including: failure to pay amounts due within 5 days after receiving written notice; reasonable determination that continued operation will result in danger to public.</p> <p>Nonrenewal – 180 days’ notice and must permit franchisee to sell to purchaser meeting franchisor’s requirements.</p> <p>Includes other statutory requirements as to form and content of notice.</p> | Franchisor must repurchase inventory if terminate/fail to renew in violation of Act. |
| Connecticut Franchise Law | Good cause required which includes refusal or failure to comply substantially with any material and reasonable obligations of the franchise agreement. | <p>60 days written notice stating reason for termination, cancellation or nonrenewal, unless nonrenewal where franchisee leased real property and improvements from franchisor, then 6 months.</p> <p>Some exceptions.</p> | <p>1) Upon termination – Franchisor must compensate for inventory, supplies, equipment, furnishings purchased from franchisor or approved sources.</p> <p>2) Term or successive term of franchise agreement shall not be less than 3 years.</p> |
| Delaware Franchise Security Law | Termination or failure to renew shall be unjust if without good cause or done in bad faith – good cause and bad faith are not defined. | 90 days’ notice must be provided. | Cannot unjustly refuse to deal with franchise distributor when franchisor has dealt with it for 2 years. |
| Hawaii Franchise Rights and Prohibitions Law | <p>Good cause required to terminate or not renew in accordance with current terms and standards applicable to all franchisees required, unless franchisor proves discriminatory treatment reasonable, justifiable and not arbitrary.</p> <p>Good cause includes failure to comply with lawful, material provisions of franchise agreement.</p> <p>Franchisor and franchisee must deal with each other in good</p> | Written notice with opportunity to cure the failure in a reasonable period of time. | <p>1) Cannot discriminate between franchisees in charges for royalties, goods, services, etc., unless certain distinctions apply: franchises granted at different times, local experimentation, etc.</p> <p>2) Cannot impose any unreasonable, arbitrary standard of conduct.</p> <p>3) Cannot require a franchisee to purchase goods from franchisor or designated sources unless justified on business grounds.</p> <p>4) Cannot establish or franchise similar business in franchisee’s exclusive area except as allowed by franchise agreement.</p> |

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|-------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | faith. | | 5) On termination, must compensate franchisee for inventory, supplies, etc. purchased from franchisor; if nonrenewal for conversion to franchisor-owned unit, must also compensate for loss of goodwill (certain deductions permitted). |
| Illinois Franchise Disclosure Act | Termination and nonrenewal requires good cause, which includes failure to comply with any lawful provisions of the franchise agreement and failure to cure after notice and opportunity to cure. | Termination – notice and reasonable opportunity to cure – up to 30 days to cure except in certain circumstances. Nonrenewal – provide 6 months’ notice prior to expiration date. | 1) Cannot discriminate between franchisees in charges for franchise fees, royalties, goods, etc. unless certain distinctions apply (for example, different times, different programs). 2) Nonrenewal – must repurchase franchise for fair market value if under certain covenant against competition or if proper notice not given. |
| Indiana Deceptive Franchise Practices Act | It is unlawful to terminate or not renew a franchise without good cause, which includes any material violation of franchise agreement, or in bad faith. | At least 90 days’ notice prior to termination or nonrenewal. | 1) Cannot discriminate unfairly among franchisees or unreasonably fail/refuse to comply with any terms of franchise agreement. 2) Cannot use deceptive advertising. 3) Cannot establish a franchisor-owned outlet in franchisee’s exclusive territory. 4) Cannot substantially modify franchise agreement without consent in writing of franchisee. |
| Iowa Franchise Relationship Act | Termination – Good cause (a legitimate business reason), which includes failure to comply with lawful provisions of franchise agreement provided that termination is not arbitrary or capricious compared to actions of franchisor in similar circumstances. Nonrenewal – One of the following (i) good cause (a legitimate business reason), (ii) mutual agreement, or (iii) franchisor completely withdraws from distributing products or services in the franchisee’s market and doesn’t enforce non-compete covenant. | Termination – Written notice and reasonable cure period – between 30 and 90 days. Some exceptions include: franchisee repeatedly failing to compel with material provisions of the franchise agreement, or franchisee operates the franchised business in a manner that imminently endanger the public health and safety. Nonrenewal – 6 months advance notice to franchisee. | 1) Imposes duty of good faith in performance and enforcement of franchise agreement. 2) Person violating Iowa Act liable for damages resulting from violation including costs and attorneys’ and experts’ fees. 3) Must repurchase assets of franchised business (which the franchisor or its agents previously sold to the franchisee) for fair market value if enforcing non-compete covenant and former franchisee is not relying on marketing plan substantially similar to the franchise. 4) Encroachment – provides existing franchisees with a cause of action if the franchisor establishes a new outlet which sells the same goods or services under the same marks within an unreasonable distance of the existing unit; prohibition will not apply if the franchisee has been granted reasonable territorial rights and the new franchise does not violate such rights. Many exceptions apply. |

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Michigan Franchise Investment Law | Termination – Good cause required, which includes failure to comply with lawful provisions of franchise or failure to cure. | Termination – Written notice and reasonable opportunity to cure (up to 30 days). Nonrenewal – Provide 6 months advance notice. | 1) Cannot refuse to renew on terms generally available to other franchisees of similar class or type. 2) Nonrenewal – must repurchase franchisee’s inventory, supplies, etc. if (i) term is less than 5 years, (ii) post-term non-compete, (iii) less than 6 months’ notice. |
| Minnesota Franchise Law | Termination or nonrenewal – good cause is required, which includes failure to substantially comply with reasonable requirements or franchise. | Termination – 90-day notice setting forth the reasons for termination and franchisee fails to cure within 60 days of receipt of the notice. Some exemptions. Nonrenewal – 180 days written notice and opportunity to recover investment, unless nonrenewal for good cause. | 1) Cannot discriminate between franchisees in charges for royalties, goods, etc. unless discrimination based on reasonable grounds. 2) Cannot impose on franchisee any unreasonable standard of conduct. 3) Cannot require/prohibit any change in management/personnel of franchisee unless they have failed to meet franchisor’s present qualification standards. 4) Cannot compete with franchisee or grant competitive franchise in franchisee’s exclusive territory. |
| Mississippi Franchises Law | | Must provide 90-day notice, except for criminal misconduct, fraud, abandonment, bankruptcy, insolvency or giving insufficient funds check. | |
| Missouri Franchises Law | | Must provide 90-day notice, except for criminal misconduct, fraud, abandonment, bankruptcy; insolvency or giving insufficient funds check. | |
| Nebraska Franchise Practices Act | Good cause required, which is failure to substantially comply with requirements imposed by franchise. | Must provide 60-day notice. Some exceptions. | 1) Cannot impose unreasonable standards of performance upon franchisee. 2) Cannot require/prohibit change in management unless for good cause stated in writing. |
| New Jersey Franchise Practices Act | Good cause required, which is failure to substantially comply with requirements imposed by franchise. | Must provide 60-day notice. Some exceptions. | 1) Cannot impose unreasonable standards of performance upon franchisee. 2) Cannot require/prohibit change in management unless for good cause stated in writing. |
| Rhode Island Fair | | Must provide 90-day notice and 60-day | If a dealership terminated by grantor, grantor must repurchase trademarked |

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Dealership Act | | opportunity to cure (10 for nonpayment of sums due). | inventory at fair wholesale price. |
| Tennessee | Termination – Good cause asserted in good faith. Non-renewal – Good cause | Termination - Must provide written notice and 30-day cure period. Some exceptions. Non-renewal – 60-day notice | |
| Virginia Retail Franchising Act | Cancellation – Reasonable cause required. | | Cannot use undue influence to induce franchisee to surrender rights under franchise agreement. |
| Washington Franchise Investment Protection Act | Termination – Good cause required, which includes failure of franchisee to comply with lawful, material provisions of franchise agreement and failure to cure. | Termination – Written notice and up to 30-day cure period. Some exceptions apply. Nonrenewal – Fairly compensate the franchisee for fair market value of inventory, supplies, equipment and furnishings purchased from the franchisor, and goodwill; however, compensation for goodwill is not required if nonrenewal, one-year advance notice nonrenewal provided and agree not to enforce post term covenant not to compete. | 1) Cannot discriminate between franchisees in charges made for royalties, goods, etc. unless franchisor proves discrimination based on reasonable distinctions and is not arbitrary. 2) Cannot impose unreasonable, unnecessary standard of conduct upon franchisee. 3) The parties must deal with each other in good faith. 4) Cannot compete with or grant competitive franchises in franchisee’s exclusive territory. 5) Cannot refuse to renew unless compensate franchisee for inventory, supplies, etc. and goodwill (unless give one-year notice to franchisee and agree not to enforce covenant not to compete). |
| Wisconsin Fair Dealership Law | Good cause required, which is failure to comply with essential and reasonable nondiscriminatory requirements or bad faith by dealer in carrying out terms of dealership. Provision covers termination, cancellation, nonrenewal and substantial change in competitive circumstances. | Must provide 90 days’ notice with written explanation and 60-day cure period. Some exceptions apply. | Termination – Must repurchase inventories containing brand name merchandise identifying franchisor. |
| Puerto Rico Dealers’ Contracts Law | Just cause required, which includes nonperformance of essential obligations or acts adversely and substantially affecting promotion or distribution. | | |

| State Law | Termination, Cancellation, Nonrenewal | Notice Required | Unfair Practices/ Other |
|----------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------|--------------------------------------------------------------------------|
| Virgin Islands Franchised Business Law | Good cause required, which is failure to substantially comply with essential and reasonable requirements imposed by franchise or franchisee's bad faith in carrying out terms of franchise. | Must provide 120 days written notice. | Cannot engage in unfair method of competition within meaning of FTC Act. |