

**American Bar Association
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**GO TO THE HEAD OF THE LINE: HOW TO GET
REGISTERED, AMENDED, RENEWED OR EXEMPTED**

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I. INTRODUCTION

Franchise compliance is a multifaceted and variable experience in the U.S. In most states, a franchisor may not have to comply with any franchise disclosure law at all by virtue of an exemption under the FTC Franchise Rule (the "FTC Rule"). If not exempt, the franchisor must prepare a Franchise Disclosure Document ("FDD") but need not file it with any government agency.

In 14 states, however, the compliance burden increases. Four of those states - Indiana, Michigan, South Dakota and Wisconsin - add only a minimal filing and a fee. The other ten states - California, Hawaii, Illinois, Maryland, Minnesota, New York, North Dakota, Rhode Island, Virginia and Washington - up the ante. And several of those states put a franchisor through a virtual gauntlet before they will allow franchise offers in the state.

This paper is intended to give guidance to franchisors on various strategies, techniques and best practices relating to four major aspects of franchise compliance: initial registration; registration renewal; amendments and obtaining exemptions. The authors do not pretend to have all of the answers but are representative of the various constituencies involved in the franchise compliance processes described above. In addition, while the authors attempted to prepare an integrated paper, there are considerable variations in points-of-view expressed in this paper. However, all share the desire to streamline and rationalize the compliance process for the benefit of franchisors while taking into account the need to protect prospective investors.

II. ORIGINAL APPLICATIONS FOR REGISTRATION

Applications for franchise registration differ widely among the registration states in what is required to be filed as well as the level of review the application is given. Four states, Indiana, Michigan, South Dakota and Wisconsin only require that the FDD be filed and it is effective upon receipt by the regulatory authority. The remainder of the registration states require the filing of various documents including the franchise disclosure document and a filing fee. In these states, the regulators have the authority to conduct whatever level of review they choose. Since the focus of this paper is to provide franchisor counsel the information it needs to expedite successful registration, this section will focus on the initial application process for franchisors, with an emphasis on expediting registration in the State of Illinois which is well known for conducting "thorough" reviews of the entire application. In addition, this Section also provides some of the "Hot Button" issues for regulators in all of the states.

Under the Illinois Franchise Disclosure Act (the "Illinois Franchise Act"), sales to Illinois residents or for franchises to be located in Illinois where the offer of the franchise is made or accepted in Illinois must be registered prior to the offer of the franchise. Prior to registration, the franchisor must limit its contact with prospective franchisees to taking their contact information. The Illinois Attorney General's Franchise Bureau (the "Bureau") is the state's regulatory authority. The Bureau maintains approximately 1200 registrations per year and received over 350 original applications for registration in 2010.

Once filed, the Bureau has 21 calendar days to review and act upon the application. If no action has been taken within the 21 day period, the application is automatically registered. However, it should not be assumed that because franchisor counsel has not received any response to the application within the 21 day period that it is registered. Counsel should contact the Bureau to determine the status to avoid the offer and sale of unregistered franchises which would put the franchisor in violation of the Act. Once reviewed, the application may be denied

by administrative order, registered subject to certain revisions or, if the application is in complete compliance, it will be registered with no additional revisions required.

All of the review states require the 2008 NASAA Guidelines (the "Guidelines") application documents be filed. Although these forms have been required with each franchise application filed since July 1, 2008, many franchisors are still filing the forms which were required under the UFOC Guidelines. The documents are fairly self-explanatory in the manner in which they are to be completed, but the NASAA Guidelines includes directions. These documents should not be included in the franchise disclosure document (the "FDD"). The Certification which is attached to and made part of the Uniform Franchise Registration Application form and the Uniform Consent to Service of Process must contain original signatures from an officer of the franchisor. The Auditor's Consent Letter must be manually signed and placed on the accountant's letterhead. If another entity will guarantee the franchisor's performance, submit an originally executed Guaranty of Performance and an originally executed Uniform Consent to Service of Process from the guarantor. The Guidelines require the filing of CD-ROM in Portable Document Format ("PDF"), but for original applications filed in Illinois, the CD-ROM should not be filed until the application is registered.

The first way to expedite the registration process in the State of Illinois is to include the correct financial statements in the FDD. Failure to do so will result in the denial of the application with no further review of the FDD (outside the financial statements). The FDD must include audited financial statements for the prior three fiscal years which have been prepared according to United States generally accepted accounting principles ("US GAAP"). However, franchisors who are filing their first application with the Bureau and who have never had audited statements may request the "Phase in of Audit" which allows them to file financial statements which have been compiled by an independent CPA in accordance with US GAAP. The franchisor should notify its CPA to count the opening inventory at the beginning of the franchisor's fiscal year which commences after registration has been granted because at the end of that year the balance sheet must be audited. The remainder of the statements for that fiscal year may be unaudited but must be independently prepared in accordance with US GAAP. Financial statements for the following fiscal year must be fully audited.

Franchisor counsel should next evaluate the franchisor's financial condition to determine whether or not the imposition of financial assurance requirements is likely to occur because of the franchisor's financial condition and, if so, provide for that requirement when the application is filed. Financial assurance requirements are automatically imposed if the franchisor's most recent balance sheet discloses a negative net worth or the auditor has issued a going concern opinion. If counsel is uncertain as to whether such requirement would be imposed by the Bureau, it is free to contact one of the Illinois Examiners prior to filing the application. Contacting state examiners directly to discuss financial assurance requirements is often the most informative and efficient way to determine whether an assurance such as a fee deferral, escrow, impound, bond or surety may be required. If the Bureau determines that financial assurances are required and no provision has been made for them in the application, then the application will be denied with no review of the FDD having been made.

Whether the application is denied for deficient financial statements or financial condition, the franchisor will have 90 days to cure the deficiency. Failure to do so in that time period will require the franchisor to file a new application, including the fee, should it choose to pursue registration in Illinois. If a response is made within the 90 day cure period, the examiner will have 21 days to review it. If the deficiency has been cured, the entire FDD will be reviewed. If that review indicates significant deficiencies, the Franchisor will be granted a new 90 day cure

period to file a compliant FDD. If the deficiency has not been cured, a letter will be sent and the Franchisor will only have the remainder of the initial 90 day cure period, if any, to do so. Either way, the application process will take significantly more time.

Assuming there is no problem with the franchisor's financial statements or its financial condition, the application documents and the FDD will be reviewed for compliance with the NASAA Guidelines, the Commentary on the Guidelines (the "Commentary"), the Act and certain provisions of the FTC Rule. The Illinois Examiners conduct an extensive and thorough review of each FDD filed with an original application. Therefore, the document should be written with the following overall rules in mind:

- First and foremost, disclose all information required by the Guidelines whether or not it applies to the franchisor applicant and/or the franchise being offered. If information is not applicable, a negative disclosure must be made. For example: if the franchisor does not have parent company, state that; if no officer of the franchisor owns an interest in a supplier, state that; etc.
- Disclose all information in the manner required by the Guidelines and the Commentary. The Commentary provides guidance on what needs to be disclosed and how to disclose certain information. The Commentary can be found on the Illinois Attorney General's website at www.illinoisattorneygeneral.gov by clicking on "Protecting Consumers" and "Franchise Information." The FAQs on the FTC Rule should also be examined and followed.
- Do not use ambiguities in the FDD. For example, do not disclose in Item 6 that certain fees "will vary." If no set fee or cost can be given, disclose a range or formula for determining the amount. Do not state that the franchisor may grant an exclusive territory in Item 12 without providing the factors or criteria that it uses in making this decision.
- Make certain there are no inconsistencies in the disclosure within each Item, between two Items or between the Items and the agreement(s). We often see disclosure in Item 5 that states that the initial fee is not refundable, but in Item 11 it states that, if an acceptable site is not agreed upon or the franchisee fails to complete training to the satisfaction of the franchisor, the fee will be partially refunded. If in Item 5 it is disclosed that the franchisee must purchase certain goods or services from the franchisor or an affiliate prior to opening of the franchise business, make certain that in Item 8 it is not disclosed that the franchisee can purchase these goods or services from the franchisor, its affiliate, or an approved supplier.
- Do not disclose information which is not required to be disclosed. The FDD is not promotional material and, therefore, should not contain that type of information. Do not use introductory paragraphs unless the Guidelines requires them.
- Do not use bold, italics or upper case type unless so required by the Guidelines. This is often done in Item 19 to accentuate disclaimers and admonitions.

- Do not disclose any disclaimers or admonitions unless required by the Guidelines. Item 19 requires only one admonition, "that a new franchisee's individual financial results may differ from the result stated in the financial performance representation." Item 11 should not include site location and lease approval disclaimers.
- Amend any provisions which are inconsistent with state law or the FTC Rule. State modifications may be made in an addendum to the disclosure document and the agreements. Generally, these provisions relate to governing law, jurisdiction and venue and waivers. If an addendum is used to amend an agreement, it must contain a signature and date line for both parties and must be executed simultaneously with the agreement. Addendums to the disclosure Items can only be used to provide for state specific information which does not include a revision required by only one specific state. All information required by the Guidelines must be disclosed in the applicable Item. Integration clauses must be amended in the agreement(s).
- Use plain english. This is not limited to the avoidance of legal jargon. The FDD must be written in a manner that is easily understood by a person unfamiliar with the business. Do not use run on sentences or disclosure which is unclear and convoluted. Proofread and edit the FDD before filing.

Some Key FDD Review Issues

- **Cover Pages.** Follow the mandatory format and make sure the amounts are identical to those used in Items 5 and 7. Include risk factors only if required under the FTC Rule or by state examiners.
- **Item 1.** A reader should be able to discern the franchisor's history and its current corporate family.
- **Item 3.** The disclosure should include 3 types of cases: (a) pending cases involving enumerated claims or those that are financially material; (b) concluded cases involving claims described in (a) above where the franchisor was held liable or entered into an adverse settlement; and (c) cases the franchisor filed against a franchisee in the prior fiscal year.
- **Item 5.** Initial fees include not just franchise fees, but also all other initial payments to the franchisor or any affiliates.
- **Item 6.** Include all ongoing payments to the franchisor, including contingent payments.
- **Item 7.** Make sure the range used is all-inclusive so it covers the highest possible investment for a typical franchise. Note that some items focus on opening amounts (such as inventory) while other amounts reflect a period beyond opening, often 3 months (such as rent or working capital).
- **Item 8.** This item is intended to cover all items that are subject to any sourcing restrictions. Also the amount of sales of source-restricted products by the franchisor or its affiliates must be provided as of the most recent fiscal year end.

The same is true of rebates paid to the franchisor by suppliers who sell to franchisees.

- **Item 10.** All direct and "indirect" financing must be disclosed and indirect financing includes situations where the franchisor receives payments from a lender or has an agreement with the lender to provide franchisee financing.
- **Item 11.** Some of the key issues in this information-packed item are: reporting allocations of expenditures from the advertising fund; accessibility of operating manuals; computer system costs; and details on the training programs.
- **Item 12.** Disclose any reservation of rights by the franchisor to engage in other forms of distribution.
- **Item 13.** If the marks are licensed to the franchisor, describe the term of and rights provided by the license.
- **Item 17.** Provisions should be summarized and not copied from the agreement. Note the special disclosure regarding any integration clause (that it cannot negate any representations in the FDD).
- **Item 19.** Franchisors have great flexibility in preparing a financial performance representation but the key concern is whether the data used is a representative sample. It is difficult to use anything other than historical data.
- **Item 20.** All of the numerical data should be reconciled and the summary data in Tables 3 and 4 should flow over to Table 1. Also, the lists of current and former franchisees should reconcile with the tables. And don't forget to address confidentiality agreements and franchisee associations.
- **Item 21.** If the financial statements reflect a negative net worth, a working capital deficiency or a history of losses, expect questions from examiners. Disclose any guaranties.
- Finally, make certain that the Receipt pages are placed at the end of the entire FDD and are separate and detachable from it.

These rules, of course, are not all inclusive and do not attempt to represent all potential disclosure problems. However, by following them, franchise counsel is less likely to have the document summarily rejected or to receive an incomplete review.

As stated above, if there are no deficiencies in the FDD, registration will be granted and a letter to that effect will be sent. Registration can also be granted when there are a few deficiencies on the condition that they be cured within 30 days and that the FDD is not given out until the revisions are made. The letter to the franchisor's counsel will have an attachment on which the deficiencies will be listed. Unfortunately, in most cases, the application is denied by administrative order because the FDD has too many deficiencies. In this case an Order of Denial is issued to which is attached the list of deficiencies and the franchisor is allotted 90 days to cure them. It is important to note that it is a 90 day cure period. That does not mean that the franchisor has 90 days to respond to the Order of Denial, but rather 90 days to fix all of the problems in it. It is important to contact the examiner assigned to the application with any

questions or disagreements regarding a deficiency. Do not express your disagreements and/or arguments in a cover letter because it may waste valuable time if the examiner determines that the argument is incorrect.

The best way to contact an examiner in Illinois is by e-mail. If the examiner believes it is an issue that warrants a conversation, he/she will telephone counsel or arrange for a convenient time to speak. Please do not attempt to contact the examiner only to determine the status of a filing. That information can be provided by the secretary who answers the call. Only contact the examiner if you have a specific question or disagreement and not just to argue with them about their review practices. No matter the level of review an application gets, the mere fact that only one state requires a certain revision, does not mean that the deficiency does not exist and an examiner will rarely accept this rationale in determining whether to waive a requirement.

It is in the best interest of not only prospective franchisees, but also the franchisor who offers the franchise, that the FDD be fully compliant with all state and federal requirements. Although a compliant FDD will not prevent all problems which can arise in the franchise relationship, it will help to lessen the risks of those problems resulting from poor or inadequate disclosure. State examiners do not enjoy issuing lengthy comments and appreciate franchise counsel that file compliant applications. This makes everyone's job easier and allows the franchisor to begin offering and selling franchises sooner rather than later.

III. RENEWAL OF STATE FRANCHISE REGISTRATION

a. Renewal Process

According to the FTC Rule, a franchisor must update its FDD annually (at a minimum) to include current information about the franchise system. This must be done within 120 days of the close of the franchisor's fiscal year. Annual updates must include new audited financial statements, updated litigation disclosures, the most recent information about current and former franchisees and any other new material information about the franchisor, the system or the terms of the franchise offering.

It is important to note that many franchise registration/disclosure states have annual reporting requirements that are different from the annual update required by the FTC Rule. In most of these states, the franchise registration expires at the end of a fixed one-year registration period, usually tied to the initial registration date. A renewal application must be filed in a timely manner (usually 15-30 days prior to the anniversary date of the current registration) to avoid a lapse in registration.

Other states, rather than using an annual renewal date, require renewal and FDD updating within 90 – 120 days of the franchisor's fiscal year end. This is similar to the FTC Rule's annual update requirement but differs in that an application (and fee) must be filed and, except as mentioned below, the franchisor must obtain clearance from the state before the updated FDD may be used for franchise sales activities.

The following states assign expiration dates based on a fixed registration period or one-year anniversary date:

Indiana
Maryland
Michigan
North Dakota

South Dakota
Virginia
Washington
Wisconsin

In these states, at least two updates per year may be necessary (once within 120 of the franchisor's fiscal year-end and again at the time of renewal). However, by submitting renewal applications early, and requesting a revised annual expiration date, over time many franchisors have had their expiration dates in the above states adjusted to fall within the FTC's 120 day annual update period.

States requiring renewal or annual reports within 90 – 120 days after the close of the franchisor's fiscal year are:

California (110 days)
Hawaii (90 days)
Illinois (120 days)

Minnesota (120 days)
New York (120 days)
Rhode Island (120 days)

b. Effectiveness of Renewed and Amended FDD

The franchisor must also pay proper attention to the date on which it is authorized by the state to use the updated FDD filed in connection with a timely renewal application. In some registration/disclosure states, a franchisor must cease offering and selling franchises until the state has approved the updated FDD. This is sometimes referred to as "going dark" in a particular state. These states view the previously registered FDD as out-of-date once an amended FDD is filed.

However, as noted below, in limited circumstances some states permit use of the previously registered FDD while the updated FDD is under consideration by the state.

The following list summarizes the manner in which the registration/disclosure states assign effective dates to the amended FDD filed as part of a renewal application:

- **California** -- If the renewal application is submitted at least 15 days prior to the expiration date, and if no stop order in effect, automatic renewal occurs at 12 noon on the date on which the prior registration is due to expire.
- **Hawaii** – Seven days after filing the amended FDD with the state.
- **Illinois** – Upon receipt by the Administrator. If deficiencies are noted later by the Administrator, however, use of the amended FDD must cease and any prospective franchisees must be redisclosed with a corrected and approved FDD.
- **Indiana** – On the annual expiration date.
- **Maryland** – If the renewal application is made in a timely manner (See MD Regulations § 2.02.08.07A), on the annual effective date. If not timely filed or deficiencies are found, Maryland will provide notification of the effective date.

In Maryland, franchisors may continue to use the previously registered FDD while the updated FDD is pending. See MD Regulations § 02.02.08.06. Redisclosure of a prospective franchisee is required if the updated FDD is approved before the sale.

- **Michigan** – Upon receipt.
- **Minnesota** -- Upon order of the commissioner.
- **New York** – For annual renewals that also contain an amended FDD, 15 days after submission of the updated FDD, unless deficiencies are identified and reported to the franchisor within the 15 day period.

If certain procedures are followed with regard to prospective franchisees, franchisors may continue to offer and sell franchises in New York during the time the Department is acting on its filing. See N.Y. Comp. Codes R. & Regs tit. 13 § 200.3

- **North Dakota** – Upon notification by the commissioner.
- **Rhode Island** – On the thirtieth business day after filing of the application or the last amendment to the application or at an earlier time ordered by the director unless the applicant requests postponement of effectiveness of the application or the director has made a good faith effort to communicate why the application does not meet the requirements of this Act.

Offers – but not sales – of the franchise are permitted by Rhode Island while the amended FDD is pending. Franchisors are permitted to use the previously registered FDD for these offers. Once the state clears the new FDD, a marked copy showing it's changes from the prior document must be given to the prospective franchisee at least ten business days before execution of the agreement or payment of consideration. See § 19-28.1-6(h) of the Rhode Island Franchise and Distributorship Investment regulations Act.

- **South Dakota** – Upon receipt of the renewal application by the director.
- **Virginia** – Upon notification by the Division.

In Virginia, a franchisor may select the effective date of the updated FDD by submitting an optional Affidavit of Compliance (Form E). In the affidavit, the franchisor formally certifies it is not insolvent (as defined by Virginia statute) and its FDD is in compliance with Virginia's disclosure regulations. If material deficiencies are later found by the Division, prospective franchisees must be redisclosed with a corrected FDD.

- **Washington** -- 15 days after filing or the filing of last amended FDD; if deficiencies are identified, staff will request a waiver of automatic effectiveness, in which case the effective date is determined by the administrator.
- **Wisconsin** – Upon receipt

A note of caution: The effective dates described above will generally not apply if the state has begun a stop order or cease and desist proceeding against the franchisor or a principal of the franchisor.

c. Information to be Updated at Renewal

Franchisors that renew their state registrations with 90 – 120 days after their fiscal year must always make certain updates to their FDD. These are litigation updates (as described in Item 3), new audited financial statements (Item 21), and updated outlet and franchisee information (Item 20). In addition, the following items are most likely to change as of the end of the franchisor's previous fiscal year:

- Company history (Item 1)
- Officers and directors (Item 2)
- Initial and other fees (Items 5 & 6)
- Total initial investment (Item 7)
- Revenues from required franchisee purchases (Item 8)
- Financing terms (Item 10)
- Advertising and computer costs (Item 11)
- Trademarks (Item 13)
- Financial performance representations (Item 19)
- Contract changes

d. Financial Statements Updates at Renewal

Franchisors that renew their registration within 90 – 120 days after the close of their fiscal year must include their new audited financial statements in the updated FDD. If the franchisor's expiration date is more than 90 – 120 days from the end of its fiscal year, the new audited financial statements may need to be supplemental with unaudited financial statements dated within 90 – 120 days of the date the renewal application is submitted.

If the new financial statements contained in the renewal application fail to demonstrate that the franchisor has sufficient financial strength to provide promised pre-opening obligations and services, a state may require a financial assurance condition (escrow, fee deferral, guarantee, etc) in order to renew the registration.

At the time of renewal, upon request most states will revisit the need for an existing financial assurance arrangement to remain in place. However, absent a clear and justifiable reason, a franchisor should not assume that a financial assurance is no longer necessary and arbitrarily remove it from the franchise offering documents.

e. **Tips for Faster Renewal**

1. **Blacklining of the Amended FDD**

Careful attention should be paid to accurately and completely marking changes in the revised FDD. If an examiner notices something that is not marked, the examiner may decide that the entire document should be reviewed rather than only the blacklined changes

2. **Submitting Old Version of the FDD**

There is no better way to draw intense scrutiny of an FDD than to file a version where certain disclosure has previously been noted as deficient by the state. This throws into doubt whether the franchisor ever really corrected the deficiencies and may lead to questions about exactly what the franchisor has been giving prospective franchisees.

3. **Financial Assurances**

If the franchisor anticipates that a financial assurance will be required, it should consider including it in its renewal application from the outset.

4. **Removal of Financial Assurance**

If a financial assurance condition is in place for an existing registration, do not remove it from the updated FDD without a clear reason or checking with the state first.

5. **Issuance Date**

Failing to include an updated issuance date on the FDD (or confusing the issuance date with the state effective date).

6. **Initial Investment Totals**

Make sure total initial investment estimates on the cover page and in Item 7 match.

7. **Item 7 Table**

Any dollar amount changes should also be reflected in the table totals so the columns add correctly.

8. **Royalty and Fee Changes**

Any initial fee, royalty fee, and other fee changes in the FDD should also be changed in franchise agreement, if applicable.

9. **Revenue from Required Purchases**

In Item 8, revenues received from required franchisee purchases should be from the latest fiscal year.

10. Guarantee of Performance

If applicable, the franchisor must include a copy of the current version of a guarantee of performance in the FDD.

IV. **AMENDMENTS**

An FDD is not carved in stone at its creation. It evolves over time, with revisions made at a minimum once each year when a franchisor prepares an annual update (or renewal). But putting aside the annual update (which is described in Section II of this paper), what would cause a franchisor to revise its FDD on an interim basis? And how can it complete the interim update in a timely and efficient manner? While the franchise registration states are the key concern with respect to these inquiries, the FTC Rule is also important. No filings are made with the FTC, but the rules for amending an FDD are an important feature of the FTC Rule. Whether under federal or state law, a franchisor must establish sound and effective policies for evaluating the need for an amendment and then, if required, take the necessary steps to process the FDD changes and state filings.

a. When Is Amendment Required?

There is no absolute standard for determining when an FDD amendment is required. What is clear is that there is a difference between the FDD changes to be made at the annual update versus the changes to be made via amendment.

The FTC Rule states that, with respect to the annual update: “All information in the [FDD] shall be current as of the close of the franchisor’s most recent fiscal year” (emphasis added).¹ The FTC Compliance Guide likewise states that the FDD must be updated after the fiscal year end “to ensure that the document is current.”² Thus, it is clear that the entire FDD must be reviewed on an annual basis and updated “from stem to stern.”

The FDD amendment requirements of the FTC Rule are as follows: “The franchisor shall [on a quarterly basis] prepare revisions to be attached to the disclosure document to reflect any material change to the disclosures included or required to be included, in the disclosure document.”³ Accordingly, an amendment is intended to capture only material changes, if any, and not a comprehensive revision of the FDD. The FTC implicitly recognized the limited nature of amendments by noting that: (a) some FDD items require annual updates only (e.g., certain information in Items 8 and 11) and thus would not be the subject of quarterly amendments; and (b) if there is a material change in the information presented in the audited annual financial statements, such changed information can be reflected in a quarterly amendment via the use of unaudited financial statements.⁴

If an amendment is triggered only by a “material change,” how is that term defined? The FTC Rule is silent on the issue although the original version of the Franchise Rule defined “material,” “material fact” and “material change” to include:

¹ 16 CFR 436.7(a)

² Bus. Franchise Guide (CCH) ¶ 6086, p. 9129-263

³ 16 CFR 436.7(b)

⁴ Bus. Franchise Guide (CCH) ¶ 6086, pp. 9129-263, 264

"[A]ny 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 has any significant financial impact on a franchisee or prospective franchisee."⁵

State franchise laws follow a similar path but, in some cases, provide specific examples of events constituting a material change. For example, the regulations to the Minnesota franchise law contain one of the more comprehensive lists of exemplars of events constituting a material change, as follows:

Material event" or "material change" shall include, but not be limited to, the following:

1. the termination, closing, or failure to renew by the franchisor during any consecutive three-month period after registration of ten percent of all franchises of the franchisor, regardless of location, or ten percent of the franchises of the franchisor located in the state of Minnesota;
2. any change in control, corporate name, or state of incorporation, or reorganization of the franchisor;
3. the purchase by the franchisor during any consecutive three-month period after registration of ten percent of its existing franchises, regardless of location, or ten percent of its existing franchises in the state of Minnesota;
4. the commencement of any new product, service, or model line involving, directly or indirectly, an additional investment in excess of 20 percent of the current average investment made by all franchises or the discontinuation or modification of the marketing plan or marketing system of any product or service of the franchisor where the average total sales from such product or service exceed 20 percent of the average gross sales of the existing franchisees on an annual basis;
5. any change in the franchise fees charged by the franchisor; or
6. any significant change in:
 - a. the obligations of the franchisee to purchase items from the franchisor or its designated sources;
 - b. the limitations or restrictions on the goods or services which the franchisee may offer to his customer;
 - c. the obligations to be performed by the franchisor; or

⁵ Bus. Franchise Guide (CCH) ¶ 6192(n)

- d. the franchise contract or agreement, including all amendments thereto.⁶

Some of the items listed are entirely sensible but others do not appear to fit the common understanding of materiality. For example, it hardly seems appropriate to classify as material a franchisor's reincorporation from Illinois to Delaware. Similarly, the repurchase or termination of the only, or one of the few, units in Minnesota should not automatically be treated as material.

While it is impossible to compile all of the possible occurrences, actions and events that would necessitate an amendment, they can be placed in three general categories:

1. Franchise agreement changes; for example, a fee increase or discount, or a change in territorial rights.
2. The opinions expressed in this paper are not those of the Illinois Attorney General, the Virginia Division of Securities and Retail Franchising or the North American Securities Administration Association ("NASAA"). Additions to the FDD; for example, the inclusion of a financial performance representation or the establishment of a new lending program.
3. Changes to existing FDD disclosures; for example, a corporate restructure, an acquisition or divestiture, personnel changes, the filing of litigation or updates to litigation, initial investment modifications or sourcing program changes.

Some might argue that there should be a fourth category encompassing material changes that do not fall within the disclosure items specified in the FDD. While this may be theoretically possible, it is difficult to envision the types of events or actions that would fall within this category. For example, is a franchisor required to point out in an FDD that an economic recession might affect a franchisee's business prospects? Or are there some common occurrences or widely-known conditions about which a franchisee should be expected (as a "reasonable" investor) to have knowledge? Note the FTC's express prohibition of the inclusion of "any information that is not required or expressly permitted, either by the amended Rule itself or by state law."⁷ The FTC's position also supports an argument that extraneous information (i.e., information outside the scope of the FDD items) should be excluded because, in part, it is difficult to establish the relative priority of the infinite variety of such information.

The decision on whether or not to amend the FDD is a complex one. While some may opt to err on the side of treating all changes as material, that position may result in deferred or lost franchise sales. Also, because amendments usually require redisclosure and cooling-off periods, it increases the likelihood of technical violations and other problems. On the other hand, ignoring material changes until the next annual update creates legal risks, whether from governmental enforcement or private actions.

⁶ Minnesota Rules, Section 2860.2400

⁷ 16 CFR 436.6(d)

b. Timing of Amendment

Under the FTC Rule, any necessary amendments are to be made on a quarterly basis (although the FTC allows more frequent amendments if desired). Typically, amendments are implemented during the month following the franchisor's fiscal quarter.

The rules are different with respect to material changes to a franchisor's Item 19 presentation. Rather than quarterly updates, the FTC determined that a franchisor must "notify the prospective franchisee of any material changes that the [franchisor] knows or should have known occurred in the information contained in any financial performance representation in Item 19..."⁸ In basic terms, this means that a franchisor must monitor any changes in its Item 19 data and, if material, notify prospects of such changes. While this sounds relatively straightforward, implementation could be somewhat difficult. For example, if a franchisor uses accurate historical data in Item 19, is there an obligation to revise Item 19 when current data indicates a trend varying from the historical information? It may be a question of degree but, in all likelihood, the FTC would answer in the affirmative.

The FTC's sensible quarterly updating requirement (for changes other than those affecting financial performance representations) does not necessarily apply in all 50 states. Some of the franchise regulatory states have differing amendment timing requirements and they require filings and/or disclosure to the prospect as follows:

California	promptly (after a material change) ⁹
Hawaii	prior to any additional franchise sale ¹⁰
Maryland	promptly ¹¹
Minnesota	within 30 days ¹²
New York	promptly ¹³
North Dakota	promptly ¹⁴
Rhode Island	promptly ¹⁵
Virginia	upon the occurrence of a material change ¹⁶

⁸ 16 CFR 436.7(d)

⁹ Cal. Corp. Code, Section 31123

¹⁰ Hawaii Rev. Stat., Section 482E-3(b)

¹¹ Maryland Stat., Section 14-220

¹² Minnesota Stat., Section 80C.07

¹³ N.Y. Gen. Bus. Law, Section 683.9(a)

¹⁴ N.D. Century Code, Section 51-19-07

¹⁵ R.I. Gen. Laws, Section 19-28.1-11

¹⁶ Va. Admin. Code, Section 5-110-40

Washington as soon as reasonably possible and in any case before the further sale of any franchise¹⁷

Wisconsin within 30 days¹⁸

As should be apparent, these varying requirements are difficult to reconcile and in some cases even harder to implement. For example, how does a franchisor comply with Virginia law and file an amendment “upon the occurrence” of a material change? What is clear is that the FTC’s quarterly updating requirement may be subject to the stricter standards, however vague and nebulous, of the states listed above.

In addition, two of the states have created some degree of flexibility in connection with the amendment process. California allows franchisors to continue to offer, but not to sell, franchises while the franchisor awaits approval of its amendment application. To take advantage of this right to continue offering franchises, the franchisor must provide to the prospect: (1) the FDD filed with the state; (2) a statement that the FDD has been filed but has not been reviewed and is not yet effective; and (3) prior to the sale, the final effective FDD (i.e., which incorporates any of the state’s comments on the filing) and a description of the material differences between the filed FDD and the final FDD.¹⁹

New York goes a step further and even allows a sale to take place while an amendment application is under review, albeit with some unappealing collateral requirements.²⁰ In order to qualify for this process, a franchisor must inform the prospect that its FDD has been submitted for review by the state. If the franchise sale occurs, the funds paid by the prospective franchisee must be held in trust until the prospect receives and has had an opportunity to review the final registered FDD. The prospect then has an opportunity to rescind the purchase, in which case the transaction is unwound and the funds are repaid. Also, if the state never approves the FDD, the transaction is rescinded and the prospect is refunded all monies paid.

c. How to Implement an Amendment

Once a decision has been made to amend an FDD and it is an appropriate time to do so, how does a franchisor carry out the process?

The FTC appears to favor amendment via an attachment to the FDD, but there is no reason to believe that the FTC would prohibit interlineal changes within the FDD itself. Naturally, because an FDD is not filed with the FTC, any amendment can be incorporated without any waiting period. But the FTC has some unique rules on delivery of an amended FDD that contrast with the state requirements.

Under the FTC Rule, a prospective franchisee must receive the current FDD (i.e., the version most recently updated within 120 days after the franchisor’s fiscal year end), along with the most recent quarterly update, if any.²¹ But this delivery requirement only applies to the initial disclosure to a prospective franchisee. If a franchisor updates its FDD (either an annual or a

¹⁷ Wash. Rev. Code, Section 19.100.070(3)

¹⁸ Wis. Stat., Section 553.31

¹⁹ Cal. Corp. Code, Section 31108

²⁰ N.Y. Regulations, Section 200.3(h)(3)

²¹ 16 CFR 436.7(b)

quarterly update) after the initial disclosure to the prospect, it is not obligated to redisclose to that prospect. However, the franchisor must provide all updates (since the original date of disclosure) if the franchisee makes a reasonable request for them. In this context the word "reasonable" probably means that a request must be honored if there have been any updates and the franchisor continues to offer franchises. In addition, there is a twist on the timing of the updates. A franchisor need not provide the update at least 14 days before contract signing or payment of consideration. Instead, the update must be provided a "reasonable time" before the franchise agreement is signed, which presumably means something less than 14 days in advance.

The state laws vary considerably from the FTC Rule. In most cases, if an amendment is required, it must be filed with the state regulator and the franchisor must await state approval. This would exclude states where amendment filings are not required, such as Indiana, Michigan and South Dakota, and states where the amendment is effective upon filing, such as Illinois and Wisconsin (although in Illinois, comments may be provided after the filing, in which case the amendment is in suspense until the franchisor responds to the comments).

In addition, most states mandate that the franchisor redisclose all prospective franchisees in the "pipeline" and wait the normal 14-day cooling-off period until the sale can be consummated. For example, the Illinois law is typical with respect to this requirement:

The franchisor shall deliver the amended disclosure statement in accordance with the requirements of...this Act to any prospective franchisee including prospective franchisees to whom a disclosure statement was previously delivered if the material change relates to or affects the franchise offered to such prospective franchisees.²²

An interesting side issue here, which is reflected in the Illinois law, relates to the vehicle used to convey the amended information. As described earlier, the FTC seems to prefer an addendum to the FDD to cover the amended information. On the other hand, the states appear to require the delivery of a full FDD, which would include the amended information as interlineal changes. None of the states require that these interlineal changes be marked in any way to facilitate the prospect's review of the amended items. In this respect, the FTC-preferred addendum would seem to be a better method to focus the reader's attention on any amended information.

Finally, notwithstanding the technical requirements of state law, some franchisors will use a form of "self-help" and simply notify all prospective franchisees of amended information and forego any filings with the states. This may be done to avoid delays in the state reviews and to start the clock running on the 14-day cooling-off period. This certainly is not sanctioned by any of the state regulators (unless the amended information could be viewed as a non-material change) but it does have the effect of putting prospects on notice of the amended information, thereby potentially ameliorating the risks of a fraud-based private action in the future.

²² 815 ILCS 705/11

d. The California Aberrations

While not falling strictly under the topic of amendments, it may be of interest to briefly summarize two oddities under the California Franchise Investment Law – negotiated changes and material modifications.

The FTC Rule and most other state franchise laws encourage negotiations between franchisor and franchisee. While California law does not expressly contradict this position, the law indirectly inhibits negotiations by requiring that a franchisor jump through various hoops if it ever negotiates any aspect of a franchise offer. Section 31109.1 of the California law establishes the procedures for dealing with negotiated changes, which are treated as exceptions to the rule that only the franchise terms registered with the state can be offered to franchisees.²³ (It may make sense for the California regulators to take a negative view of changes to franchise terms that solely favor the franchisor (i.e., a variant on the bait-and-switch device) but this provision applies to all changes, even those that wholly favor the franchisee.) Thus, unless there is an exemption like Section 31109.1, the law would require an amendment filing on every occasion that a franchisor negotiates any term with a franchisee. Basically, Section 31109.1 mandates that a franchisor:

1. provide a prospect with a summary of all terms that have been negotiated in the last 12 months;
2. at the prospect's request, provide the specific previously negotiated terms;
3. file with the DOC a notice of negotiated sale that describes the negotiated change; and
4. certify in its renewal filing that it has complied with these requirements.

In addition, any negotiated changes must “on the whole, confer additional benefits on the franchisee.”

The unintended end result of this misguided regulation is that franchisors often refuse to negotiate with California franchisees. While it is improper to state that it is “illegal” to negotiate, it is entirely appropriate for a franchisor to reject negotiations because of the complications and red tape associated with the California law. Alternatively, a franchisor may amend its FDD to encompass, in broad ranges, the types of issues that may be negotiated to avoid the need for filing notices of negotiated changes and then providing the lists of negotiated changes to future prospects.

Perhaps even worse is the material modification process contained in Section 31125 of the law, which is somewhat out of place in a statute that principally regulates offers to prospective franchisees.²⁴ This provision essentially requires disclosure to existing franchisees if the franchisor proposes to change any terms of the franchise agreement. (For some unknown reason, the California legislature ignored the fact that a change to an existing contract can only be effectuated by the voluntary agreement of both parties.) If a franchisor desires to implement

²³ Cal. Corp. Code, Section 31109.1

²⁴ Cal. Corp. Code, Section 31125

a modification, it must file a description of the modification with the state and then allow a franchisee a cooling-off period (or a rescission period) during which the franchisee can consider the proposed revision. Alternatively, there are various exemptions to the normal process, the most prominent of which exempts a voluntary offer which does not adversely impact the franchisee's rights and obligations. Of course, this exemption may be unavailable if any aspect of the negotiated transaction, however minor or inconsequential, favors the franchisor.

In any event, the need for this type of legislation is quite unclear and it further complicates and impedes a franchisor's business activities in California.

V. EXEMPTIONS

Anyone who has flown in coach class on an airline in the United States in the last 10 years probably knows the pain and frustration of waiting in line to be screened by security. The security screening is – at least in principle – a good thing. It helps to keep us safe, so we tolerate it. But, it is hard not to be envious as passengers in first class move practically effortlessly to a dedicated lane with virtually no wait and are zipped through the process in a fraction of the time. For many franchisors, the process of obtaining, amending and renewing their state franchise registrations is a lot like standing in an airport security line. For them, to be exempt from a state's registration process is the equivalent of getting a pass into the first class lane.

In the best of circumstances, a state franchise exemption may allow a franchisor to be able to offer and sell franchises in the state much faster than they would if they had to file a full franchise registration application – sometimes less expensively. The biggest problem with franchise exemptions is that there is little uniformity from state to state in the eligibility and filing requirements. The lack of uniformity can necessitate a close evaluation of each state's requirements for the exemption and additional administrative attention to maintain compliance.

This section will identify the types of exemptions that are generally useful to franchisors in managing their state franchise filing²⁵ obligations and highlight the definitional nuances that may apply in the states that recognize each exemption type. Also, because filing requirements (and deadlines) may be different for a particular exemption than the state's franchise registration requirements, this section will address the extent to which each exemption is subject to special rules.

a. State Exemptions

There is great variety in what exemptions a state may recognize, what must be done for a franchisor or a transaction to be deemed exempt from franchise registration in a state, and what must be done in the future for that transaction or franchisor to remain exempt in that state. While some states may require a filing for a sale of a franchise to someone who qualifies as an insider of the franchisor, other states automatically exempt it and require no filing. Even for exemptions that are ostensibly similar, the states use different criteria for a franchisor, franchisee, or transaction to qualify for the exemption. While a franchisor may qualify as a large franchisor and be exempt in one state, the franchisor may not have enough business experience to qualify for the same exemption in another state.

²⁵ As most franchise law practitioners know, franchisors often must make filings under other state statutes usually referred to as "Business Opportunity Laws." These filings are beyond the scope of this section.

The states also distinguish between exemptions from registration and exemptions from disclosure. If a franchisor is exempt from registration, it does not have to file a full franchise registration application with the state agency. But, exemption from registration does not relieve a franchisor of its obligation to provide prospective franchisees with a franchise disclosure document. If a franchisor (or a transaction) qualifies for an exemption from disclosure, the franchisor does not need to provide a franchisee with a disclosure document (under state law). Unless otherwise indicated, the exemptions described apply to exemption from registration only.

Conceptually, it is helpful to think of the various exemptions as falling into 3 main categories. Exemptions may be based on: (1) characteristics of the franchisor, (2) the nature of the transaction, or (3) characteristics of the franchisee. Of course, not all available exemptions fall neatly into these categories, but the ones that do not are generally not particularly useful to a typical franchisor in planning their compliance program. Brief discussions of the exemptions most likely to be useful to a typical franchisor are provided below. The state-specific requirements for each exemption are discussed in Section III, below. A chart that identifies each category of exemption and the states that recognize them is attached as Appendix B to this paper. A chart summarizing the requirements for filing each of the exemptions discussed below is attached as Appendix C.

1. Exemptions Based on Franchisor's Characteristics

a. Large Franchisor Exemption

Several states provide exemptions from franchise registration for franchisors that have substantial net worth and/or experience in franchising. The apparent justifications for this exemption are that (i) a franchisor with substantial net worth is likely to have assets that can be used to pay a judgment in the event that the franchisee has a legal claim against the franchisor, and (ii) the franchisor's track record is substantial enough to expose any concerns a franchisee may have about the viability of the business or the franchisor's ability to run it. A "large franchisor" may be defined by state law by its net worth alone or by its net worth coupled with its business experience. There is usually a threshold amount for the franchisor's net worth, such as \$5 million, but the threshold amount varies substantially by state. Most states also include a provision where the franchisor may have a lower net worth than the general threshold if a parent of the franchisor meets the higher threshold for net worth. In these cases, some states require the parent to guarantee the franchisor's duties and obligations. If a state includes a business experience requirement to be exempt, it may require that the franchisor have been in business for a set amount of time, have a certain number of franchisees, have conducted the type of business that is the subject of the franchise, or have a parent that fits those categories.

b. Cooperative Organizations Exemption

Cooperative organizations are generally organizations operated for independent retailers. The members usually own equal shares in these organizations and membership itself is limited to people who will directly benefit from the services the organization provides.

2. Exemptions Based on the Nature of the Transaction or Franchise System

a. Limited Offer Exemption

Some states provide an exemption for transactions arising in situations where the franchisor has not actively solicited franchises for sale in the state. Generally, the sale of a limited number of franchises (one or two) within a certain time period, when the franchisor has not advertised the sale, may be exempt. This exemption is often useful in situations where a franchisor is contacted by a prospect in a state in which the franchisor does not have a general intention to expand. If the transaction is exempt, the franchisor can pursue the opportunistic sale without having to spend the time and effort needed to obtain a registration.

b. Fractional Franchise Exemption

A fractional franchise may exist when the putative franchised business is expected to represent a small portion of an existing business. Generally, a fractional franchise exists where the putative franchised business will account for 20% or less of the existing businesses' sales in the first year. Some states will also require that the putative franchisee have a certain amount of experience in a related business for the transaction to qualify as the sale of a fractional franchise.

c. Minimum Payment Exemption

A business which would otherwise be a franchise but requires a nominal payment, such as less than \$500, may be either excluded from the definition of a franchise or exempt from the registration and disclosure requirements.

d. Large Initial Investment Exemption

If the initial investment made by a franchisee is large, the state may presume that if the franchisee can afford the payment, the franchisee must have enough business experience to assess the risks and benefits of the franchise investment and does not need the protection of the franchise laws. Note that this exemption is similar to the Large/Experienced/Seasoned Franchisee exemption discussed below.

e. Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption

There may be an exemption when a franchise agreement is extended, renewed, modified or amended and there is neither an interruption in the operation of the franchised business, nor a material change in the agreement.

3. Exemptions Based on Franchisee's Characteristics

a. Large/Experienced/Seasoned Franchisee Exemption

A franchisee with a large net worth and/or significant experience in the business to be franchised are very likely — in theory — to take their due diligence seriously and/or consult with knowledgeable advisors before signing a franchise agreement. So, some states exempt transactions involving these franchisees from registration.

b. **Insider Exemption**

Certain people who have intimate knowledge of the operations of the franchisor are often presumed to be in a position that would not benefit greatly from the additional protections that a state agency's review of a franchise registration may provide. These "insiders" are usually defined as persons who own at least a 50% interest in the prospective franchisee and for at least the previous two years have been an officer, director, or owner of an interest in franchisor.

4. **Other Exemptions**

a. **Exemption by Order**

Many states allow the state agency responsible for enforcing the franchise registration law to grant exemptions when registration is not necessary to protect prospective investors and is not in the public interest. This may be called an "exemption by order." An exemption by order is an individualized ruling that generally requires that a franchisor articulate a specific explanation of why the sale of their franchises should be exempt.

b. **Miscellaneous Exemptions**

There are several other exemptions that states may recognize, but most are of little practical impact for traditional franchisors in managing their state sales compliance process. They are mentioned here and are noted in the overview chart attached as Appendix A, but are not included in the following state-by-state review. The "leased departments" exemption covers businesses operating within a retail establishment, such as a department or division, that is not required to purchase goods or services from the retail operator. A few states specifically exempt the sale of securities from the franchise laws. Franchise sales by a sheriff, executor, administrator, marshal, receiver, trustee in bankruptcy, guardian or conservator are often exempt. The sale of a franchise to a bank, savings institution, trust company or insurance company often does not require registration. A few states exempt bank credit card plans which are credit cards issued by a bank. Petroleum franchises are often exempt from the requirements of the franchise laws as other state and federal laws specifically apply to them. The sale of motor vehicle dealerships may be excluded from the definition of a franchise or may be exempt from registration and/or disclosure requirements. The sale of a cable telecommunications business by a governmental entity may not require registration. If there is no written document with any of the material terms of the franchise agreement, registration and disclosure may not be required. Finally, a franchisee who offers or sells a franchise for his own account, when the sale is not effected by the franchisor, may be exempt from registration and disclosure. California allows the sale of franchises once an application has been filed with the state even though the franchise may not yet be registered. Some states will allow an exemption when the franchisee will not operate the business in that state and is not a resident of that state. The sale of an additional franchise to a franchisee currently operating the same type of franchise may be exempt from registration and/or disclosure.

B. State Exemptions and Variations

1. California

a. Large Franchisor Exemption

The large franchisor exemption in California exempts a transaction from registration and some disclosure,²⁶ but the franchisor must file an annual notice with the state and pay a fee.²⁷ To qualify for this exemption, (i) the franchisor must have a net worth of at least \$5 million, on a consolidated basis, (ii) the franchisor must have a net worth of \$1 million and a company owning at least 80% of the franchisor (a “Parent”) must have a net worth of at least \$5 million, or (iii) the franchisor must have a net worth of at least \$1 million — according to its unaudited financial statement — and the Parent must have a net worth of at least \$5 million, and must guarantee to assume the franchisor’s duties and obligations under the franchise agreement should the franchisor become unable to perform them.²⁸ Also, the franchisor or Parent, at all times during the previous five years, must have had at least 25 franchisees, or conducted the same type of business as is the subject of the franchise.²⁹ In California, the large franchisor exemption does not completely exempt the franchisor from disclosure. While the franchisor is not required to provide prospective franchisees with a franchise disclosure document, the franchisor must provide specific information, much of which is extensive and is very similar to what is required to be included in a franchise disclosure document, including a copy of the franchise agreement, a description of payments and fees, and a statement regarding any restrictions on from whom the franchisee may purchase products, to name a few.³⁰ If an existing franchise agreement is being materially modified, the disclosure must include the proposed modifications.

The required annual notice filing should be filed between July 1 and December 31 of the year before the year for which the exemption will be claimed.³¹ A notice may be filed in the same year that an exemption is claimed, but the effective date will be the filing date and it will expire on December 31 of that year. A renewal notice should be filed prior to the end of the calendar year.

b. Cooperative Organization Exemption

California’s Franchise Investment Law’s definition of a franchise excludes nonprofit organizations operated on a cooperative basis by and for independent retailers.³² To be excluded though, the organization must fit all of the following criteria, including: (i) substantially equal control and ownership by the members, (ii) limited membership to those who will avail themselves of the organization’s services, (iii) limited or no transfer of ownership, (iv) no return on the capital investment, (v) members receive substantially equal benefits, (vi) no personal liability by the members for the organization’s obligations, (vii) the organization provides services mainly for the member’s use, (viii) each member receives a disclosure document, and

²⁶ CAL. CORP. CODE § 31101.

²⁷ CAL. CODE REGS. tit. 10, § 310.101.

²⁸ CAL. CORP. CODE § 31101(a).

²⁹ CAL. CORP. CODE § 31101(b).

³⁰ See CAL. CORP. CODE § 31101(c)(1).

³¹ CAL. CODE REGS. tit. 10, § 310.101.

³² CAL. CORP. CODE § 31005(c).

(ix) none of the organization's receipts, income or profit is paid to a for-profit entity, other than for necessary goods and services.³³ Because one of the criteria for this exemption is to provide members of the organization with a disclosure document, it only exempts the organization from registration. However, no filing with the state is required.

c. **Fractional Franchise Exemption**

California law recognizes the fractional franchise exemption when the franchise adds a new product or service line to the franchisee's existing business.³⁴ While this exemption releases the franchisor from both the disclosure and registration requirements, the franchisor must file a notice of exemption and pay a fee before any offer or sale. To qualify as a fractional franchise in California, all of the following must be met: (i) the prospective franchisee has been involved in a business offering products or services substantially similar to those of the franchised business for the previous 24 months, (ii) the new product or service is substantially similar or related to the products or services the prospective franchisee's business currently offers, (iii) the franchised business will be offered from the same location as the current business, (iv) at the time of the agreement establishing the franchise, both parties anticipate that the new business would not compose more than 20% of the franchisee's annual total sales, and (v) the franchisor does not control the prospective franchisee.³⁵

As discussed in the Large Franchisor Exemption, the required annual notice filing should be filed between July 1 and December 31 of the year before the year for which the exemption will be claimed.³⁶ A notice may be filed in the same year that an exemption is claimed, but the effective date will be the filing date and it will expire on December 31 of that year. A renewal notice should be filed prior to the end of the calendar year.

d. **Minimum Payment Exemption**

An offer or sale of a franchise in California for which the initial fee is \$500 or less is exempt from both registration and disclosure.³⁷ No filing is required.

e. **Large/Experienced/Seasoned Franchisee Exemption**

California allows for an exemption for large franchisees and a different exemption for experienced franchisees. Both exempt a franchisor from registration and disclosure.

A sale of a franchise to a large franchisee can be exempt from both registration and disclosure, provided that the franchisor files a notice of exemption and pays a fee.³⁸ To qualify as a "large franchisee," each purchaser of the franchise must be either: (i) a partner, executive officer or director of the franchisor, or any executive officer of its corporate general partner if franchisor is a partnership, or a manager if franchisor is a limited liability company, (ii) an entity with over \$5 million in assets, but not an entity specifically formed to acquire the franchise, (iii) a

³³ *Id.*

³⁴ CAL. CORP. CODE § 31108.

³⁵ *Id.*

³⁶ CAL. CODE REGS. tit. 10, § 310.101.

³⁷ CAL. CODE REGS. tit. 10, § 310.011.

³⁸ CAL. CORP. CODE § 31109(e).

person whose net worth — including joint net worth with a spouse — is more than \$1 million, (iv) a person whose income exceeds \$300,000 per year in the prior two years, or whose joint income with a spouse exceeds \$500,000 per year in the prior two years, and the person or spouses have a reasonable expectation of receiving at least the same income in the current year, or (v) an entity of which all equity owners fit the qualifications described in sections (i) through (iv).³⁹ Each purchaser of the franchise must also have knowledge and experience in financial and business matters to the extent that the franchisor believes they can adequately evaluate the risks of the investment.⁴⁰ The purchase must be conducted with the intent to operate the franchise and not to resell the franchise.⁴¹ The initial cash fee cannot exceed 10% of the purchaser's net worth, if the purchaser is a natural person.⁴² Finally, the law makes clear that this exemption may not be used as a plan to avoid registration — the franchisor or its officers, directors, employees or agents may not form, organize, engage or assist anyone to purchase a franchise for resale or distribution to qualify for an exemption.⁴³ As with California's Large Franchisor Exemption, the required annual notice filing should be filed between July 1 and December 31 of the year before the year for which the exemption will be claimed.⁴⁴ A notice may be filed in the same year that an exemption is claimed, but the effective date will be the filing date and it will expire on December 31 of that year. A renewal notice should be filed prior to the end of the calendar year.

The sale of a franchise to an “experienced franchisee” may also be exempt from registration and disclosure in California. An experienced franchisee is one where any one of the following apply: (i) at least one owner of at least a 50% interest in the prospective franchisee, in the prior seven years had at least 24 months of responsibility for both financial and operational aspects of a business that is substantially similar to the franchised business and the owner is not controlled by the franchisor, (ii) at least one owner of at least a 50% interest in the prospective franchisee, within the previous 60 days has had at least 24 months of experience as an officer, director, managing agent or owner of at least a 25% interest in the franchisor, or (iii) the sale is to an existing franchisee, or an entity of which an officer, director, managing agent or owner holds at least a 25% interest in a current franchisee, as long as in either case the entity or person, for at least 24 months, has been involved in a business that is substantially similar to the franchised business.⁴⁵ To claim this exemption the franchisor must file a notice with the Commissioner of Corporations and pay a fee within 15 calendar days after the sale.⁴⁶

f. Insider Exemption

An explanation of the California Insider Exemption⁴⁷ is included in the discussion of the California Large/Experienced/Seasoned Franchisee Exemption.

³⁹ CAL. CORP. CODE § 31109(a).

⁴⁰ CAL. CORP. CODE § 31109(b).

⁴¹ CAL. CORP. CODE § 31109(c).

⁴² CAL. CORP. CODE § 31109(d).

⁴³ CAL. CORP. CODE § 31109(f).

⁴⁴ CAL. CODE REGS. tit. 10, § 310.101.

⁴⁵ CAL. CORP. CODE § 31106(a).

⁴⁶ CAL. CORP. CODE § 31106(b).

⁴⁷ CAL. CORP. CODE §§ 31106(a)(2), 31109(a)(1).

2. Hawaii

a. Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption

Neither registration nor disclosure is required when (i) an existing franchise is extended or renewed, (ii) a modified or amended franchise agreement is exchanged or substituted, or (iii) the location of a franchise is transferred, but there is no interruption in the franchisee's business, and there is no material change in the franchise relationship.⁴⁸ The franchisor is not required to file anything with the state.

b. Exemption by Order

The Director of Commerce and Consumer Affairs may deem certain transactions, people, entities or industries exempt from registration and disclosure after considering if such an exemption is within the public interest and whether information which would otherwise be required to be disclosed would be material to a determination of whether a prospective franchise has a reasonable chance of success.⁴⁹ The franchisor should submit a letter explaining the reasoning for why it should be granted an exemption by order.

3. Illinois

a. Large Franchisor Exemption

Illinois recognizes two forms of "large franchisor" exemption — one with a net worth threshold of \$5 million and another with a net worth threshold of \$15 million.

An offer or sale made by a franchisor with a net worth of at least \$15 million (or at least \$1 million, if its Parent has a net worth of at least \$15 million) is exempt from registration.⁵⁰ No filings with the state are required. On a practical note though, if a franchisor has previously been registered, it may be advisable to withdraw any existing registration before relying on this exemption so that the franchisor's application is not listed as "terminated" upon expiration. A terminated registration may have the effect of chilling potential franchise sales.

Alternatively, if a franchisor's net worth is at least \$5 million (or at least \$1 million, if its Parent's net worth is at least \$5 million, and the Parent guarantees to assume the franchisor's duties and obligations under the franchise agreement in the event that the franchisor becomes unable to perform them), an offer or sale made by that franchisor may be exempt from registration.⁵¹ To be exempt, the franchisor, its Parent or Parent of franchisor's predecessor, also must have had at least 25 franchises conducting business in the franchise system in the previous five years.⁵² If the franchisor has conducted a business that is substantially the same as the franchised business, that can fulfill three years of the required experience.⁵³ The

⁴⁸ HAW. REV. STAT. § 482E-4(a)(5).

⁴⁹ HAW. REV. STAT. § 482E-4(b).

⁵⁰ ILL. COMP. STAT. § 815: 705/8(a)(1).

⁵¹ ILL. ADMIN. CODE tit. 14, § 200.202(e)(1).

⁵² ILL. ADMIN. CODE tit. 14, § 200.202(e)(2).

⁵³ *Id.*

franchisor must still provide disclosure and the exemption will immediately terminate if the franchisor no longer meets the requirements of it.⁵⁴ To qualify for this exemption, the franchisor must submit a cover letter to the Illinois Attorney General, explaining how the net worth and experience requirements were met, and including a copy of the disclosure document, uniform consent to service of process, and a certification page.⁵⁵ This information must be submitted prior to any offer or sale. Exemption applications in Illinois receive an expedited review, but the exemption is not deemed effective upon receipt. Once the application has been reviewed and deemed effective, the exemption will be given an effective date and a termination date. The termination date is the same as the anniversary date for a franchise registration, so if a franchisor would like to continue using the exemption, an annual renewal must be filed before the termination date.

b. **Limited Offer Exemption**

See the discussion below of the Exemption by Order.

c. **Fractional Franchise Exemption**

If a franchisee has been in the same type of business as the franchised business for at least two years and at the time of the agreement both the franchisee and franchisor anticipate, or should have anticipated, that sales from their relationship would comprise no more than 20% of franchisee's sales in the first year operating the franchised business, there is no registration or disclosure required.⁵⁶ No filing with the state is required for this exemption.

d. **Minimum Payment Exemption**

Under the Illinois Franchise Disclosure Act of 1987, the definition of "franchise" only includes agreements under which a franchise fee of \$500 or more is required.⁵⁷ Therefore, transactions requiring a fee of less than \$500 are not subject to either the franchise registration or disclosure laws.

e. **Large Initial Investment Exemption**

See the discussion below of the Exemption by Order.

f. **Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption**

An offer or sale involving an extension or renewal of an existing franchise or the exchange or substitution of a modified or amended franchise agreement, that includes no interruption of the operation of the franchised business is exempt from registration and disclosure.⁵⁸ No filing with the state is required.

⁵⁴ ILL. ADMIN. CODE tit. 14, § 200.202(e)(3)–(4).

⁵⁵ ILL. ADMIN. CODE tit. 14, § 200.202(e)(5).

⁵⁶ ILL. COMP. STAT. § 815: 705/3(1)(ii).

⁵⁷ ILL. COMP. STAT. § 815: 705/3(1)(c).

⁵⁸ ILL. COMP. STAT. § 815: 705/7.

g. **Large/Experienced/Seasoned Franchisee Exemption**

An offer or sale to a franchisee, its Parent or its affiliates, who has been in business at least five years and has a net worth of at least \$5 million is also exempt from registration, but not disclosure.⁵⁹ There is no required filing with the state.

h. **Insider Exemption**

If one of the purchasers of at least a 50% ownership interest in the franchise has been an officer, director, general partner, individual with management responsibility for the offer and sale of the franchisor's franchises, the administrator of the franchised network, or has been an owner of at least a 25% interest in franchisor, for at least two years, an offer or sale to that person is exempt from registration.⁶⁰ The franchisor does not need to file anything with the state.

i. **Exemption by Order**

By order, the Illinois Attorney General may limit what disclosures are required for certain classes of franchises when in the public interest.⁶¹

A franchisor that plans to sell only one or two franchises within the following year is likely able to use this exemption, but the exemption is discretionary. Also, exemption from disclosure will only be allowed if the Illinois Attorney General specifically excuses the franchisor from the disclosure requirements.⁶² Illinois characterizes the exemption from registration of the sale of one or two franchises within a year as being within the public interest. To apply for an exemption by order, the franchisor should submit a cover letter describing the basis for the exemption to the Illinois Attorney General, along with a copy of the disclosure document, among other things.⁶³

When an offer or sale applies to a single unit franchise for which the minimum initial investment is more than \$1 million, it may be exempt from disclosure and registration.⁶⁴ The franchisor is only exempt from disclosure though if the Illinois Attorney General specifically excuses the franchisor from that requirement. The following must be submitted for consideration of this exemption: (i) a cover letter describing the basis for the exemption, (ii) a list of administrative agencies which have granted or denied exemptions or opinions, along with copies of those exemptions or opinions, (iii) a statement of the number of franchises the franchisor plans to sell in Illinois in the next 12 months, (iv) a list of all Illinois franchise sales since the most recent franchise disclosure document submitted with the exemption application, (v) the Uniform Franchise Registration Application, (vi) Supplemental Information Page, (vii) Sales Agent Disclosure Form, (viii) Uniform Consent to Service of Process, (ix) Certification

⁵⁹ ILL. COMP. STAT. § 815: 705/8(a)(2).

⁶⁰ ILL. COMP. STAT. § 815: 705/8(a)(3).

⁶¹ ILL. COMP. STAT. § 815: 705/9.

⁶² ILL. ADMIN. CODE tit. 14, § 200.201(b).

⁶³ ILL. ADMIN. CODE tit. 14, § 200.201 (including the list of what is required in the cover letter, how the state defines "in the public interest," and the criteria to apply for an exemption for the sale of a single unit franchise in which the minimum investment is more than \$1,000,000).

⁶⁴ ILL. ADMIN. CODE tit. 14, § 200.201(c).

Page, (x) auditor's consent letter, and (xi) franchise disclosure document, current within 120 days.⁶⁵

Applications for exemption by order will not be effective upon receipt, but the review will be conducted on an expedited basis.

4. Indiana

a. Large Franchisor Exemption

An offer or sale is exempt from registration and disclosure if the franchisor meets net worth, experience and disclosure requirements.⁶⁶ For the net worth requirement, the franchisor must have a net worth of at least \$5 million (or at least \$1 million, if its Parent has a net worth of at least \$5 million).⁶⁷ The franchisor's (or its Parent's) experience must consist of having had at least 25 franchisees conducting business at all times during the previous five years, or the franchisor (or its Parent) conducting the business which is the subject of the franchise continuously for the prior five years.⁶⁸ The franchisor must also disclose, in writing, some items of information (which are typically included in a disclosure document) to each prospective franchisee, including the franchisor's business experience, a statement of fees charged to franchisees, any limitation on goods or services the franchisees may offer, and must provide the prospective franchisee with a copy of the proposed franchise contract, to name a few requirements.⁶⁹ This exemption is self-executing, meaning that a franchisor does not need to file any documents with the state. But, if a franchisor would prefer to have confirmation from the state that it does in fact meet the requirements for this exemption, the franchisor may submit a cover letter, financial statements, a franchise disclosure document on CD-ROM, and a \$50 fee. The Securities Division of the Indiana Secretary of State will review the materials and will provide written confirmation of exempt status.

b. Limited Offer Exemption

If the franchisor sells no more than one franchise in any 24 month period, the offer or sale of that franchise does not need to be registered or disclosed.⁷⁰ No notice filing is required prior to the offer or sale.⁷¹

c. Exemption by Order

The rules regarding registration and disclosure do not apply to an offer or sale exempted by the Indiana Securities Commissioner by rule or order because it is not necessary in the public interest or for the protection of investors.⁷² A franchisor who wishes to apply for an

⁶⁵ ILL. ADMIN. CODE tit. 14, § 200.201(a).

⁶⁶ IND. CODE § 23-2-2.5-3.

⁶⁷ IND. CODE § 23-2-2.5-3(a).

⁶⁸ IND. CODE § 23-2-2.5-3(b).

⁶⁹ IND. CODE § 23-2-2.5-3(c).

⁷⁰ IND. CODE § 23-2-2.5-3

⁷¹ SECURITIES DIVISION, STATE OF INDIANA SECRETARY OF STATE, IN THE MATTER OF: FRANCHISE ISOLATED SALE EXEMPTION CLAIMS PURSUANT TO IC 23-2-2.5-3, Administrative Order No. 96-0133 (1996).

⁷² IND. CODE § 23-2-2.5-5

exemption by order should send the Securities Division of the Indiana Secretary of State a letter explaining why an exemption by order should be granted.

5. Maryland

a. Large Franchisor Exemption

An offer or sale is exempt from registration when the franchisor has a net equity of at least \$10 million (or \$1 million, if its Parent has a net equity of at least \$10 million and the Parent guarantees the performance of the franchisor's obligations), and the franchisor has had at least 25 franchisees conducting the same franchised business continuously during the past five years.⁷³ The franchisor must file a notice of exemption no less than 10 business days before the offer or sale and a notice of exemption must be filed annually.⁷⁴ The franchisor must also file a consent to service of process, agree to supply any additional requested information, pay a fee, submit financial statements to prove the net worth requirement, submit a representation that the franchisor meets the experience requirement, and file its current disclosure document.⁷⁵ A self-addressed stamped envelope should also be included for the state to provide confirmation of receipt of the filing and the assigned exemption number.⁷⁶ The Securities Division of the Maryland Attorney General's Office will have 10 business days to review the application and will assign an effective date.

b. Minimum Payment Exemption

The offer or sale of a franchise where the franchise fee does not exceed \$100 on an annual basis is exempt from the registration provisions of the Maryland Franchise Law.⁷⁷ There is no filing with the state required.

c. Large Initial Investment Exemption

If the franchisor requires an initial investment of more than \$750,000, the registration provisions of the Maryland Franchise Registration and Disclosure Law do not apply.⁷⁸ But, the franchisor must file a notice of exemption no later than 10 business days before the offer or sale. The filing is not effective upon receipt as the state will have 10 business days in which to review the submission. The notice of exemption must be filed annually, and with the initial filing, the franchisor must also file the consent to service of process, agree to supply any requested additional information, pay a filing fee, and file a copy of the current franchise disclosure document.⁷⁹ A self-addressed stamped envelope should also be included for the state to provide confirmation of receipt of the filing and the assigned exemption number.⁸⁰

⁷³ MD. CODE REGS. 02.02.08.10.D(1).

⁷⁴ MD. CODE REGS. 02.02.08.10.D(2)(a).

⁷⁵ MD. CODE REGS. 02.02.08.10.D(2)(b)–(g).

⁷⁶ MD. CODE REGS. 02.02.08.10.H.(3).

⁷⁷ MD. CODE REGS. § 02.02.08.10.C.

⁷⁸ MD. CODE REGS. § 02.02.08.10.E

⁷⁹ MD. CODE REGS. 02.02.08.10.E(2)(b)–(e).

⁸⁰ MD. CODE REGS. § 02.02.08.10.H.(3).

d. **Exemption by Order**

The Securities Commissioner may exempt any transaction from registration if registration is not within the purpose of the franchise law, or is not necessary or appropriate in the public interest or for the protection of investors.⁸¹ To apply for an exemption by order, either the franchisor or a franchisee shall file with the Securities Commissioner a description of the transaction or class of franchises and explain why an exemption is appropriate, including providing a representation that any additional information requested will be provided.⁸² If the Securities Commissioner believes that the criteria for the exemption have been satisfied, then the franchisor must file a notice of exemption no later than 10 business days before the offer or sale of any franchise, and must file the notice of exemption annually. Also, at the same time the franchisor files the notice of exemption, the franchisor must file a consent to service of process, agree to provide any additional requested information, pay a filing fee, and must file one copy of the current disclosure document.⁸³ A self-addressed stamped envelope should also be included for the state to provide confirmation of receipt of the filing and the assigned exemption number.⁸⁴ Note that the notice of exemption must be filed at least 10 business days in advance of the offer or sale, so the application for exemption by order must be submitted far enough in advance to allow the Securities Commissioner time to review and possibly grant the exemption, and for the franchisor to provide proper disclosure to the prospective franchisee.

6. **Michigan**

a. **Cooperative Organizations Exemption**

An offer or sale involving a nonprofit organization operated on a cooperative basis by and for independent retailers is exempt from both the registration and disclosure requirements as long as all of the following apply: (i) the members hold substantially equal control and ownership, (ii) members must be those who use the organization's services, (iii) ownership may not be transferred, or only may be transferred in limited circumstances, (iv) members do not receive a return on any capital investments, (v) the members receive substantially equal economic benefits, on the basis of patronage in the organization, and (vi) members are generally not liable for the organization's obligations.⁸⁵ Additionally, the goods and services of the organization must be primarily received by the members, none of the income or profits of the organization may go to any profit-making entities (other than for necessary goods and services), and the members must not be required to purchase goods or services through any profit-making entity.⁸⁶ The franchisor is not required to provide any kind of notice to the state.

b. **Fractional Franchise Exemption**

An offer or sale is exempt from the notification and disclosure requirements of the Michigan Franchise Investment Law if: (i) a prospective franchisee is presently engaged in an established business of which the franchise will become a component, (ii) the franchise has

⁸¹ MD. CODE ANN., BUS. REG. § 14-214(b)(3).

⁸² MD. CODE REGS. § 02.02.08.10.G.

⁸³ MD. CODE REGS. § 02.02.08.10.G(5).

⁸⁴ MD. CODE REGS. § 02.02.08.10.H.(3).

⁸⁵ MICH. COMP. LAWS § 445.1504a(A)–(F).

⁸⁶ MICH. COMP. LAWS § 445.1504a(G)–(I).

been engaged in the type of business represented by the franchise relationship for at least two years, and (iii) the parties believe, at the time the agreement was made, that the sales from the franchise will not make up more than 20% of the franchisee's total gross sales.⁸⁷ But, if the franchisor has a disclosure statement that complies with either the FTC Rule or any state laws, then the franchisor must provide that statement to the prospective franchisee along with the notice described in Section 445.1508(3) of the Michigan Franchise Investment Law, and a copy of all proposed agreements relating to the franchise sale.⁸⁸ The franchisor is not required to file anything with the state.

c. **Minimum Payment Exemption**

If a franchise fee is not over \$500, the franchisor is not required to place the state on notice or provide prospects with disclosure.⁸⁹ However, if the franchisor has a disclosure statement that complies with either the FTC Rule or any state laws, then the franchisor must provide that statement to the prospective franchisee along with the notice described in Section 445.1508(3) of the Michigan Franchise Investment Law, and a copy of all proposed agreements relating to the franchise sale.⁹⁰

d. **Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption**

The franchisor is not required to notify the state or disclose the prospective franchisee upon the extension or renewal of an existing franchise or the exchange or substitution of a modified or amended franchise agreement.⁹¹ There also must not be either an interruption in the operation of the business, or a material change in the franchise relationship. But, if the franchisor has a disclosure statement that complies with either the FTC Rule or any state laws, then the franchisor must provide that statement to the prospective franchisee along with the notice described in Section 445.1508(3) of the Michigan Franchise Investment Law, and a copy of all proposed agreements relating to the franchise sale.⁹²

7. **Minnesota**

a. **Limited Offer Exemption**

The offer or sale of a franchise is exempt from the registration requirements of Minnesota's Franchises Law if a franchisor offers or sells only one franchise, not including an area franchise, during any period of 12 consecutive months and has not advertised the sale.⁹³ The franchisor must also place all funds related to the sale in an escrow account until all of the franchisor's obligations to the franchisee prior to opening have been completed. In addition, the franchisor must file a written notice with the Minnesota Commissioner of Commerce of its intent

⁸⁷ MICH. COMP. LAWS § 445.1506(h).

⁸⁸ MICH. COMP. LAWS §§ 445.1506(2), 445.1508.

⁸⁹ MICH. COMP. LAWS § 445.1506(c).

⁹⁰ MICH. COMP. LAWS §§ 445.1506(2), 445.1508

⁹¹ MICH. COMP. LAWS § 445.1506(e).

⁹² MICH. COMP. LAWS §§ 445.1506(2), 445.1508

⁹³ MINN. STAT. § 80C.03(e)(1)–(2).

to offer or sell a franchise pursuant to this exemption, no later than 10 business days prior to the sale.⁹⁴

b. **Fractional Franchise Exemption**

The offer or sale of a fractional franchise is exempt from Minnesota's registration requirements.⁹⁵ Under Minnesota law, a fractional franchise is one in which the franchisee or any of its principal officers or directors have been in the same type of business as the franchise for more than two years, and the parties anticipate that the sales from the relationship will not exceed 20% of the franchisee's total dollar sales volume.⁹⁶

c. **Minimum Payment Exemption**

If the "franchisee's" annual payment is less than \$100, the relationship is excluded from the definition of a franchise, and is therefore not subject to Minnesota's franchise registration or disclosure laws.⁹⁷

d. **Large Initial Investment Exemption**

If the initial, unfinanced investment in a franchise system exceeds \$200,000, the disclosure requirements are not as detailed, but the franchisor must file the registration with the Commissioner of Commerce, in addition to the financial statements and the names, addresses and business telephone numbers of all franchisees located in Minnesota.⁹⁸

e. **Exemption by Order**

The Commissioner of Commerce may exempt a transaction from the registration rules if it is not within the purposes of the franchise laws and the registration is not necessary or appropriate in the public interest or for the protection of investors.⁹⁹

8. **New York**

a. **Large Franchisor Exemption**

New York recognizes two forms of "Large Franchisor" exemption — one with a net worth threshold of \$15 million and another with a net worth threshold of \$5 million. An offer or sale made by a franchisor with a net worth of at least \$15 million (or \$3 million, if its Parent has a net worth of at least \$15 million), may be exempt from the registration provisions of the New York franchise law if it meets more limited disclosure obligations that are required of non-exempt franchisors.¹⁰⁰ A franchisor may take advantage of this exemption if it provides the limited disclosure to each prospect at least 7 days before the execution of a franchise agreement or the

⁹⁴ MINN. STAT. § 80C.03(e)(3)–(4).

⁹⁵ MINN. STAT. § 80C.03(f).

⁹⁶ MINN. STAT. § 80C.01.18.

⁹⁷ MINN. STAT. § 80C.01(c).

⁹⁸ MINN. R. § 2860.8100–8300.

⁹⁹ MINN. STAT. § 80C.03(g).

¹⁰⁰ N.Y. GEN. BUS. LAW § 684.3(a).

receipt of any consideration.¹⁰¹ This larger of the “Large Franchisor” exemptions is self-executing — no filing is required. The limited disclosures generally include information already required by the FTC Rule, so as a practical matter, a franchisor’s disclosure obligations under this exemption are met by providing a standard franchise disclosure document.

An offer or sale made by a franchisor with a net worth of at least \$5 million (or, if the franchisor has a net worth of at least \$1 million and its Parent has a net worth of at least \$5 million) may also be exempt from registration.¹⁰² The disclosure obligations for a franchisor intending to take advantage of this smaller of the “Large Franchisor” exemptions are the same as those of the larger “Large Franchisor” exemption.¹⁰³ But, the exemption also requires that the franchisor file a consent to service of process and an exemption application, along with paying a fee.¹⁰⁴

b. Limited Offer Exemption

If a franchisor does not actively solicit franchise sales in New York, it may be able to respond to limited opportunities in the state without having to file a full registration application.¹⁰⁵ If a transaction is the result of an offer that is directed to no more than two people, the franchisee has no right to offer franchises to others, and there is no commission paid for soliciting a prospective franchisee in New York, the sales resulting from those offers may be exempt from registration.¹⁰⁶ The only requirement to take advantage of this exemption (other than providing disclosure) is that the franchisor be domiciled in New York or have filed a consent to service of process with the Department of Law.¹⁰⁷

c. Fractional Franchise Exemption

The offer or sale of a fractional franchise may be exempt from registration. A fractional franchise in New York exists if: (i) the franchisee has been engaged in the business of offering products or services substantially similar or related to what is offered by the franchised business for the previous 24 months, (ii) the franchised business will be operated from the same location as the existing business, (iii) both parties anticipated that the sales from the franchised business would not account for more than 20% of the franchisee’s total annual sales, and (iv) the franchisee is not controlled by the franchisor.¹⁰⁸ Unlike many fractional franchise exemptions available in other states, in New York the franchisor must notify the Department of Law of the specific circumstances of the transaction and pay a fee.¹⁰⁹

¹⁰¹ *Id.*

¹⁰² N.Y. GEN. BUS. LAW § 684.2(a).

¹⁰³ N.Y. GEN. BUS. LAW § 684.2(b)–(c).

¹⁰⁴ N.Y. GEN. BUS. LAW § 684.2; N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(3).

¹⁰⁵ N.Y. GEN. BUS. LAW § 684.3(c).

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(2)(a)–(e).

¹⁰⁹ N.Y. COMP. CODES R. & REGS. tit. 13, §§ 200.10(2)(f), 200.10(3)

9. North Dakota

a. Large Franchisor Exemption

Like several other states, North Dakota provides an exemption from registration for offers or sales made by large franchisors. To be eligible, a franchisor must have a net worth of at least \$10 million (or a net worth of at least \$1 million if the franchisor's Parent has a net worth of at least \$10 million).¹¹⁰ In addition, it (or its Parent) must have had at least 25 franchisees for the previous five years.¹¹¹ Exempt franchisors must provide disclosure of certain information to prospects, including information that is typically provided in a disclosure document and a description of any material modifications.¹¹² To obtain the large franchisor exemption, a franchisor must file a notice of exemption with the Securities Commissioner and pay a fee.¹¹³ The exemption is not effective upon receipt, but is effective on the day that the payment enters the North Dakota Securities Department's system, which may be a day or so later. The North Dakota Securities Department will send the franchisor a notice with that effective date. The notice of exemption must be renewed annually, with the effective date being the date the Securities Commissioner receives the notice.

b. Cooperative Organization Exemption

Offers or sales involving cooperative organizations may be exempt from the registration requirements of the North Dakota Franchise Investment Law if the organization is a nonprofit entity formed for the exclusive benefit of its own members. To obtain this exemption, the cooperative organization must satisfy the following conditions: (i) each member's control and ownership is equal, (ii) only those who benefit from the services the organization provides may be members, (iii) ownership transfer is limited or prohibited, (iv) there is no return on the capital investment, (v) without a direct undertaking, members are not personally liable for the corporation's obligations, (vi) the services provided to the members are primarily for only their use, (vii) each member or prospect receives the most recent audited financial statements, governing documents, and agreement, and (viii) the corporation has had at least 25 franchises conducting business during the previous five years or has conducted the business which is the subject of the franchise for the previous five years.¹¹⁴ The exemption is obtained by filing a certification with the Securities Commissioner.

c. Exemption by Order

The Securities Commissioner may also exempt a transaction from the registration requirements by rule if the transaction is not within the purposes of the Franchise Investment Law and registration of the transaction is not necessary or appropriate in the public interest or for the protection of investors.¹¹⁵ A franchisor needs to submit a letter explaining why the Securities Commissioner should grant an exemption by order.

¹¹⁰ N.D. CENT. CODE § 51-19-04.1.a.

¹¹¹ N.D. CENT. CODE § 51-19-04.1.b.

¹¹² N.D. CENT. CODE § 51-19-04.1.c.

¹¹³ N.D. CENT. CODE § 51-19-04.1.e.

¹¹⁴ N.D. ADMIN. CODE § 73-03-01-01.

¹¹⁵ N.D. CENT. CODE § 51-19-04.3.

10. Rhode Island

a. Large Franchisor Exemption

Rhode Island's form of Large Franchisor Exemption is available for franchisor's that have a net worth of at least \$10 million (or whose Parent — who unconditionally guarantees the franchisor's performance and consents to service in Rhode Island — has a net worth of at least \$10 million).¹¹⁶ Like several other states, to be eligible for this exemption the franchisor must also meet an experience requirement, meaning that the franchisor or its Parent must have had at least 25 franchisees, all at different locations, conducting the business that is the subject of the franchise for the previous five years.¹¹⁷ The franchisor must also file an annual notice of exemption with the Director of Business Regulation, and pay a fee.¹¹⁸ An exempt franchisor must still provide disclosure to prospective franchisees.¹¹⁹ The notice of exemption must include the disclosure document and must be filed prior to the offer or sale. It is not effective upon receipt. The disclosure document will be reviewed by the state examiner. While the review of the disclosure document is not expedited, it is not as thorough as it would be for a full franchise registration application. Unless noted otherwise by the Director of Business Regulation, the exemption expires 15 months after the close of the period covered by the most recent audited financial statement filed in connection with the exemption.¹²⁰

b. Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption

If an offer or sale of a franchise involves a renewal, extension, modification or amendment of an existing franchise agreement, and there is no interruption in the operation of the franchised business and no material change in the franchise relationship, then it is exempt from registration.¹²¹ No filing with the state is required.

c. Large/Experienced/Seasoned Franchisee Exemption

No filing with the state is required for Rhode Island's experienced franchisee exemption, which exempts an offer or sale from registration. An experienced franchisee under the Rhode Island Franchise Investment Act is one who has a net worth of at least \$1 million (including the spouse's income, but excluding the value of their residence, personal vehicles and personal effects), or has joint income with the spouse that is greater than \$200,000 in the past two years and has a reasonable expectation of reaching the same amount for the current year.¹²² The franchisee must also have sufficient knowledge and experience in business and financial affairs to be able to evaluate the risks and benefits of the franchise.¹²³

¹¹⁶ R.I. GEN. LAWS § 19-28.1-6(a)(1).

¹¹⁷ R.I. GEN. LAWS § 19-28.1-6(a)(2).

¹¹⁸ R.I. GEN. LAWS § 19-28.1-6(a)(4).

¹¹⁹ R.I. GEN. LAWS § 19-28.1-6(a)(3).

¹²⁰ R.I. GEN. LAWS § 19-28.1-6(a)(4).

¹²¹ R.I. GEN. LAWS § 19-28.1-6(f).

¹²² R.I. GEN. LAWS § 19-28.1-6(d)(1).

¹²³ R.I. GEN. LAWS § 19-28.1-6(d)(2).

d. **Insider Exemption**

An offer or sale to a person who, for at least two years, has been an officer, director, partner or affiliate of the franchisor, when that offer or sale is for the person's own account, is exempt from registration.¹²⁴ The franchisor does not need to file anything with the state.

e. **Exemption by Order**

The Director of Business Regulation may exempt the offer or sale of a franchise from registration by order when registration is neither necessary nor appropriate in the public interest or for the protection of prospective franchisees.¹²⁵ The franchisor should submit a letter to the Director of Business Regulation explaining why an exemption by order should be granted.

11. **South Dakota**

a. **Fractional Franchise Exemption**

When a fractional franchise exists in South Dakota, neither registration nor disclosure is required.¹²⁶ A fractional franchise under the South Dakota Franchise Investment Law exists when there is a reasonable basis to anticipate that sales from a relationship will not exceed 20% of the franchisee's total sales in the first year.¹²⁷ The franchisee or any of its directors or officers, or the directors or officers of a Parent or affiliate must also have more than two years of experience in the same type of business.¹²⁸ No filing with the state is required.

b. **Minimum Payment Exemption**

Similar to other states, an offer or sale is exempt from registration and disclosure if the total of the required payments, or commitments to make a required payment are less than \$500. These are payments made to the franchisor or an affiliate between the time before operations begin to within 6 months after operations begin.¹²⁹ The franchisor does not need to file anything with the state.

c. **Large Initial Investment Exemption**

When a franchisee's initial investment is at least \$1 million (excluding the cost of unimproved land and any financing from the franchisor or an affiliate), the transaction is exempt from registration and disclosure. The franchisee is required to sign an acknowledgment to verify the amount of the transaction.¹³⁰ The state does not require any filing or notification.

¹²⁴ R.I. GEN. LAWS § 19-28.1-6(c).

¹²⁵ R.I. GEN. LAWS § 19-28.1-6(j).

¹²⁶ S.D. CODIFIED LAWS § 37-5B-12(3).

¹²⁷ S.D. CODIFIED LAWS § 37-5B-1(10)(b).

¹²⁸ S.D. CODIFIED LAWS § 37-5B-1(10)(a).

¹²⁹ S.D. CODIFIED LAWS § 37-5B-12(5).

¹³⁰ S.D. CODIFIED LAWS § 37-5B-13(1).

d. **Large/Experienced/Seasoned Franchisee Exemption**

An offer or sale to a large franchisee may be exempt if the large franchisee is one whose net worth is at least \$5 million and it has been in business for at least 5 years.¹³¹ The exemption may also be satisfied if the franchisee's Parent or affiliate meets the net worth and experience requirements.¹³² If an offer or sale is exempt, there is no required registration, disclosure or filing with the state.

e. **Insider Exemption**

Offers or sales to insiders will be exempt from both registration and disclosure and there is no state filing required. An insider, under the South Dakota Franchise Investment Law's insider exemption, is an officer, director, general partner, individual with management responsibility for the offer and sale of franchises, the administrator of the franchised network, or an owner of at least a 25% interest in the franchise.¹³³ To qualify for the exemption one or more purchasers of at least a 50% ownership interest in the franchise, within 60 days of the sale, must be an insider who has been in the position for at least two years.¹³⁴

f. **Exemption by Order**

The Director of the Division of Securities may exclude the offer and sale of a franchise from the registration and disclosure requirements if registration and disclosure are not necessary or appropriate in the public interest or for the protection of prospective franchisees.¹³⁵ Prior to the offer or sale, the franchisor should submit a letter to the Director of the Division of Securities explaining why an exemption by order may be warranted.

12. **Virginia**

a. **Large Franchisor Exemption**

When a franchise is offered or sold by a franchisor who has a net equity of not less than \$15 million (or not less than \$1 million and a Parent has a net equity of not less than \$15 million and the Parent guarantees the franchisor's obligations), and the franchisor, a Parent, or predecessor had at least 25 franchisees conducting the same business as the type that is offered for the prior five years, then there is no registration requirement.¹³⁶ Ten business days before the offer or sale, the franchisor must file a notice of claim of exemption and the franchisor must submit financial statements to demonstrate compliance with the financial requirements.¹³⁷ The State Corporation Commission will notify the franchisor as to the date the exemption becomes effective. In addition to filing the notice of claim of exemption, the franchisor must also file, at least 10 business days before the offer or sale of any franchise, a consent to service of process, an authorizing resolution if the franchisor is a corporation or partnership and the

¹³¹ S.D. CODIFIED LAWS § 37-5B-13(2).

¹³² *Id.*

¹³³ S.D. CODIFIED LAWS § 37-5B-13(4).

¹³⁴ *Id.*

¹³⁵ S.D. CODIFIED LAWS § 37-5B-15.

¹³⁶ 21 VA. ADMIN. CODE § 5-110-75.4.

¹³⁷ 21 VA. ADMIN. CODE § 5-110-75.4.b(1).

application is verified by someone other than an officer or general partner, the franchise disclosure document, a statement in which franchisor agrees to supply any additional information requested by the commission, and an application fee.¹³⁸ The exemption must be renewed annually, with the initial exemption period expiring at midnight on the annual exemption effective date. The renewal must be filed at least 10 business days before the expiration date and must include the notice of claim of exemption, a copy of the franchise disclosure document, and a renewal fee.¹³⁹ With the filing, the franchisor should also include a self-addressed, stamped envelope for the commission to return a confirmation of receipt.¹⁴⁰

b. Fractional Franchise Exemption

Under Virginia law, fractional franchises fall outside of the definition of a franchise. A fractional franchise is defined as a contract or agreement that grants a retailer the right to utilize a marketing plan or system to promote the sale or distribution of goods or services which are incidental and ancillary to the principal business of the retailer, in that they account for less than 20% of the retailer's gross sales. In Virginia, neither registration nor disclosure is required.¹⁴¹ Also, there is no required filing with the state.

c. Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption

When a franchise is offered or sold and it involves a renewal or extension of an existing franchise, no interruption in the operation of the franchised business, and no material change in the franchise relationship, it is exempt from registration.¹⁴² There is no required filing with the state.

13. Washington

a. Large Franchisor Exemption

A large franchisor in Washington will be exempt from registration. Similar to other states, the large franchisor exemption includes both a net worth and an experience requirement, in addition to a disclosure requirement. The franchisor's net worth must be at least \$5 million (or if the franchisor has a net worth of at least \$1 million and its Parent has a net worth of at least \$5 million), and the franchisee's initial payment must be more than \$100,000.¹⁴³ For the experience requirement, either the franchisor or its Parent must have had at least 25 franchisees conducting the business which is the subject of the franchise during the previous five years.¹⁴⁴ But, the franchisor must annually file with the Director of Financial Institutions a

¹³⁸ *Id.*

¹³⁹ 21 VA. ADMIN. CODE § 5-110-75.7.c.

¹⁴⁰ 21 VA. ADMIN. CODE § 5-110-75.6.b

¹⁴¹ VA. CODE ANN. § 13.1-559.B

¹⁴² 21 VA. ADMIN. CODE § 5-110-75.2.

¹⁴³ WASH. REV. CODE §§ 19.100.030(4)(a), 19.100.030(4)(b)(i)(A), 19.100.030(4)(b)(i)(C).

¹⁴⁴ WASH. REV. CODE §§ 19.100.030(4)(b)(i)(B).

statement that the franchisor is claiming this exemption and must pay filing fees initially and upon annual renewal.¹⁴⁵

b. **Minimum Payment Exemption**

When a franchisor provides the disclosure document to a prospective franchisee and charges a franchise fee that is not more than \$500, the transaction is exempt from registration.¹⁴⁶

c. **Large/Experienced/Seasoned Franchisee Exemption**

An offer or sale is exempt from registration if it is made to an accredited investor.¹⁴⁷ An accredited investor is one of the following, or one who the franchisor believes is one of the following: a bank, savings and loan association or other institution whether acting in its individual or fiduciary capacity, a broker or dealer, an insurance, investment or business development company, a plan established and maintained by a state for the benefit of its employees if the total assets are over \$5 million, an employee benefit plan if the investment decision is made by a fiduciary that is a bank, savings and loan association, insurance company or investment adviser, or the plan has total assets of more than \$5 million, or it is a self-directed plan with investment decisions made solely by people who are accredited investors.¹⁴⁸ Under Washington's Franchise Investment Protection Act, the following are also accredited investors: (i) a private business development company; (ii) a nonprofit organization, corporation, Massachusetts or similar business trust, or partnership that was not formed specifically to acquire the franchise offered, that also has total assets of more than \$5 million; (iii) a director, executive officer, or general partner of franchisor; (iv) an individual who has a net worth of more than \$1 million, which may include joint net worth with the person's spouse; (v) an individual with income of more than \$200,000, or joint income with the spouse of more than \$300,000, in the previous two years with a reasonable expectation of receiving the same income this year; (vi) a trust with assets in excess of \$5 million that was not formed for the purpose of purchasing the franchise, when the purchase is directed by a sophisticated person described in 17 C.F.R. § 230.506(b)(2)(ii); and (vii) an entity in which all equity owners are accredited investors.¹⁴⁹

d. **Insider Exemption**

See the discussion of the Experienced Franchisee Exemption.

¹⁴⁵ WASH. ADMIN. CODE § 460-80-100.

¹⁴⁶ WASH. REV. CODE § 19.100.30(4)(a), (4)(b)(iii).

¹⁴⁷ WASH. REV. CODE § 19.100.030(5).

¹⁴⁸ WASH. ADMIN. CODE 460-80-108(1).

¹⁴⁹ WASH. ADMIN. CODE 460-80-108(2)-(8).

14. Wisconsin

a. Cooperative Organizations Exemption

When an organization operates on a cooperative basis by and for independent retailers and sells goods at wholesale to its members or primarily serves its members, it is not bound by the franchise registration or disclosure requirements.¹⁵⁰

b. Fractional Franchise Exemption

Neither registration nor disclosure is required for fractional franchises. Similar to other states, Wisconsin's fractional franchise exemption covers when sales from a relationship are anticipated to only account for 20% or less of the franchisee's total sales during the first year.¹⁵¹ The exemption also includes an experience requirement under which a franchisee, its officers or directors must have been in the business which is the subject of the franchise for at least two years.

c. Minimum Payment Exemption

Registration is not required for an offer or sale of a franchise including a payment for the right to participate in a distribution or marketing plan where the payment does not exceed \$1,000 more than the bona fide wholesale price for the products or services in wholesale transactions.¹⁵² Also, a fee must be paid to the Division of Securities,¹⁵³ and a self-addressed, stamped envelope should be included if you would like to receive a written approval of the exemption.

d. Extension, Renewal, Modification, or Amendment of Franchise Agreement Exemption

The modification or amendment of an existing franchise agreement, with no interruption in the operation of the franchise business and no material change in the franchise relationship, does not require registration.¹⁵⁴ When a franchise business interrupts service to relocate, that does not constitute an interruption in operation or a material change in the franchise relationship. Also, a fee must be paid to the division,¹⁵⁵ and a self-addressed, stamped envelope should be included if you would like to receive a written approval of the exemption.

e. Large/Experienced/Seasoned Franchisee Exemption

The experienced franchisee exemption under the Wisconsin Franchise Investment Law applies when the fee for the purchase of the franchise is at least \$100,000, provided that the initial amount does not exceed 20% of the franchisee's net worth (excluding the values of the principal residence, furnishings and automobiles).¹⁵⁶ In addition to the financial requirements,

¹⁵⁰ WIS. STAT. § 553.22(3).

¹⁵¹ WIS. STAT. § 553.22(1).

¹⁵² WIS. ADMIN. CODE SEC § 32.05(1)(b).

¹⁵³ WIS. ADMIN. CODE SEC § 35.01(1)(a).

¹⁵⁴ WIS. ADMIN. CODE SEC § 32.05(1)(g).

¹⁵⁵ WIS. ADMIN. CODE SEC § 35.01(1)(a).

¹⁵⁶ WIS. STAT. § 553.235(1).

the franchisor must reasonably believe that the franchisee has sufficient knowledge and experience in the business that is the subject of the franchise to evaluate the merits and risks of the investment. This exemption may not be used for a motor vehicle dealer, distributor, or wholesaler.¹⁵⁷

f. **Exemption by Order**

If registration is not necessary or appropriate in the public interest or for the protection of investors, the division may exempt a franchise from registration.¹⁵⁸ If within 10 days of filing an application for exemption by order the Division of Securities requires the filing of additional information, the exemption will not be effective until 10 days after that information is filed, unless the Division of Securities allows for a shorter period.¹⁵⁹ If a franchise is exempt by order, franchisors must notify the division in writing, within 30 days, of any material event or material change that affects the exempted franchises or the franchisor,¹⁶⁰ and pay a fee.¹⁶¹

15. NASAA Proposed Model Exemptions

No discussion of the status of state franchise exemptions would be complete at this time without a brief mention of the current initiative underway by the North American Securities Administrators Association ("NASAA") to adopt a set of model exemptions. NASAA's current draft of proposed model exemptions is attached as Appendix D. Currently, NASAA's proposed exemptions include a form of fractional franchise exemption, an experienced franchisor exemption, four types of sophisticated purchaser exemption, and a discretionary exemption. Interested parties will be able to submit comments on the proposed exemptions for a period of 30 days from the date of publication.¹⁶² Following the comment period, NASAA may amend the proposal and reissue it for additional comments. NASAA intends to work towards creating a model act that it will ask the states to adopt. While most of the proposed model exemptions include the same criteria for the exemptions as are required by the states, some add new criteria.

VI. CONCLUSION

Complying with the franchise laws can be an overwhelming task. This paper hopes to clarify some of the requirements to help franchisors avoid a "dark period" or lapse in registration. For any franchisor (or franchisor's counsel) seeking to navigate the process as seamlessly as possible, certainly the best advice would be to begin with a thorough reading of the FTC Franchise Rule, the NASAA Guidelines and the various state franchise statutes and regulations. That advice alone will help avoid most of the stumbling blocks encountered in the registration process. Occasionally, counsel for a franchisor may encounter an issue that is – by its nature – vague or not well defined by applicable law. In these circumstances, the most expeditious approach may be to contact the appropriate state regulator and work out an acceptable solution in advance.

¹⁵⁷ WIS. STAT. § 553.235(2).

¹⁵⁸ WIS. STAT. § 553.25.

¹⁵⁹ WIS. STAT. § 553.24.

¹⁶⁰ WIS. ADMIN. CODE SEC § 32.03.

¹⁶¹ WIS. ADMIN. CODE SEC § 35.01(1)(a).

¹⁶² At the time this paper was submitted for publication, the comment period was still open.

State Franchise Registration Renewal Information

State	Date of Expiration	CD Rom?	Blackline required?	Effectiveness of Timely Filed Renewal Application	Financial Assurances Permitted	Imposition of Financial Assurance	14 calendar day presale disclosure?	Fee	Special Renewal Requirements
California	110 days from end of fiscal year	Paper required, CD optional	Yes	If renewal application is submitted at least 15 days prior to exp date, and If no stop order in effect, automatic renewal at 12 noon on the date on which the prior registration is due to expire.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the franchisor fails to demonstrate that its financial condition is adequate to fulfill its franchise offering obligations.	Yes	\$450	
Hawaii	3 months after close of fiscal year	Paper required, CD optional	Yes	Seven days after receipt.	Escrow, fee deferral, surety bond, guarantee, capital infusion	The franchisor or subfranchisor has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate improvements, equipment, training, or other items included in the offering.	Yes	\$250	Franchisors must report any new franchise sales (and proceeds therefrom) within 90 days after its FY end.
Illinois	120 days after fiscal year end	Paper required for review, CD required for final FDD	Yes	Upon receipt. If deficiencies are noted later by the Administrator, however, use of the amended FDD must cease and any prospective franchisees must be redisclosed with a corrected and approved FDD.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the Administrator finds that a franchisor has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training, or other items to be included in the establishment and opening of the franchise business being offered.	Yes	\$100	
Indiana	1 year from effective date	CD only	No	On the annual expiration date.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the franchisor has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training, or other items included in the offering.	No	\$250	
Maryland	1 year from effective date	Paper required, CD optional	Yes	If timely filed, on the annual date of effectiveness. If not timely filed, MD will provide notification of the effective date.	Escrow, fee deferral, surety bond, Guarantee, capital infusion, undertaking	If the Commissioner finds that it is necessary and appropriate for the protection of prospective franchisees or subfranchisors because a franchisor has not made adequate financial arrangements to fulfill the franchisor's obligations under an offering.	Yes	\$250	
Michigan	1 year from effective date	Not required	No	Upon receipt.	N/A	N/A	No	\$250	
Minnesota	No expiration; annual report due within 120 days of fiscal year end	Paper required, CD optional	Yes (if amendments are made)	Upon order of the commissioner.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the franchisor fails to demonstrate that its financial condition is adequate to fulfill its franchise offering obligations.	No - 7 days	\$200	
New York	No expiration unless franchisor fails to file an annual report within 120 days of its fiscal year end	Paper required, CD optional	Yes (if amendments are made)	15 days after submission of the amended FDD unless deficiencies are identified.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the department of law finds that the applicant for registration has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training, or other items included in the offering.	No - 10 business days	\$150	Franchisors must report various information about new franchise sales within 120 days after its FY end.

State	Date of Expiration	CD Rom?	Blackline required?	Effectiveness of Timely Filed Renewal Application	Financial Assurances Permitted	Imposition of Financial Assurance	14 calendar day presale disclosure?	Fee	Special Renewal Requirements
North Dakota	1 year from effective date	Paper required, CD optional	Yes	Upon notification by the commissioner.	Escrow, fee deferral, surety bond, guarantee, capital infusion	That the financial condition of the franchisor adversely affects or would adversely affect the ability of the franchisor to fulfill obligations under the franchise agreement.	Yes	\$100	
Rhode Island	120 days from end of fiscal year	CD only	Yes	On the thirtieth business day after filing of the application or the last amendment to the application or at an earlier time ordered by the director unless the applicant requests postponement of effectiveness of the application or the director has made a good faith effort to communicate why the application does not meet the requirements of this Act.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the franchisor fails to demonstrate to the director the franchisor's financial ability to fulfill its initial obligations to franchisees, the director may require an escrow of funds paid by the franchisee or subfranchisor to the franchisor or its affiliate until the franchisor performs its initial obligations and the franchisee has commenced operations. The director may allow alternatives to escrow.	No - 10 business days	\$300	
South Dakota	1 year from effective date	Preferred, but not required	No	Upon receipt	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the franchisor is unable to demonstrate to the director the franchisor's financial ability to fulfill its initial obligations to franchisees, the director may require an escrow of funds paid by the franchisee to the franchisor or its affiliate until the franchisor performs its initial obligations and the franchisee has commenced operations. The director may allow alternatives to escrow depending upon the various facts presented on a case by case basis.	Yes	\$150	
Virginia	1 year from effective date	Paper required, CD optional	Yes	Upon notification by the Division.	Escrow, fee deferral, guarantee, capital infusion	If the franchisor is insolvent in the sense that its liabilities exceed its assets.	Yes	\$250	
Washington	1 year from effective date	Paper required, CD optional	Yes	15 days after filing or filing of last amendment; waiver of auto effectiveness is routinely requested, in which case the effective date is determined by the Administrator.	Escrow, fee deferral, surety bond, guarantee, capital infusion	If the Administrator determines in the public interest.	May be considered by legislature in 2012	\$100	
Wisconsin	1 year from effective date	Required	No	Upon receipt.	Escrow, surety bond	If the division finds that the applicant has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training or other items included in the offering and if the franchisee so requests.	Yes	\$400	

APPENDIX B

EXEMPTIONS BY STATE

Exemption	Cal.	Haw.	Ill.	Ind.	Md.	Mich.	Minn.	N.Y.	N.D.	R.I.	S.D.	Va.	Wash.	Wis.
Exemptions Based on Franchisor's Characteristics														
Large Franchisor	X		X	X	X			X	X	X		X	X	
Cooperative Organizations	X					X			X					X
Exemptions Based on the Nature of the Transaction or Franchise System														
Limited Offer Franchise			X	X			X	X						
Fractional Franchise	X		X			X	X	X			X	X		X
Minimum Payment	X		X		X	X	X				X		X	X
Large Initial Investment			X		X		X				X			
Extension, Renewal, Modification, or Amendment of Franchise Agreement		X	X			X				X		X		X
Exemptions Based on Franchisee's Characteristics														
Large/Experienced/Seasoned Franchisee	X		X							X	X		X	X
Insider Exemption	X		X							X	X		X	
Other Exemptions														
Exemption by Order		X	X	X	X		X		X	X	X			X
Leased Departments			X				X			X	X	X		
Securities							X							X
Sale by Judicial Officer		X			X	X	X			X	X		X	
Bank as Franchisee		X	X		X	X	X	X			X	X	X	X
Bank Credit Card Plans	X							X						
Petroleum Wholesaler	X		X				X	X			X			
Motor Vehicle Franchise		X					X				X			
Cable Telecomm.														X
No Written Document											X			
Substantially Similar					X									
Sale by Current Franchisee	X	X	X	X	X	X	X	X	X	X		X	X	X
Exemption while Application Pending	X							X		X				
Out-of-State Franchise	X	X			X	X	X			X		X	X	X

Exemption	Cal.	Haw.	Ill.	Ind.	Md.	Mich.	Minn.	N.Y.	N.D.	R.I.	S.D.	Va.	Wash. .	Wis.
Sale to Current Franchisee	X	X				X		X		X	X	X	X	X

APPENDIX C

FILING REQUIREMENTS FOR EXEMPTIONS

CALIFORNIA

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, Notice of Exemption	No	No	Between July 1 and Dec. 31 of year before year for which exemption will be claimed. May file within same year but effective date of notice will be filing date.	\$450 initially and \$150 for renewal	Registration and some disclosure (not required to provide an FDD but must provide similar information to what is in an FDD)
Cooperative Organization	No	N/A	N/A	N/A	None	Registration
Fractional Franchise	Yes, Notice of Exemption	No	No	Between July 1 and Dec. 31 of year before year for which exemption will be claimed. May file within same year but effective date of notice will be filing date.	\$450 initially and \$150 for renewal	Registration and Disclosure
Minimum Payment	No	N/A	N/A	N/A	None	Registration and Disclosure
Large Franchisee	Yes, Notice of Exemption	No	No	Between July 1 and Dec. 31 of year before year for which exemption will be claimed. May file within	\$450 initially and \$150 for renewal	Registration and Disclosure

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is required, is it effective upon receipt?	If filing is required, is there a deadline for it?	Required Fee?	Exempt from?
				same year but effective date of notice will be filing date.		
Experienced Franchisee	Yes, Notice of Exemption	No	No	Within 15 days of the sale	\$450	Registration and Disclosure
Insider	Yes, Notice of Exemption	No	No	Within 15 days of the sale	\$450	Registration and Disclosure

HAWAII

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is required, is it effective upon receipt?	If filing is required, is there a deadline for it?	Required Fee?	Exempt from?
Extension, Renewal, Modification, or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration and Disclosure
Exemption by Order	Yes	No	No	Prior to any offer or sale	None	Possibly Registration and Disclosure

ILLINOIS

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is required, is it effective upon receipt?	If filing is required, is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor - \$5 million	Yes, letter to IL Attorney General explaining how the requirements are met, consent to service of process and certification page	Yes	No, but the review is expedited	Prior to any offer or sale	\$500 initially and \$100 for renewals	Registration
Large Franchisor - \$15 million	No	N/A	N/A	N/A	None	Registration
Limited Offer	See the Exemption by Order					
Fractional Franchise	No	N/A	N/A	N/A	None	Registration and Disclosure

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Minimum Payment	No	N/A	N/A	N/A	None	Registration and Disclosure
Large Initial Investment	See the Exemption by Order					
Extension, Renewal, Modification, or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration and Disclosure
Large/Experienced/ Seasoned Franchisee	No	N/A	N/A	N/A	None	Registration
Insider	No	N/A	N/A	N/A	None	Registration
Exemption by Order	Yes, letter describing the basis for the exemption, certification page, and a list showing all IL franchise sales since the most recent FDD submitted with the application	Yes	No	Prior to offer or sale	None	Registration (May be exempt from disclosure if specifically excused from it by the IL Attorney General)

INDIANA

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	No (State will provide a confirmation letter if franchisor submits a cover letter, financial statements, FDD on CD-ROM, and a \$50 fee.)	N/A	N/A	N/A	None	Registration and Disclosure
Limited Offer	No	N/A	N/A	N/A	None	Registration and Disclosure
Exemption by Order	Yes, a letter explaining why an exemption by order should be granted	No	No	Prior to offer or sale	None	Registration and Disclosure

MARYLAND

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, notice of exemption, consent to service of process, financial statements, a representation that the franchisor meets the experience requirement, and franchisor must agree to supply any additional information requested	Yes	No	At least 10 business days before offer or sale	\$250	Registration
Minimum Payment	No	N/A	N/A	N/A	None	Registration
Large Initial Investment	Yes, notice of exemption, consent to service of process, and agree to supply any additional information requested	Yes	No	At least 10 business days before offer or sale	\$250	Registration
Exemption by Order	Yes, a description of the transaction or class of franchises, explain why an exemption is appropriate, and agree to supply any additional information requested	Yes, but not initially	No	Securities Commissioner must be able to review and approve the request, and franchisor must then file a notice of exemption at least 10 business days prior to offer or sale	\$250, but paid only after exemption by order granted, when notice of exemption is filed	Registration

MICHIGAN

Exemption	Any Filing Required?	If required, must filing FDD be filed?	If required, is it filing effective upon receipt?	If required, is there a filing deadline for it?	Required Fee?	Exempt from?
Cooperative Organization	No	N/A	N/A	N/A	None	Registration and Disclosure
Fractional Franchise	No	N/A	N/A	N/A	None	Registration and Disclosure
Minimum Payment	No	N/A	N/A	N/A	None	Registration and Disclosure
Extension, Renewal, Modification, or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration and Disclosure

MINNESOTA

Exemption	Any Filing Required?	If required, must filing FDD be filed?	If required, is it filing effective upon receipt?	If required, is there a filing deadline for it?	Required Fee?	Exempt from?
Limited Offer	Yes, written notice of franchisor's intent to offer or sell a franchise pursuant to this exemption	No	Yes, unless requesting an interpretive opinion	10 business days prior to the sale	Yes, unless requesting an interpretive opinion	Registration
Fractional Franchise	No	N/A	N/A	N/A	None	Registration
Minimum Payment	No	N/A	N/A	N/A	None	Registration and Disclosure
Large Initial Investment	Yes, must file registration application, including financial statements and the names and contact information for all franchisees in MN	Yes, but many disclosure items are not required	Yes, unless requesting an interpretive opinion	N/A	Yes, unless requesting an interpretive opinion	Some disclosure
Exemption by Order	Yes, submit a letter explaining why an exemption by order should be granted	Depends on the circumstances	No	N/A	\$50	Registration

NEW YORK

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor - \$5 million	Yes, exemption application and consent to service of process	No	No	Prior to offer or sale	\$150	Registration (less stringent disclosure requirements though)
Large Franchisor - \$15 million	No	N/A	N/A	N/A	None	Registration (less stringent disclosure requirements though)
Limited Offer	Possibly, the franchisor either needs to be domiciled in NY or file a consent to service of process	No	No	Generally prior to offer or sale, but could be filed after	None	Registration
Fractional Franchise	Yes, written notification of the specific circumstances surrounding the fractional franchise exemption	No	No	Prior to offer or sale	\$150	Registration

NORTH DAKOTA

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, notice of exemption	No	No, effective on day payment enters system (may be a day or so later)	Prior to offer or sale	\$100	Registration
Cooperative Organization	Yes, governing board of corporation must	No	No	Prior to offer or sale	None	Registration

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
	certify to the securities commissioner by resolution that they meet the conditions					
Exemption by Order	Yes, submit a letter explaining why an exemption by order should be granted	No	No	Prior to offer or sale	None	Registration

RHODE ISLAND

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, notice of exemption	Yes	No	Prior to offer or sale	\$360	Registration
Extension, Renewal, Modification, or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration
Experienced Franchisee	No	N/A	N/A	N/A	None	Registration
Insider	No	N/A	N/A	N/A	None	Registration
Exemption by Order	Yes, submit a letter explaining why an exemption by order should be granted	No	No	Prior to offer or sale	None	Registration

SOUTH DAKOTA

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing is it effective upon receipt?	If filing is there a deadline for it?	Required Fee?	Exempt from?
Fractional Franchise	No	N/A	N/A	N/A	None	Registration and Disclosure
Minimum Payment	No	N/A	N/A	N/A	None	Registration and Disclosure
Large Initial Investment	No	N/A	N/A	N/A	None	Registration and

Exemption	Any Filing Required?	If required, filing must be filed?	If required, is it effective upon receipt?	If required, is there a deadline for it?	Required Fee?	Exempt from?
						Disclosure
Large/Experienced Franchisee	No	N/A	N/A	N/A	None	Registration and Disclosure
Insider	No	N/A	N/A	N/A	None	Registration and Disclosure
Exemption by Order	Yes, letter explaining why an exemption by order is warranted	No	No	Prior to offer or sale	None	Registration and Disclosure

VIRGINIA

Exemption	Any Filing Required?	If required, filing must be filed?	If required, is it effective upon receipt?	If required, is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, notice of claim of exemption, financial statements to prove compliance, consent to service of process, an authorizing resolution, a statement agreeing to supply any additional information requested	Yes	No	At least 10 business days prior to offer or sale	\$500	Registration
Fractional Franchise	No	N/A	N/A	N/A	None	Registration and Disclosure
Extension, Renewal, Modification or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration

WASHINGTON

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing required, is it effective upon receipt?	If filing required, is there a deadline for it?	Required Fee?	Exempt from?
Large Franchisor	Yes, must file a notice that you are claiming the exemption which must include audited financial statements	No	No, there is some review and an acknowledgment will be sent saying that they received the filing	Prior to offer or sale	\$100	Registration
Minimum Payment	No	N/A	N/A	N/A	None	Registration
Large/Experienced/ Seasoned Franchisee	No	N/A	N/A	N/A	None	Registration
Insider	No	N/A	N/A	N/A	None	

WISCONSIN

Exemption	Any Filing Required?	If filing required, must FDD be filed?	If filing required, is it effective upon receipt?	If filing required, is there a deadline for it?	Required Fee?	Exempt from?
Cooperative Organization	No	N/A	N/A	N/A	None	Registration and Disclosure
Fractional Franchise	No	N/A	N/A	N/A	None	Registration and Disclosure
Minimum Payment	No	N/A	N/A	N/A	None	Registration
Extension, Renewal, Modification, or Amendment of Franchise Agreement	No	N/A	N/A	N/A	None	Registration
Large/Experienced/Seasoned Franchisee	No	N/A	N/A	N/A	None	Registration
Exemption by Order	Yes, letter explaining why an exemption by order is warranted	No	No	Prior to offer or sale	\$200	Registration

Appendix D

PROPOSED MODEL EXEMPTIONS

TEXT OF PROPOSED STATUTE GRANTING GENERAL AUTHORITY TO EXEMPT [If Required]

The [administrator] may, by regulation or order, and subject to any conditions [the administrator] requires, exempt any offer or sale, including transfer, of a franchise from any or all of the provisions of [the subtitle] if the [administrator] finds that the requirement is not within the purpose of [the subtitle] and not necessary or appropriate in the public interest or for the protection of prospective franchisees.

MODEL EXEMPTIONS

1. Fractional Franchise Exemption

(a) The registration and disclosure provisions of [the subtitle] shall not apply to any offer or sale, including transfer, of a franchise that satisfies the following criteria when the relationship is created:

(i) The franchisee, any of the franchisee's current directors or officers, or any current directors or officers of an affiliate, has more than 2 years of experience in the same type of business; and

(ii) The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

(b) The exemption set forth in §1(a) of this (regulation)(statute) may be claimed only if the franchisor:

(i) Files a Notice of Exemption in the form prescribed by the [administrator] not less than 14 calendar days before the offer or sale of any franchise in this State subject to this exemption;

(ii) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state; and

(iii) Pays the fee provided under this [subtitle] for filing an exemption.

(c) When interpreting the phrase "same type of business" contained in §1(a)(i), the required experience may be in the same business selling competitive goods or services, or in a business that a consumer would reasonably expect to sell the type of goods or services to be distributed under the franchise.

(d) In determining whether a "reasonable basis" exists to anticipate sales volume sufficient to qualify for the exemption, the [administrator] will consider whether both parties are

capable of demonstrating that the franchisee can derive 80% of its total dollar volume in sales independent of the franchise relationship.

(e) By filing a Notice of Exemption under §1(b) of this (regulation)(statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

2. Experienced Franchisor Exemption

(a) The registration provisions of § _____ of [the subtitle] shall not apply to any offer or sale, including transfer, of a franchise when and for as long as the franchisor meets all of the following requirements:

(i) The franchisor has shareholders,' members' or partners' equity of not less than:

(1) \$10,000,000 on a consolidated basis, according to the franchisor's audited financial statements for the immediately preceding fiscal year; or

(2) \$1,000,000, according to the franchisor's financial statements for the immediately preceding fiscal year which may be audited or unaudited, and the franchisor is at least 80 percent owned directly or indirectly by a corporation or entity that has a shareholders,' members' or partners' equity, on a consolidated basis, according to the entity's audited financial statements for the immediately preceding fiscal year, of not less than \$10,000,000, and the 80 percent owner absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor under the franchise agreement (the "80 Percent Owner"); and

(3) In either case, the audited financial statements shall be accompanied by an auditor's standard report that contains an unqualified opinion within the meaning of Statement on Auditing Standards No. 79 issued by The American Institute of Certified Public Accountants and codified at AU §508.07-08, as the same may be amended from time to time (or the equivalent provision of standards of the applicable governing body for accounting principles that are permitted for use by the Securities and Exchange Commission);

(ii) The franchisor or the 80 Percent Owner of the franchisor had at all times during the 5-year period immediately preceding the offer or sale at least 25 operating franchisees conducting substantially the same business as the franchise being offered, each of which was in operation for at least 24 months;

(iii) During the 10-year period immediately preceding the offer or sale, neither the franchisor, a predecessor, an affiliate who induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor's performance, an affiliate who offers franchises under the franchisor's principal trademark nor any of the franchisor's directors, trustees, general partners, principal officers or other individuals who will have management responsibility relating to the sale or operation of franchises was convicted of or pleaded nolo contendere to a felony charge; and

(iv) Neither the franchisor, a predecessor, or an affiliate who induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor's performance, an affiliate who offers franchises under the franchisor's principal

trademark nor any of the franchisor's directors, trustees, general partners, principal officers or other individuals who will have management responsibility relating to the sale or operation of franchises is:

(1) subject to any currently effective order of the Securities and Exchange Commission or the securities administrator of any state denying registration to or revoking or suspending the registration of the person as a securities broker or dealer or investment advisor or is subject to any currently effective order of any national securities association or national securities exchange (as defined in the Securities and Exchange Act of 1934) suspending or expelling the person from membership in the association or exchange; or

(2) subject to a currently effective injunctive or restrictive order, decree or judgment issued during the 10-year period immediately preceding the offer or sale resulting from a pending or concluded action brought by any federal or state public agency or department and relating to the franchise or to a Federal, State, or Canadian franchise, securities, antitrust, trade regulation, or trade practice law.

(b) the exemption set forth in §2(a) of this (regulation)(statute) may be claimed only if the franchisor:

(i) Files a Notice of Exemption in the form prescribed by the [administrator] not less than 14 calendar days before the offer or sale of any franchise in this State subject to this exemption;

(ii) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state;

(iii) Pays the fee required under this [subtitle] for filing an exemption;

(iv) Submits financial statements demonstrating compliance with the conditions set forth in §2(a)(i) of this (regulation)(statute);

(v) Submits a written certification that the franchisor meets all of the conditions set forth in §2 (a)(ii) - (iv) of this (regulation)(statute); and

(vi) Files with the [administrator], in the format the [administrator] shall specify, one copy of the franchisor's current franchise disclosure document prepared under the Federal Trade Commission Franchise Rule, 16 C.F.R. Part 436 (the "FTC Franchise Rule") or the Franchise Registration and Disclosure law of another state.

(c) By filing a Notice of Exemption under §2(a) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

(d) The [administrator] may, by order or written notice, summarily deny, suspend, or revoke an exemption claimed under this (regulation) (statute) or condition the exemption on additional requirements if, in the [administrator]'s discretion, granting the exemption does not serve the public interest or adequately protect prospective franchisees. The [administrator]'s summary denial, suspension or revocation of an exemption under §2(d) of this (regulation) (statute) does not act to summarily deny, suspend, or revoke a franchisor's registration filed under §___ of [the subtitle].

(e) The Notice of Exemption filed under §2(b) of this (regulation) (statute) shall expire after a period of one year. If the franchisor intends to offer or sell under this exemption for additional one year periods, the franchisor shall file a Notice of Exemption and all other documents required under §2(b), and pay the fee required under this [subtitle] for filing an exemption, not less than 14 calendar days before the expiration of each previously filed Notice of Exemption.

3. Sophisticated Purchaser Exemptions

(a) Existing Franchisee

(i) The registration provisions of § _____ of [the subtitle] shall not apply to any offer or sale, including transfer, of a franchise that meets all of the following requirements:

(1) The offer or sale is of an additional franchise (i) to an existing franchisee of the same franchisor, or (ii) to an entity of which one or more of its officers, directors, managing agents or owners has at least a 50 percent interest in an existing franchisee of the same franchisor;

(2) For twenty-four (24) months or more the franchisee, or an officer, director, managing agent or owner with at least a 50 percent interest in the franchisee, has been engaged in a business offering products or services substantially similar to those to be offered by the franchise being sold;

(3) The existing franchisee purchases the franchise from the franchisor in order to operate the business and not for the purpose of resale;

(4) The first sale to the existing franchisee was lawful at the time of the sale; and

(5) The sale under this exemption involves the execution of a franchise agreement that is substantially similar to the first franchise agreement between the franchisor and the existing franchisee.

(ii) The exemption set forth in §3(a)(i) of this (regulation)(statute) may be claimed only if the franchisor:

(1) Reports the sale to the [administrator] on the Notice of Exemption in the form prescribed by the [administrator] within 14 calendar days following the sale;

(2) Obtains from the prospective franchisee a signed acknowledgement verifying the grounds for the exemption;

(3) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state;

(4) Pays the fee required under this [subtitle] for filing an exemption;
and

(5) Delivers to the prospective franchisee at least 14 calendar days before the sale of the franchise a Franchise Disclosure Document prepared under the FTC Franchise Rule or the Franchise Registration and Disclosure law of another state.

(iii) The exemption set forth in §3(a)(i) of this (regulation)(statute) applies only to the registration provisions, and not the disclosure provisions, of the [subtitle].

(iv) By filing a Notice of Exemption under §3(a)(ii) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

(b) Franchisor Insider

(i) The registration and disclosure provisions of § _____ of [the subtitle] shall not apply to any offer, sale, including transfer, of a franchise that meets all of the following requirements:

(1) The offer, sale, or other transfer is made to one or more purchasers having at least a 50% ownership interest in the franchise who, within 60 days of the sale, has been, for at least two years, (i) an officer, director, general partner, individual with management responsibility for the offer and sale or the operation of the franchisor's franchises; or (ii) an owner of at least a 25% interest in the franchisor; and

(2) The purchase of the franchise is in order to operate the business and not for the purpose of resale.

(ii) The exemption set forth in §3(b)(i) of this (regulation)(statute) may be claimed only if the franchisor:

(1) Reports the sale to the [administrator] on the Notice of Exemption form required by the [administrator] within 14 calendar days following the sale;

(2) Obtains from the prospective franchisee a signed acknowledgement verifying the grounds for the exemption;

(3) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state; and

(4) Pays the fee required under this [subtitle] for filing an exemption.

(iii) The exemption set forth in §3(b)(i) of this (regulation)(statute) applies to both the registration and disclosure provisions of [the subtitle].

(iv) By filing a Notice of Exemption under §3(b)(ii) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

(c) Sophisticated Franchisee (Accredited Investor)

(i) The registration provisions of § _____ of [the subtitle] shall not apply to any offer or sale, including transfer, of a franchise that meets all of the following requirements:

(1) Each and every purchaser of the franchise is one of the following:

a. A High Net Worth Individual, defined as a person whose net worth, or joint net worth with that person's spouse, exceeds three million dollars (\$3,000,000) at the time of his or her purchase of the franchise, excluding the value of that person's personal residence, any and all retirement or pension plan accounts or benefits, home furnishings, and automobiles;

b. A High Income Individual, defined as a person whose gross income exceeds five hundred thousand dollars (\$500,000) per year in each of the two most recent years, or whose joint gross income with that person's spouse exceeds seven hundred fifty thousand dollars (\$750,000) per year in each of those years, and who reasonably expects to reach the same income level in the year following the purchase of the franchise;

c. Any entity with shareholders, ' members' or partners' equity exceeding five million dollars (\$5,000,000) according to its most recent financial statements and which has been in business for not less than five (5) years prior to the sale;

d. A trust with total assets exceeding five million dollars (\$5,000,000) according to its most recent financial statements and which has been in business for not less than five (5) years prior to the sale; or

e. Any other entity or a trust in which all of the equity owners are High Net Worth Individuals or High Income Individuals;

(2) The prospective franchisee is represented by legal counsel in the transaction; and

(3) The franchisor reasonably believes immediately before making the offer or sale that the prospective franchisee, either alone or with the prospective franchisee's representative, has sufficient knowledge and experience in the type of business operated under the franchise such that the prospective franchisee is capable of evaluating the merits and risks of the prospective franchise investment.

(ii) The financial statements of the prospective franchisee set forth in §3(c)(i)(1)(c) and §3(c)(i)(1)(d) of this (regulation)(statute) shall be:

(1) As of date not more than 90 calendar days prior to the earlier of either (i) the date on which the prospective purchaser signs any binding franchise or other agreement with the franchisor in connection with the sale of the franchise, or (ii) the date on which the franchisor receives any consideration from the prospective purchaser in connection with the sale of the franchise; and

(2) Prepared under United States generally accepted accounting principles.

(iii) The exemption set forth in §3(c)(i) of this (regulation)(statute) may be claimed only if the franchisor:

(1) Reports the sale to the [administrator] on the Notice of Exemption in the form prescribed by the [administrator] within 14 calendar days following the sale;

(2) Obtains from the prospective franchisee a signed certification verifying the grounds for the exemption;

(3) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state;

(4) Pays the fee required under this [subtitle] for filing an exemption;
and

(5) Delivers to the prospective franchisee at least 14 calendar days before the sale a Franchise Disclosure Document prepared under the FTC Franchise Rule or the Franchise Registration and Disclosure law of another state.

(iv) The exemption set forth in §3(c)(i) of this (regulation)(statute) applies only to the registration provisions, and not the disclosure provisions, of [the subtitle].

(v) By filing a Notice of Exemption under §3(c)(i) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

(d) Substantial Investment

(i) The registration provisions of § _____ of the [subtitle] shall not apply to any offer or sale, including transfer, of a franchise that meets all of the following requirements:

(1) The offer or sale is of a single unit franchise in which the actual minimum initial investment is in excess of two million dollars (\$2,000,000) and does not exceed 20% of the franchisee's net worth, excluding the franchisee's principal residence, furnishings and automobiles for personal use;

(2) The prospective franchisee is represented by legal counsel in the transaction; and

(3) The franchisor reasonably believes immediately before making the offer or sale that the prospective franchisee, either alone or with the prospective franchisee's representative, has sufficient knowledge and experience in the type of business operated under the franchise such that the prospective franchisee is capable of evaluating the merits and risks of the prospective franchise investment.

(ii) The exemption set forth in §3(d)(i) of this (regulation)(statute) may be claimed only if the franchisor:

(1) Reports the sale to the state [administrator] on the Notice of Exemption in the form prescribed by the [administrator] within 14 calendar days following the sale;

(2) Obtains from the prospective franchisee a signed certification verifying the grounds for the exemption;

(3) Files a Consent to Service of Process naming the [administrator] as the franchisor's agent to receive process in this state;

(4) Pays the fee required under this [subtitle] for filing an exemption;
and

(5) Delivers to the prospective franchisee at least 14 calendar days before the sale a Franchise Disclosure Document prepared under the FTC Franchise Rule or the Franchise Registration and Disclosure law of another state.

(iii) The exemption set forth in §3(d)(i) of this (regulation)(statute) applies only to the registration provisions, and not the disclosure provisions, of [the subtitle].

(iv) By filing a Notice of Exemption under §3(d)(i) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

4. Discretionary Exemption

(a) The [registration, or registration and disclosure] provisions of § _____ of [the subtitle] shall not apply to any offer or sale, including transfer, of a franchise when [the administrator], by order or written notice, finds that the offer sale, or other transfer is not one within the purpose of [the subtitle], and that registration of that offer, sale or other transfer is not necessary or appropriate in the public interest or for the protection of prospective investors;

(b) The exemption set forth in §4 of this (regulation)(statute) may be claimed only if the franchisor:

(i) Prior to the filing of a Notice of Exemption, has made a written request to [administrator] with a proposed order of exemption setting forth the basis for the exemption in the form the [administrator] requires, which proposed order of exemption the [administrator] accepts;

(ii) Submits a copy of the [administrator's] signed order of exemption;

(iii) Files a Notice of Exemption in the form prescribed by the [administrator] not less than 14 calendar days before the offer or sale of any franchise in this State subject to this exemption;

(iv) Files a Consent to Service of Process naming the administrator as the franchisor's agent to receive process in this state;

(v) Pays the fee required under this [subtitle] for filing an exemption; and

(vi) If required under the Order of Exemption, files with the [administrator], in the format the [administrator] shall specify, one copy of the franchisor's current franchise disclosure document prepared under the FTC Franchise Rule or the Franchise Registration and Disclosure law of another state.

(c) By filing a Notice of Exemption under §4(b) of this (regulation) (statute), the franchisor agrees to supply any additional information related to the franchise offering that the [administrator] may from time to time reasonably request.

ANNE CONNELLY

Ms. Connelly has been with the Illinois Attorney General's Office for over 28 years beginning as a Consumer Advocate in 1983 and transferring to the Franchise Bureau in 1984. Her duties with the Franchise Bureau include the review of franchise registration and exemption filings, assisting the Bureau Chief with enforcement actions and assisting in training new employees to the Bureau. Ms. Connelly received both her Bachelor and Master of Arts degrees in Political Science and Public Administration from Eastern Illinois University. Prior to receiving her Master's Degree, she was a high school social studies teacher.

PATRICK J. MASLYN

Patrick Maslyn is the Founder of Maslyn Law PLC. Maslyn Law PLC focuses primarily on providing franchise businesses with experienced and cost-effective legal advice. Mr. Maslyn provides counseling to franchisors in all facets of operating and structuring their franchise systems. In particular, he drafts franchise and development agreements and franchise disclosure documents and manages state registration and exemptions, as needed. He also assists franchisors with the negotiation and memorialization of vendor supply agreements and with system compliance issues and the enforcement of franchisee obligations. In 2007, Mr. Maslyn successfully lobbied the Virginia legislature, and served as lead legislation draftsman, for an amendment to the Virginia Retail Franchising Act which provided for exemptions from franchise registration and the escrow and deferral of franchise fees for "insolvent" franchisors.

Mr. Maslyn has served as Chair of the Virginia State Bar's Antitrust, Franchise and Trade Regulation Section. He served on the International Franchise Association's (IFA) Legal Symposium Task Force in 2005 and 2006. In 2007, Mr. Maslyn co-presented a paper on *Contractual and Business Aspects of Structuring Supplier Agreements* at the American Bar Association 30th Annual Forum on Franchising. He was also speaker and moderator on the *Best Practices for Handling Default and Termination for Established Franchisors* at the IFA's 2007 Annual Convention. Mr. Maslyn co-presented a paper on *Franchise Agreement Drafting* at the 2005 IFA Legal Symposium. He has also served as a faculty member for a joint CLE program of the Maryland, Virginia and District of Columbia bar associations entitled *Understanding and Negotiating a Franchise Agreement*. Mr. Maslyn has published articles on franchising in *Franchising World* magazine and the *New York Law Journal*.

Mr. Maslyn received his law degree in 1997 from The George Washington University Law School and he received a Bachelor of Arts degree from Miami University in 1992 with a double major in Diplomacy & Foreign Affairs and Economics. He is a member of the Virginia and Washington, D.C. bars.

TIMOTHY O'BRIEN

Tim O'Brien is the Chief Securities and Franchise Examiner with the Virginia State Corporation Commission's Division of Securities and Retail Franchising. He is responsible for administration of and compliance with the Virginia Retail Franchising Act and the Virginia Securities Act. He began his career with the Securities Division over twenty years ago. From 2000-2006, he was employed as a Senior Public Finance Analyst with the Virginia Department of the Treasury and served as staff to the Virginia Public Building Authority, the Virginia College Building Authority and the Debt Capacity Advisory Committee. He returned to the Securities Division in 2006, and was named Chief Examiner in 2008. Tim received his B.B.A. from James Madison University in 1987.

DENNIS E. WIECZOREK

Dennis E. Wieczorek is a partner with the law firm of DLA Piper US LLP. He is Chair of the Franchise and Distribution practice group at DLA Piper. He has concentrated in U.S. and international franchising, licensing, antitrust and distribution law matters for more than 30 years. He holds a law degree from Duke University, Durham, North Carolina, and a bachelors degree from Washington University, St. Louis, Missouri. He is Past Chair of the American Bar Association Forum on Franchising. He serves as general counsel to the International Franchise Association.

Dennis has written extensively for franchise and other legal and business publications, including the Franchise Law Journal and the Franchise Lawyer (both published by the ABA Forum on Franchising), and has contributed materials to various programs of the International Franchise Association. He is a co-author of "Annual Franchise and Distribution Law Developments 2002" (ABA Press) and "Franchising: A Planning and Sales Compliance Guide" (Commerce Clearing House) and a contributing author of "Fundamentals of Franchising" and "Franchise Desk Book" (both published by ABA Press). From 1990, he has been a member of the Advisory Committee to the North American Securities Administrators Association Franchise and Business Opportunities Project Group. From 1993 to 2006, he was Chair of the Advisory Committee.

Dennis has spoken at numerous seminars and symposia for lawyers, executives, accountants and government regulators, including the Annual Forum of the ABA Forum on Franchising and the International Franchise Association Annual Legal Symposium. He has been selected for inclusion in the publication "An International Who's Who of Franchise Lawyers." He also has been selected as an Illinois Super Lawyer and has been included in the publication "The Best Lawyers in America." He was ranked by Chambers USA as one of several lawyers in the top tier of franchise practitioners.