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EXEMPTION BASED FRANCHISING FOR ESTABLISHED AND START-UP FRANCHISORS

David B. Ramsey
Kaufmann, Gildin & Robbins LLP
New York, NY

Adam Siegelheim
Stark & Stark
Lawrenceville, NJ

Leonard Vines
Greensfelder, Hemker & Gale, P.C.
St. Louis, MO

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I. Introduction¹

The compliance burden of federal and state franchise registration and disclosure laws in the United States typically involves the preparation of a detailed Franchise Disclosure Document (“FDD”) by the franchisor, to be provided to prospective franchisees. The Federal Trade Commission (the “FTC”), and the fourteen states that have their own franchise registration or disclosure laws (the “Registration States”), provide limited exemptions from the process of FDD registration and/or disclosure. The exemption requirements vary significantly between federal and state, and from state to state.

A. The Value of Exemption Based Franchising

There are many practical reasons why a franchisor may wish to take advantage of exemptions from needing to register with state franchise regulators. Since the franchise registration process introduces some delay, restricts sales practices, requires public disclosure of information, and increases costs, many franchisors seek to utilize statutory exemptions to avoid the registration process altogether or to at least partially alleviate registration burdens.

One reason to seek exemption if available, is to avoid the cost of compliance. The administrative burden of filing with each of the Registration States, as well as the annual updates, renewal filings, and responding to comment letters from state regulators on the FDD, and (if applicable) amendment filings, can be a difficult, time consuming, and distracting process that diverts key personnel away from tasks they otherwise could be doing to help the franchise system grow.

Another reason to seek exemption is to avoid “going dark” periods. “Going dark” is what a franchisor must do with respect to sales in a Registration State, if it does not file its renewal application and, if necessary, obtain approval of its FDD prior to the expiration date of the FDD. In such cases, the franchisor must stop selling franchises in that state until it files the application and, in those states where necessary, receives approval from the state regulator for its FDD. Such a halt to sales can delay the completion of deals with franchisees, and can be difficult to coordinate with a franchisor’s different sales channels (their own sales staff, and any franchise sales brokers they may utilize). Therefore, having an exemption from FDD registration can be extremely handy to avoid this problem. (Of course, having an exemption from registration does not eliminate the need for a franchisor to update its FDD - - but it does allow a franchisor to avoid having a specific deadline after which it must halt sales or be in clear violation of franchise law.)

A third reason to seek exemption is to protect the confidentiality of the materials contained in the franchisor’s FDD, which the franchisor may not wish to be made public.

¹ The authors thank Breton H. Permesly for his input on drafts draft of this paper, and Kelsey McGonigle and Kimberly Myers for their assistance with certain parts of this paper.

For example, a franchisor that is just starting out with a very new and different concept, may be particularly sensitive to the possibility that potential competitors would know some of the details about its system which a franchisor must disclose in the FDD, or even the fact that the franchisor has begun selling franchises for the concept. Since a filed FDD is, by its nature, a public document, the franchisor may wish to benefit from an exemption wherever possible, so that it need not file its FDD.

With the above in mind, a franchisor interested in an exemption-based, or partially exemption-based, franchise system should carefully review the exemption requirements of the FTC Rule and each state where its franchise offerings trigger franchise laws, in order to determine whether its franchise sales activities meet any relevant exemption requirements.

B. Goal of this Paper

The goal of this paper is to assist franchisors, both large and small, to navigate and apply the exemptions to the U.S. federal and state franchise laws, in order to help maximize the efficiency of their franchise compliance programs.

C. Background and History of Exemption Based Franchising

1. Federal and State Exemption Laws

First, a bit of history. The first law, rule or regulation specific to franchising was enacted in 1970, with the enactment of the California Franchise Investment Law.² Since then, a myriad of federal and state laws, rules and regulations governing franchising have been enacted. As franchising exploded onto the nationwide economic scene in the 1950's and 1960's, criminals and fraudsters began to invade that scene, selling phantom, non-existent franchises to hapless victims. Tens of thousands of people nationwide collectively lost millions upon millions of dollars through criminal franchise enterprises. Franchise laws were first passed in this context, in order to protect investors by giving them information necessary to make informed investment decisions.

In 1978, the FTC promulgated its original Franchise Disclosure Rule (the "Original Rule"), which went into effect on October 21, 1979. Under the Original Rule, franchisors throughout the nation had to engage in franchise disclosure. However, there was not any federal registration requirement with respect to the FDD that a franchisor used.

Since the 1980s especially, there has been enormous growth and consolidation of both franchisors and of franchisees. Although franchising's roots may be traced to the grant of a single franchise to "Mom and Pop" operators (individual or family entrepreneurs), over the years franchising has evolved so that franchisees range in size

² CALIFORNIA CORPORATIONS CODE, §§ 31000 et seq.

from those individual entrepreneurs, to highly sophisticated corporations with the resources and background necessary to efficiently operate tens, hundreds, or even thousands of franchised units. The FTC and the franchising legal community took notice of the fact that the Original Rule, intended to protect a certain type of consumer, was a “one size fits all” federal regulation that needed amendment in order to recognize that not all franchisees need the same protection and not all franchisors need the same restrictions in order to effectively protect the public.

With this in mind, the FTC began considering amending the Original Rule.³ In July 2007, the FTC made effective the amended Franchise Rule,⁴ and in May 2008, issued a Compliance Guide for such amended rule.⁵ As we will discuss below, the amended FTC Rule, which is still in effect today (and which, for brevity, we will refer to here as the “FTC Rule”), made certain changes to franchise regulation at the federal level, including to the exemptions available to franchisors. The FTC Rule, as amended in 2007, has remained to the present day the federal law applicable to franchisor disclosure of information to prospective franchisees. It carried forward those very few exemptions which the Original Rule provided - - namely, fractional franchises, leased departments, franchise relationships requiring the payment of less than a minimum amount before or within six months after commencement of operation of the franchisee’s business; and, instances where no writing evidences any material term or aspect of the purported franchise relationship. In addition to these, the 2007 amendment added a number of broad exemptions from disclosure not extant under many state franchise registration/disclosure statutes. Furthermore, the 2007 amendment exempted petroleum marketers and resellers already covered by the Petroleum Marketing and Practices Act. Finally, the 2007 amendment added exemptions from disclosure for certain types of “sophisticated purchasers” that parallel those put in place by certain key franchise regulating states: the Large Franchisee Investment Exemption, the Large Franchisee Exemption, and the Insider Exemption, all of which are discussed in detail below.

Like the Original Rule, the amended one does not require any registration of the FDD at a federal level. However, the amended one (the FTC Rule) does not prevent states from adding their own statutory requirements for franchisors. Thus, in addition to the FTC Rule, there continues to exist state-by-state franchise disclosure law, and some states’ laws require franchise registration with the state prior to being permitted to offer or sell franchises in such state. Thus, even if the franchise sales transaction satisfies the criteria for an exemption under the FTC Rule, the analysis is not complete without a review of the relevant state statutes, rules and regulations. The fourteen Registration States each have their own franchise registration requirements: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode

³ See FTC Bureau of Consumer Protection’s August 2004 report, *Disclosure Requirements and Prohibitions Concerning Franchising: Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule*, at page 1.

⁴ Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. Part 436.

⁵ Franchise Rule / 16 C.F.R. Part 436 Compliance Guide, May 2008 (available on the FTC’s website).

Island, South Dakota, Virginia, Washington, and Wisconsin.⁶ Each Registration State has its own exemptions from compliance with its registration/disclosure requirements. In the Registration States, the franchisor cannot proceed with franchise sales unless and until the franchisor has filed the FDD with the state regulator, and, in some of those states, until the state regulator has reviewed and approved the FDD.

It is important to note that even if a franchisor is able to qualify for an exemption on a federal and state level, many of those exemptions are only exemptions from **registration** with the state (by means of some sort of filing), and not an exemption from **disclosure** of the FDD to the franchisee. Franchisors should keep this in mind when determining the extent to which an exemption-based franchising program will truly benefit their bottom line. This subject is discussed in further detail in Section II.C, below.

D. Exemptions from the Perspective of a Start-Up Franchisor

For a franchisor that is just getting started with the expansion of their franchise system, the franchisor will want to map out which states they wish to expand into, and examine the state franchise laws that may apply in those states (if any).

The franchisor will also want to examine how the FTC Rule will apply to them. If the start-up franchisor only has franchise locations in one or more states, none of which is a Registration State, and if the state(s) into which they wish to expand their franchise system are also not Registration State(s), then the franchisor will especially want to scrutinize whether they qualify for an exemption from the FTC Rule, because they may be able to avoid preparing an FDD altogether - - which could translate into very significant time and cost savings.

With this in mind, a start-up franchisor may be able to design their offering in such a way as to fall under an exemption, such as the limited offering exemption (discussed below). They might even be able to design their offering in such a way as to not meet the legal definition of a franchise in the relevant states - - such as by deferring their receipt of any fees from the franchisee for the first six months - - see Sections II.A.2 and II.B.9 (regarding the Minimum Payment Exemption), below.

E. Exemptions from the Perspective of an Established Franchisor

Unlike a start-up franchisor, for a franchisor that already has an established franchise system operating in many states, it is likely that at least one of those states

⁶ Citations by state: California (CAL. CORP. CODE §§ 31000-31156), Hawaii (HAW. REV. STAT. §§ 482E-1-5), Illinois (815 ILL. COMP. STAT. §§ 705/1-705/44), Indiana (IND. CODE § 23-2-2.5), Maryland (MD. CODE ANN., Bus. Reg. §§ 14-201-14-233), Michigan (MICH. COMP. LAWS §§ 445.1501-445.1545), Minnesota (MINN. STAT. §§ 80C.01-80C.22), New York (N.Y. GEN. BUS. LAW §§ 680-695), North Dakota (N.D. CENT. CODE §§ 51-19-01-51-19-17), Rhode Island (R.I. GEN. LAWS §§ 19-28.1-1-19.28.1-34), South Dakota (S.D. CODIFIED LAWS §§ 37-5A-1-37-5A-87), Virginia (VA. CODE ANN. §§ 13.1-557-13.1-574), Washington (WASH. REV. CODE §§ 19.100.010-19.100.940), Wisconsin (Wis. STAT. § 553.21).

will be a Registration State requiring disclosure of an FDD. In addition, the franchisor's system will likely be, for the most part, well established in terms of how the fees work, how much investment is required by the franchisee, etc. Therefore, for an established franchisor, the main focus in looking at exemptions will not likely be avoiding the need to create or update their FDD. Rather, the focus will more likely be finding ways to expedite the process as much as possible - - in particular, to avoid restrictions or stoppages in the franchise sales pipeline. For this type of franchisor in particular, exemptions such as the Large/Seasoned Franchisor exemption (described below) are more likely to be applicable in certain states.

Of course, not all franchisors are either start-up franchisors or large, established franchisors; a huge proportion of franchisors are somewhere in the middle. They will want to look closely at all of the possible exemptions, depending on the particular situation they face. For example, if they are expanding and looking to close a deal with a franchisee in a new state which is a Registration State, but they are not registered in that state, then they will want to look for applicable exemptions that fit the situation – such as the limited offering exemption (which, again, is discussed below).

II. The Four Key Steps In the Exemptions Analysis

To do an analysis of exemptions available to a franchisor, the franchisor must ask four key questions: (1) Do any federal exemptions apply? (2) Do any state exemptions apply? (3) Do the applicable exemptions relieve only registration obligations, or also relieve disclosure obligations? and (4) Even if exemptions are available, does the franchisor prefer to register and disclose anyway? We discuss each of these questions below.

A. Do Any Federal Exemptions Apply?

1. Exclusions under Original FTC Rule Incorporated by Reference in Amended FTC Rule

As noted above, the FTC amended the Original Rule in 2007.⁷ While the amendment that created the current, FTC Rule maintains all four of the exemptions set forth in the Original Rule and adds four new exemptions, one section of the Original Rule that is notably missing from the current FTC Rule is the list of *exclusions* for non-franchise relationships.⁸ Exemptions apply to relationships that meet the definition of a “franchise” under the FTC Rule but are exempt from the rule for public policy reasons. Exclusions, on the other hand, are relationships that are deemed not to constitute a “franchise” under the FTC Rule.

The Original Rule expressly provided that the following relationships were not “franchises” for purposes of the rule: (1) employer-employee relationships and general

⁷ 16 C.F.R. § 436.1(h) (2007).

⁸ For a list of the exclusions in the Original Rule, see 16 C.F.R. § 436.2(a)(4)(i)-(iv).

partnerships; (2) cooperative organizations; (3) testing or certification services; and (4) single trademark licenses.⁹ In the Statement of Basis and Purpose for the Original Rule, the FTC stressed that these four relationships could be perceived as falling within the definition of a “franchise”, but, in fact, are not franchises; therefore, the FTC had expressly excluded them in order to avoid any confusion.¹⁰

Although the exclusions are no longer included in the text of the current, FTC Rule, the FTC made clear in its commentary to the current, FTC Rule that the exclusions are incorporated by reference as a matter of public policy.¹¹ Furthermore, the FTC specifically reaffirmed the four exemptions in the 2007 Statement of Basis and Purpose. The FTC also noted that, while the exclusions serve a valuable consumer education function, it is not appropriate to include them in the Rule itself, unless there is specific evidence of problems interpreting the meaning. Thus, the more appropriate place for the consumer education tools is in the regulations and Compliance Guide. The purpose of the deletion was not to expand the breadth of the rule, but rather to streamline it and to incorporate the exclusion into a more appropriate forum.¹² Therefore, although no longer stated within the FTC Rule, employer-employee relationships and general partnerships, cooperative organizations, testing or certification services and single trademark licenses continue to be excluded from the FTC Rule.¹³

2. Minimum Payment

The Minimum Payment Exemption existed under the Original Rule¹⁴, and continues as an exemption under the current, FTC Rule¹⁵, although the utility of this exemption remains limited. To qualify for the Minimum Payment Exemption, a franchisee may not make required payments or commitments to make required payments in excess of \$570¹⁶ to the franchisor or an affiliate of the franchisor during the first six (6) months of operations.¹⁷

⁹ 16 C.F.R. § 436.2(a)(4)(i)-(iv).

¹⁰ 43 Fed. Reg. 59708.

¹¹ The FTC incorporated the exclusions into the 2007 Statement of Basis and Purpose and 2007 Compliance Guide. See 72 Fed. Reg. 15,445 (Mar. 30, 2007); 2007 Compliance Guide at 15-16.

¹² 72 Fed. Reg. 15,530 (Mar. 30, 2007).

¹³ The single trademark exclusion is an important one. It excludes trademark licensing arrangements in which a single licensee is granted the right to use the trademark. Additionally, it applies to “one-on-one” licensing arrangements of a trademark for purposes of a single licensee who manufactures the trademarked goods according to the licensor’s specifications. For example, a licensor in the clothing industry may license the trademark to the manufacture of the clothing. Furthermore, this exclusion applies to “collateral product” licensing, such as the licensing of a trademark that is well-known in one context (e.g., a soft drink) for use in another (e.g., decorative items embossed with the soft drink logo). Finally, this exclusion can also apply to settlement agreements in trademark infringement litigation in which the licensor grants the infringing party a license to use the trademark for a specified period of time. *Explanations, Laws, Cases, Rulings, New Developments, Regulation, Federal Trade Commission, h. “Single” Trademark Licenses*, BUS. FRANCHISE GUIDE (CCH) ¶ 6217.

¹⁴ In the Original Rule, the exemption was found at 16 C.F.R. § 436.2(a)(3)(iii).

¹⁵ 16 C.F.R. § 436.8(a)(1) (2007).

¹⁶ The FTC Rule requires the FTC to adjust this threshold dollar amount every fourth year based upon the Consumer Price Index for all urban consumers published by the U.S. Department of Labor. Franchise Disclosure Rule, 77 Fed. Reg. 3614 (Jun. 18, 2012). The \$570 threshold took effect on July 1, 2016.

¹⁷ The 6-month rule spans from before the franchisee signs the franchise agreement to six months after the franchisee begins doing business with the public. 16 C.F.R. § 436.2(a)(3)(iii).

A license will not be deemed a franchise under the FTC Rule even if the licensee signs a nonnegotiable, secured promissory note with no acceleration clause promising to pay the licensor an amount in excess of the minimum payment threshold after six months.¹⁸ Notably, the Original Rule did not include the words “*or commitments to make a required payment,*” which had led to some confusion as to whether a commitment to pay the franchisor more than the threshold amount (e.g., pursuant to a contract or promissory note) during the six (6) month period would bar the application of the exemption even if the payment was not actually made until after the expiration of the six (6) month period.¹⁹ The FTC cleared up the ambiguity by including the reference to “*commitments to make required payments*” in the current, FTC Rule. Accordingly, a non-negotiable promissory note signed by the franchisee under which payment is not due until after the expiration of the initial six (6) month period, and which explicitly prohibits early payment or acceleration, is not included in the minimum payment calculation.²⁰

The crux of the Minimum Payment Exemption rests on the definition of “required payment”. The FTC Rule defines the term “required payment” to mean: “all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.” Thus, the FTC Rule expressly incorporates what is often referred to as the “Inventory Exemption” into the definition of “required payment,” by adding the second sentence of the definition.²¹ “Reasonable amounts” means amounts not in excess of what a reasonable businessman would normally purchase for a beginning inventory supply.²² Although the purchase of the goods does not count toward the minimum payment threshold, the amount paid for equipment associated with those goods does.

The FTC suggests that this exemption operates to ensure that the FTC Rule focuses on franchisees who have made a “personally significant monetary investment and who cannot extricate themselves from the unsatisfactory relationship without suffering a financial setback.”²³ In short, the FTC sees no reason to regulate franchise transactions where the franchisee’s personal risk is insignificant. Practically speaking, most franchisees have made a significant monetary investment even if fees paid directly to the franchisor are minimal. For example, franchisees will likely have significant third party expenses associated with the franchise, such as rent or build-out expenses, payments for products, inventories and equipment, the cost of hiring employees and other expenses associated with the startup of a business.

¹⁸ FTC Informal Staff Advisory Op. 98-3, BUS. FRANCHISE GUIDE (CCH) ¶ 6492 (May 4, 1998).

¹⁹ Rochelle Spandorf and Leonard Vines, *Exemption Under the FTC Franchise Rule*, in EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS, ABA FORUM ON FRANCHISING 1, 4-5 (Leslie D. Curran and Beata Krakus, eds., 2017).

²⁰ Informal Staff Advisory Opinion 98-3, May 4, 1998; BUS. FRANCHISE GUIDE (CCH) ¶6492.

²¹ 16 C.F.R. § 436.1(s).

²² Compliance Guide 2007 at 6.

²³ 48 Fed. Reg. 59,704.

What constitutes a required payment is a question of fact that depends on practical necessity. The definition covers more than just an initial franchise fee or royalty payment; it also includes equipment purchases, licensing fees for software, training fees, and purchases of proprietary materials or ingredients. Whether or not the payment is a “practical necessity” depends on whether or not the franchisee has a legitimate and realistic alternative source from which it can purchase the product. The FTC, in its *Red Wing Shoe Co. Advisory Opinion*, clarifies this point, stating that “...payments... will count as ‘required payments’ unless the... services are strictly optional. Such payments cannot be regarded as optional payments under the rule if they are required by contract or as a matter of practical necessity as a condition of obtaining or maintaining the franchise. ... (T)he ‘practical necessity’ standard precludes us from viewing a payment as ‘optional’ unless a dealer has a ‘genuine and realistic’ option to obtain a good or service from alternative sources which are ‘real, legitimate and practical.’”²⁴

If a franchisee makes an optional payment to a third party, and that third party remits payment to the franchisor or an affiliate of the franchisor as a result of the franchisee’s purchases, such payments are deemed to be required payments.²⁵ However, commissions paid by a franchisor to a franchisee do not constitute franchise fees because there is no payment being made from the franchisee to the franchisor.²⁶ *Thueson v. U-Haul International, Inc.*²⁷ provides insight into this concept. In the opinion, the court noted that the franchisee made no payments at all to the franchisor. However, the franchisor did deduct expenses for the dealer’s use of a local telephone line, directory listing, and local computer terminal from the franchisee’s rental commissions.²⁸ These commission deductions were not considered “required payments” and thus were not included in the minimum payment calculation.

The Minimum Payment Exemption can be useful for franchisors that are able and willing to defer franchise fees for the initial six (6) month period and the risk of non-payment in exchange for avoiding the expenses associated with preparing the FDD.²⁹ Furthermore, even when the federal Minimum Payment Exemption is available, most Registration States do not have a comparable provision. South Dakota is the only Registration State that offers a similar exemption.³⁰ As discussed in detail in Section II.B.9 (Minimum Payment), below, some states exempt franchises with nominal fees from registration; however, in calculating the nominal fee, all fees paid by the franchisee

²⁴ FTC Informal Staff Advisory Op., *Red Wind Shoe Co., Inc.*, BUS. FRANCHISE GUIDE (CCH) ¶ 6435 (Jan. 7, 1983).

²⁵ FTC Informal Staff Advisory Op., *Amer. Motor Corp.*, BUS. FRANCHISE GUIDE (CCH) ¶ 6385 (Aug. 22, 1979) (noting that “if a dealer makes optional payments to third parties who, in turn, make a payment to [the franchisor] or an affiliate as a result of the dealer’s purchases, the dealer’s payments would be considered required payments”).

²⁶ Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2 LANDSLIDE 4 (March/April 2010).

²⁷ 2006 Cal. App. LEXIS 1736, at *12 (2006).

²⁸ *Id.*

²⁹ Rochelle Spandorf and Leonard Vines, *Exemption Under the FTC Franchise Rule*, in EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS, ABA FORUM ON FRANCHISING 1, 6 (Leslie D. Curran and Beata Krakus, eds., October 2017).

³⁰ S.D. CODIFIED LAWS § 37-5B-12 (If “the total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee’s business is less than five hundred dollars”, the franchise is exempt from registration).

during the course of the entire year, or in some states, the entire term of the relationship, are so included. Therefore, the six (6) month deferral tactic will not be a viable means of avoiding state registration requirements in most states. Furthermore, as noted in Section II.D.2 (“Possible Applicability of Business Opportunity Laws”) below, arrangements that rely on the Minimum Payment Exemption may still be covered by some state business opportunity laws.

3. Oral Franchises

The FTC Rule exempts oral franchise relationships where there is no written evidence memorializing a franchise arrangement.³¹ The FTC’s rationale for this exemption, as expressed when it was part of the Original Rule, was to avoid the costs of compliance and enforcement of an oral agreement.³² As a practical matter, this operates as a very narrow exemption. Even a handwritten, unsigned note taken by a prospective franchisee, or brochures or promotional materials given by the franchisor to the franchisee, will constitute a sufficient memorialization of a franchise agreement to take it outside the scope of this exemption.³³ Furthermore, even if an arrangement begins as a purely oral agreement but one or more material terms of the agreement are memorialized in writing at a later date, the application of this exemption will be lost.³⁴ Franchisors should be wary of relying on this exemption because a writing evidencing a material term of the agreement can easily be created at any time by an employee or other involved party, thereby invalidating this exemption.³⁵ Finally, a purely oral franchise agreement does not adequately provide protection for the franchisor’s trademark.

4. Leased Departments

The Leased Departments Exemption, which was retained from the Original Rule, operates to relieve from the disclosure requirements under the FTC Rule franchise relationships that function more like a landlord-tenant relationship than a traditional franchisor-franchisee relationship.³⁶ This exemption allows independent retailers to lease space and sell goods or services in a larger retailer’s store without requiring the larger retailer to comply with the FTC disclosure requirements. Examples include hair salons and footwear and jewelry stores that operate in a department store.

³¹ 16 C.F.R. § 436.8(a)(7).

³² 44 Fed. Reg. 49968 (Aug. 21, 1979) (“the anticipated compliance and enforcement costs, in the absence of any written evidence of any material term of the agreement, would be disproportionate to the potential benefits resulting from coverage.”).

³³ 44 Fed. Reg. 49968 (Aug. 21, 1979) (“the exemption will not be available where there is any writing, even if unsigned, with respect to a material term, such as a purchase invoice for goods or equipment”).

³⁴ Rochelle Spandorf and Leonard Vines, *Exemption Under the FTC Franchise Rule*, in EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS, ABA FORUM ON FRANCHISING 1, 14 (Leslie D. Curran and Beata Krakus, eds., October 2017).

³⁵ FTC Informal Staff Advisory Op., *Contemporary Times*, BUS. FRANCHISE GUIDE (CCH) ¶ 6421 (Jun. 18, 1980) (“We question whether any franchisor can reasonably assert that its agreements are and will remain strictly oral in the future, since such a representation would imply an ability to anticipate and prevent the creation of any document recording a material term of the agreement, whether by the franchisor, its advisors, employees or others”).

³⁶ 16 C.F.R. § 436.8(a)(3).

Oftentimes, these arrangements meet the definition of a franchise according to the FTC: (i) rent qualifies as a franchise fee; (ii) the big box retailer will usually impose certain standards and quality control measures; and (iii) the tenant's business is associated with the larger retailer's trademark. Although the trademark prong of the test might not be immediately apparent, the independent retailer is likely to use the larger retailer's trademark in connection with the operation of its business.

Thus, large retailers are exempt from disclosure requirements when they are simply receiving rent from the independent retailer-lessee, and are not otherwise profiting from the arrangement. The FTC commented that under these circumstances, the likelihood of deception is limited and the risk is small because the retail lessee's liability to the franchisor is limited to the rent amount.³⁷ Importantly, however, this exemption is lost if the retailer-tenant is required to (directly or indirectly) purchase goods or services from the retailer-landlord, or from suppliers required or approved by the retailer-landlord.³⁸

5. Petroleum Marketers and Resellers

The FTC Rule added a new exemption which was not available under the Original Rule, and which is applicable to petroleum marketers and resellers that are governed by the Petroleum Marketing Practices Act ("PMPA")³⁹. Although the Original Rule did not expressly exempt relationships governed by the PMPA, the FTC had a long-standing policy of exempting such arrangements⁴⁰, which was formally incorporated into the FTC Rule. The PMPA governs the relationship between gas station franchisors, such as BP and ConocoPhillips, and their retail franchisees. After the PMPA was enacted, the FTC concluded that potential for abuse in the gasoline franchise context was curbed significantly after the enactment of the PMPA, and the application of both the FTC Rule and the PMPA was largely duplicative and unnecessary.⁴¹

In addition to governing the gas station franchise relationship, the FTC clarified in its commentary that this exemption is intended to also apply to other services and products (such as a car wash, convenience mart, or fast food restaurant) sold to the franchisee, *so long as* the sale of such ancillary products or services is governed by the same franchise agreement as the gas station.⁴² The rationale was, that, as a practical matter, it would be impossible to separate the gasoline station component of the franchise from the other services incorporated into a single, unified franchise agreement

³⁷ 72 Fed. Reg. 15,462 (Mar. 30, 2007).

³⁸ 45 Fed. Reg. 51,766 (Aug. 5, 1990).

³⁹ 16 C.F.R. § 436.8(a)(4); 15 U.S.C. §2801.

⁴⁰ 72 Fed. Reg. 15,521 (Mar. 30, 2007) ("in 1980 the Commission granted a petition for an exemption from the Rule filed by several oil jobbers").

⁴¹ 45 Fed. Reg. 51,766 (Aug. 5, 1990) ("the potential for abuse has been sufficiently reduced by the PMPA and DOE [U.S. Department of Energy] Regulations as to render coverage by the franchise rule, as drafted, largely duplicative of other federal regulations").

⁴² 72 Fed. Reg. 15,522 (Mar. 30, 2007).

for disclosure purposes.⁴³ However, if the convenience store or other franchise is sold to a gas station franchisee pursuant to a separate or subsequent franchise agreement, it will fall outside of this exemption.⁴⁴ For example, if a single franchise agreement grants the franchise both the right to operate a gas station and a convenience mart, the franchise will fall under this exemption. If, on the other hand, the license to operate the convenience mart is granted pursuant to a separate franchise agreement than the gas station franchise agreement, the franchise agreement will not be covered by this PMPA exemption, and the petroleum marketer will be required to comply with the FTC Rule, unless another exemption applies.

6. Fractional Franchise

The FTC Rule also retains the exemption for the “fractional franchise” relationship, and adds further clarity and precision to it.⁴⁵ A franchise will be exempt from FTC disclosure requirements if both of the following conditions are satisfied:

- (1) the franchisee, or any of its current directors or officers (or officers or directors of a parent or affiliate) have more than two (2) years of experience in the same type of business as the franchisor; and
- (2) there is a reasonable basis to conclude that the franchised business will not exceed 20% of the franchisee’s total sales during the first year of operation.⁴⁶

Fractional franchise relationships can be established in a variety of situations, but are commonly found in hotels, universities and airports that operate branded food service operations under a license from the brand owner.⁴⁷

The rationale behind the Fractional Franchise Exemption is that the fractional franchisee is essentially adding a new line of products or services to an already existing business.⁴⁸ Accordingly, the franchisee should be familiar with risks and benefits associated with operating the business, and should not be dependent upon the knowledge and expertise of the franchisor. Furthermore, because 80% of the franchisee’s sales are derived from other products and services, the franchisee is not dependent upon the success of the franchised business in order to succeed as a whole.⁴⁹ The rationale is that if the relationship with the franchisor fails, the franchisee will be able to continue operating its existing business and will not fail as a result of the

⁴³ 72 Fed. Reg. 15,522 (Mar. 30, 2007).

⁴⁴ *Id.*

⁴⁵ 16 C.F.R. § 436.8(a)(2).

⁴⁶ 16 C.F.R. § 436.1(g).

⁴⁷ Rochelle Spandorf and Leonard Vines, Exemptions Under the FTC Franchise Rule, in EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS, ABA FORUM ON FRANCHISING 1, 8 (Leslie D. Curran and Beata Krakus, eds., October 2017).

⁴⁸ FTC Informal Staff Advisory Op. 98-6, BUS. FRANCHISE GUIDE (CCH) ¶ 6495 (August 12, 1998); Leonard D. Vines, Beata Krakus, Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 FRANCHISE L.J. 72, 73 (2010).

⁴⁹ FTC Informal Staff Advisory Op. 94-8, BUS. FRANCHISE GUIDE (CCH) ¶ 6464 (December 24, 1964). Leonard D. Vines, Beata Krakus, Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 FRANCHISE L.J. 72, 73 (2010).

termination of the franchise.⁵⁰ Thus, in the fractional franchise context, the inherent risks of a typical franchise scenario that the FTC Rule is designed to protect against are significantly reduced.

a. Two Years of Experience in the Same Line of Business

The fractional franchise requirements are broadly defined, and ultimately require a factual analysis of the franchise relationship in order to determine whether the requirements for a fractional franchise are satisfied. The requisite two years of experience in the “same type” of business has been cautioned as a subjective standard subject to various interpretations. According to the 2007 Compliance Guide, “same line of business” means a business that either (i) sells the same types of goods and services as the franchised business or (ii) would ordinarily be expected to sell the type of goods or services being distributed under the franchise agreement.⁵¹ In the 2007 Statement of Basis and Purpose, the FTC noted that experience in the same industry is not sufficient.⁵² Additionally, it refused to expand the definition to include “complementary goods,” noting that the definition of complementary goods may be very subjective.⁵³ Nevertheless, what constitutes the “same line of business” is not clear-cut and requires a judgment call in which there can be differences of opinion.⁵⁴

The FTC Rule makes clear that the “two years of experience” requirement can be satisfied by an officer or director of the franchise, and this element can be satisfied based upon such officer or director’s experience at a prior place of employment that has no relation to the franchise. Furthermore, the FTC Rule does not set any time limit on how far back a franchisee can look to satisfy the 2 year requirement. Presumably, even if the 2 years of experience occurred 10 years ago, that would nonetheless satisfy the FTC Rule. Note that this is in contrast to some state exemptions that require the officer or director to be employed with the potential franchisee for the 2 year period and set restrictions on the look back period for satisfying the 2 year requirement.⁵⁵

Although a fractional franchise is often located within the franchisee’s existing business (e.g., a Starbucks within a Target), the FTC Rule does not expressly require the fractional franchise to be in the same location as the existing business.⁵⁶ Although the FTC will look at the location as one factor in its analysis, a stand-alone operation is permissible, provided that the fractional franchise is part of the same line of business;⁵⁷

⁵⁰ FTC Informal Staff Advisory Op. 94-8, BUS. FRANCHISE GUIDE (CCH) ¶ 6464 (December 24, 1964). Leonard D. Vines, Beata Krakus, Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 FRANCHISE L.J. 72, 73 (2010).

⁵¹ 2007 Compliance Guide, at p. 18.

⁵² 72 Fed. Reg. 15,548 (Mar. 30, 2007).

⁵³ *Id.* at 15,459.

⁵⁴ Karen B. Satterlee and Leslie D. Curran, *Exemption-Based Franchising: Are You Playing in a Minefield?*, 28 FRANCHISE L.J. 49 (2009).

⁵⁵ California and New York are two examples. For a more detailed look at the state fractional franchise exemptions, see Section II.B.6, *infra*.

⁵⁶ Informal Staff Advisory Op. 99-5 (July 2, 1999) (“It is the nature of the franchisees’ business experience, not the location of its business per se, which may bring the business relationship within the fractional franchise exemption”).

⁵⁷ *Id.* (“[l]ocation is one factor we will consider in determining the similarities and differences between the established

however, some commentators have noted that the Informal Staff Advisory Opinion 99-5 does not specifically state that stand-alone units can qualify for the Fractional Franchise Exemption, only that they are not inherently outside its scope.⁵⁸ Furthermore, some state exemptions, however, require that the fractional franchise be located within the franchisee's existing business.⁵⁹

b. Less than 20% of Total Sales

Once the hurdle regarding the "same line of business" is cleared, the next issue is determining if the sale from the franchised business will constitute less than 20% of the total sales of the potential franchisee's entire business during its first year of operation. The FTC Rule added further clarity to the Original Rule by adding the requirement that there be a "reasonable basis" for the 20% estimate and by limiting the time frame of the test to the first year of operations.⁶⁰ This requirement may come as a surprise to franchisors, who typically use historical data to prepare financial performance representations in order to avoid the risks associated with making future predictions that are not met.⁶¹ The original Statement of Basis and Purpose suggested that the use of "dollar volume" rather than "number of goods and services sold" was the proper metric to use for determining whether the 20% limit had been satisfied.

Ultimately, the burden of proof lies with the franchisor to show that the potential franchise satisfies the Fractional Franchise Exemption. However, in conducting its analysis, the FTC will also consider whether the franchisee estimates that its existing business will continue to bring in 80% or more of its total sales.⁶² Thus, in determining whether the 20% limit is satisfied, it would be prudent for the franchisor to prepare its own projections and analysis and to require the potential franchisee to do the same. That said, the franchisor should avoid sharing its projections with the potential franchisee and should not comment on the franchisee's projections, in order to avoid the risk of making an inadvertent financial performance representation.⁶³

The satisfaction of this element of the fractional franchise analysis is premised on the franchisor's good faith estimate that the first year sales will be under the 20% limit. If, in fact, the first year sales exceed the 20% limit, the Fractional Franchise Exemption will still stand, so long as the franchisor's determination was premised on a good faith estimate and reasonable basis.⁶⁴

business and the new franchised business").

⁵⁸ *Infra*, note 44.

⁵⁹ For example, New York and California. For a more detailed look at the state fractional franchise exemptions, see Section II.B.6, *infra*.

⁶⁰ Compare 16 C.F.R. § 436.8(a)(2) to 16 C.F.R. § 436.2(h) (2007).

⁶¹ FTC Informal Staff Advisory Op. 94-8, BUS. FRANCHISE GUIDE (CCH) ¶ 6464 (December 24, 1964). Leonard D. Vines, Beata Krakus, Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 FRANCHISE L.J. 72, 81 (2010).

⁶² FTC Informal Staff Advisory Op. 96-2, BUS. FRANCHISE GUIDE (CCH) ¶ 6477 (May 20, 1996).

⁶³ FTC Informal Staff Advisory Op. 94-8, BUS. FRANCHISE GUIDE (CCH) ¶ 6464 (December 24, 1964). Leonard D. Vines, Beata Krakus, Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 FRANCHISE L.J. 72, 81 (2010).

⁶⁴ FTC Informal Staff Advisory Op., *Real Amer. Real Estate Corp.*, BUS. FRANCHISE GUIDE (CCH) ¶ 6428 (April 9,

As discussed in more detail in Section II.B.6, below (discussing “Fractional Franchise” in the state exemptions context), while the federal exemption only requires the franchisee’s sales to stay below the 20% threshold for the first year of operation, some states do not place a durational limit on this threshold, thereby making it harder to remain exempt in future years should the fractional franchise increase in size or business.

7. Large Franchise Investment

The FTC Rule contains an exemption for offers and sales of “large franchise investments.” To qualify for this exemption, the “initial investment” must exceed \$1,143,100,⁶⁵ not including the cost of unimproved land or any financing from the franchisor or its affiliate.⁶⁶

The underlying rationale of this exemption is predicated upon the assumption that a prospective franchisee’s ability to make a large investment equates to a certain level of sophistication.⁶⁷ These individuals are presumed to be capable of obtaining material information to evaluate the investment without the assistance of the government.

For this reason, when the prospective franchisee is comprised of an investor group, at least one individual must invest at the required level for the exemption to apply (a husband and wife can be considered a “single individual” since their assets are typically commingled). Similarly, if the prospective franchisee is a corporate entity, one of its individual equity owners must invest at the \$1,143,100 level.⁶⁸ Otherwise, the underlying assumption that the prospective franchisee has a certain level of sophistication is absent when no individual investor is investing at the requisite threshold level.⁶⁹

The “initial investment” is limited to the type of expenses ordinarily contained in Item 7 of the franchisor’s FDD. It does not include anticipated expenses beyond the amounts listed in Item 7 (including anticipated royalty payments and other fees payable to the franchisor over the term of the franchise agreement).⁷⁰

The initial investment threshold is based on the sale of one unit. Even if a franchisee purchases multiple units or executes a development deal, the franchisor cannot rely on the Large Franchise Investment Exemption unless the initial investment for a single unit exceeds \$1,143,100.⁷¹

1982).

⁶⁵ 81 Fed. Reg. 97, 31500 (May 19, 2016). (Initially, the initial investment threshold was \$1,000,000. The FTC Rule requires the FTC to adjust the thresholds for inflation every four years based on the Consumer Price Index.)

⁶⁶ 16 C.F.R. § 436.8(a)(5)(i)

⁶⁷ 2007 Compliance Guide, at p. 12.

⁶⁸ Id.

⁶⁹ Amended Franchise Rule FAQ #3.

⁷⁰ Id., at p. 10.

⁷¹ 2007 Compliance Guide, at p. 11.

Similarly, if the franchisor has various models, the exemption only applies to the model type(s) that exceed the initial investment threshold. A franchisor cannot rely on the Large Franchise Investment Exemption for the sale of any models that do not exceed the one million dollar initial investment.

A franchisor must also have the prospective franchisee sign an acknowledgement that the franchise sale is exempt from the FTC Rule because the prospective franchisee will be making the required initial investment. The acknowledgment must contain the following prescribed statement⁷²:

*The franchise sale is for more than \$1,143,100 - excluding the cost of unimproved land and any financing received from the franchisor or an affiliate - and thus is exempt from the Federal Trade Commission's Franchise Rule disclosure requirements, pursuant to 16 C.F.R. § 436.8(a)(5)(i)*⁷³.

The Franchisor should confirm the then current threshold amount to qualify for this exemption prior to preparing the above acknowledgement statement. The franchisor also has the burden to prove that the acknowledgment was furnished to, and signed by, the prospective franchisee.

a. Conversion Franchises

The Large Franchise Investment Exemption may apply to conversion franchises. The primary distinction is that when evaluating whether the conversion franchise qualifies, the franchisor may consider the prior amount invested by the owner. In this case, the exemption considers the prior owner's investment (even though it was paid to a third party) and not the current value of the business being considered.⁷⁴

b. Franchise Transfers

The Large Franchise Investment Exemption may also apply to franchise transfers. If the prospective franchisee is purchasing the franchise for more than the threshold requirement (currently \$1,143,100) dollars, then the franchisor may rely on the Large Franchise Investment Exemption.⁷⁵ As in the case with a conversion franchise, the fact that the prospective franchisee is paying the monies to a third party, does not prevent the franchisor from relying on the Large Franchise Investment Exemption.

⁷² 16 C.F.R. § 436.8(a)(5)(i).

⁷³ The acknowledgement statement reflects the current threshold of \$1,143,100 based on adjustments to the Consumer Price Index. See also Footnote 65.

⁷⁴ 2007 Compliance Guide, at p. 11.

⁷⁵ Id.

8. Large Franchisee⁷⁶

The FTC Rule exempts the offer and sale of franchises to entities that (1) have been in business at least five years and (2) have a net worth of at least \$5,715,500.⁷⁷ Typical examples of large franchisees include hospitals or universities.

The exemption requires the entity to have been in business for at least five years, but does not require any specific prior business experience in the franchised business' industry.⁷⁸

When determining whether this exemption applies, a franchisor may consider the prior experience and net worth of a prospective franchisee's affiliates and parents.⁷⁹ For example, if a university has formed a new company to purchase a franchised coffee shop, even though the new company has not been in business for five years or does not meet the net worth requirement, the franchisor can still rely on this exemption, by considering the parent university company or its affiliate companies' prior experience and net worth.

9. Insiders

The FTC Rule provides for an exemption to "Insiders," including owners, officers, directors, managers, and general partners of the franchisor.⁸⁰

To meet the exemption, officers, directors, managers or general partners of the franchisor must (1) have at least 2 years recent experience (within 60 days of purchasing the franchise) with the franchisor (as an officer, director, manager or general partner) and (2) purchase a minimum 50% ownership interest in the franchise being offered for sale⁸¹.

For an owner to meet the exemption, the owner must (1) have had 25% or more ownership interest for at least two years (within 60 days of purchasing the franchise) and (2) purchase a minimum 50% ownership interest in the franchise being offered for sale.⁸²

The FTC has opined that the Insiders Exemption is intended for both established and start-up franchise companies. However, the FTC had made a distinction between the experience of a franchise company's owners, officers, directors and general partners and the experience of a franchise company's managers. To qualify for the

⁷⁶ 16. C.F.R. § 436.8(a)(5)(ii).

⁷⁷ Fed. Reg. 97, 31501 (May 19, 2016). (Initially, the initial net worth requirement was \$5,000,000. The FTC Rule requires the FTC to adjust the thresholds for inflation every four years based on the Consumer Price Index.)

⁷⁸ 2007 Compliance Guide, at p. 13.

⁷⁹ Id.

⁸⁰ 16. C.F.R. § 436.8(a)(6).

⁸¹ Id.

⁸² Id.

Insiders Exemption, the manager must have two years of management responsibility for the offer and sale of the franchise company's franchises or the administration of the franchised network. Thus, unless a manager has actually held this specific responsibility with the franchise company for two years, he or she would not qualify for this exemption. Based on this reasoning, the earliest a start-up franchise company could rely on the Insider Exemption for managers would be two years after it began to publicly offer franchises (assuming that it had a manager that was with the franchise company for the entire two year period).⁸³

The FTC noted that "an owner, officer, director or general partner of a start-up may be knowledgeable about franchising and have control over the terms of the contemplated franchise relationship, but a manager without actual experience with the company after it has begun franchising likely would not, and, therefore, would benefit from the disclosures in the FDD."⁸⁴

10. Other Relationships Excluded Under FTC Disclosure Law

a. General Partnerships

Bona fide general partnership relationships are not governed by the FTC Rule.⁸⁵ This exclusion is predicated upon the requirement that all the partners be bona fide general partners. Simply labeling the partnership a "general partnership" is not sufficient. If challenged, the partnership relationships will be examined to confirm that each partner is indeed a true general partner and that the partnership arrangement does not treat one partner as a limited partner for liability protection purposes. Therefore, if the franchisor seeks to enter a general partnership with third parties to operate the business, it must ensure that all parties retain the characteristics (and liability) of a general partner.⁸⁶

b. Employer-Employee Relationship

Bona fide employer-employee relationships are excluded from coverage under the FTC Rule.⁸⁷ The FTC's traditional test of "right to control" will be applied in determining whether an employment relationship exists. Specifically, in determining whether a bona fide employer-employee relationship exists, the following factors will be considered: (1) whether the employer pays a salary or definite sum of money as consideration for the work; (2) whether the employee can be discharged or his employment terminated without liability on the part of the employer; and (3) whether the "employee" must invest money in the business before being "hired".⁸⁸

⁸³ Amended Franchise Rule FAQ#26, available on the FTC website at: <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs> (last visited April 16, 2017).

⁸⁴ Id.

⁸⁵ Id.

⁸⁶ 2007 Compliance Guide, at p. 15

⁸⁷ Id.

⁸⁸ Id.

11. Penalties for Violating FTC Exemption Requirements

One cannot underscore enough the need to be accurate about exemptions. The penalties for violating FTC exemption requirements can be quite significant, although the FTC may or may not elect to pursue them, and conduct that is inadvertent – not intentionally in violation of the FTC Rule – may result in less of a penalty. In terms of potential monetary penalties, the FTC is empowered to seek fines of up to \$16,000 per violation from franchisors and their personnel who engage in violative conduct.⁸⁹ That can easily add up to a significant amount. It is important to understand that these FTC fines are applicable to each violation of law committed by the franchisor. It is also critical to recall that the FTC Rule governs not just the “sale” of franchises but the mere “offer” of franchises. Accordingly, if a franchisor engages in negotiations with 50 prospective franchisees and offers each of those prospects a franchise - - without preparing or disseminating to the prospective franchisees a properly crafted FDD - - then the FTC is authorized to seek fines in the amount of \$800,000 (that is, \$16,000 times 50). And this result pertains notwithstanding the fact that, in this scenario, the errant franchisor did not sell even a single franchise!

Furthermore, the above-mentioned civil penalties are payable over and above the other measures of financial relief which the FTC may seek and obtain, such as restitution, rescission, and damages. Restitution can involve paying large sums to make whole those victimized by statutorily proscribed conduct. Rescission can involve making all franchise agreements ineffective if they were unlawfully entered into. Damages amounts can vary in type and scope, under various legal theories. Note, also, that the powers granted to federal and state franchise administrators are quite broad in terms of investigating a failure to furnish a proper FDD to a franchisee where the franchisor was required to do so.

In addition, the FTC can seek temporary restraining orders and preliminary injunctions against an allegedly errant franchisor, which would prohibit the franchisor from engaging in any further franchise sales activity whatsoever, nationwide, until the restraining order or injunction is lifted.

Finally, while under the FTC Rule, the FTC may not itself institute criminal proceedings for FTC Rule violations, the FTC may refer any instances of criminal wrongdoing uncovered in the course of an FTC investigation to the U.S. Department of Justice for criminal prosecution.

As for lawsuits by private parties (such as aggrieved franchisees) against a franchisor who does not properly rely on an exemption: the courts and the FTC itself have stated that the FTC Rule does not create a private right of action to private parties injured by a franchisor’s failure to properly register or disclose in violation of the FTC

⁸⁹ See 15 U.S.C. § 45(m)(1)(A) and 81 Fed. Reg. 42476 (June 30, 2016) (adjustments to civil penalty amounts).

Rule.⁹⁰ However, aggrieved franchisees are not totally precluded from commencing legal proceedings complaining of FTC Rule violations. In certain states, they can do so, because of state unfair trade practices acts -- what are often called “Little FTC Acts.” Indeed, in states without their own franchise disclosure laws, franchisors and other businesses have seen a recent proliferation of lawsuits alleging FTC Rule violations as the basis of a state law unfair trade practice claim, or “Little FTC Act” claim.⁹¹ “Little FTC Acts” are statutes at the state level which, in essence, provide that any violation of the Federal Trade Commission Act and regulations promulgated thereunder (including the FTC Rule) is deemed to also constitute a violation of the subject “Little FTC Act.” And since these “Little FTC Acts” almost universally confer upon individuals the right to commence legal proceedings for any violation of those laws, citizens in those states featuring “Little FTC Acts” can commence court proceedings against their franchisors complaining of violations of the FTC Rule – including violations of FTC exemption requirements.⁹²

B. Do Any State Exemptions Apply?⁹³

1. Seasoned / Large Franchisor

The Seasoned / Large Franchisor Exemption differs by state. It is most likely to be available to an established franchisor with a high net worth and more than a handful of years of experience, as opposed to a start-up franchisor that has neither of those attributes. The basic reasoning behind the exemption is that franchisors with these attributes have not historically been responsible for severe franchise sales violations, and will have the financial resources and permanence to be held accountable if a sales violation is later alleged.

Nine of the Registration States - - specifically, California, Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, Virginia and Washington - - provide some form of this exemption from registration, which is commonly referred to as the large franchisor, experienced franchisor, or seasoned franchisor exemption.⁹⁴ To

⁹⁰ *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, Final Rule*, 72 Fed. Reg. 15444, 15478, n.350 (Mar. 30, 2007) (providing FTC Statement of Basis and Purpose)(“We note that there is no private right of action to enforce the Franchise Rule.”). For examples of this principle being applied in the context of a franchise lawsuit, see, e.g., *Akers v. Bonifasi*, 629 F. Supp. 1212, 1221-1222 (M.D. Tenn. 1985) (held there is no private right of action under the Federal Trade Commission Act); *Yumilicious Franchise, LLC v. Barrie*, No. 3:13-CV-4841-L, 2015 WL 2359504 (N.D. Tex. May 18, 2015) (no private right of action is available to franchisee for franchisor’s failure to furnish required information under FTC Rule).

⁹¹ Bethany L. Appleby, Robert S. Burstein & John M. Doroghazi, *Causes of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations*, 36 FRANCHISE L.J. 3 (2017).

⁹² For a more in-depth discussion of such penalties, see, e.g., Dale Cantone, Kim A. Lambert and Karen C. Marchiano, *So It Really Is a Franchise: Bringing Non-Compliant Franchisors Into Compliance*, Proceedings of the American Bar Association 37th Annual Forum on Franchising, October 15-17, 2014.

⁹³ For a comprehensive state-by-state summary of all exemptions and exclusions, see Leslie D. Curran & Beata Krakus, eds., *EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS* (ABA Forum on Franchising, 2017).

⁹⁴ CAL. CORP. CODE § 31101; ILL. ADMIN. CODE tit. 14, § 200.202(e); Ind. Code § 23-2-2.5-3(a) - (b); MD. CODE REGS. 02.02.08.10(D); N.Y. GEN. BUS. LAW § 684(2); N.D. CENT. CODE § 51-19-04(1); R.I. GEN. LAWS § 19-28.1-6; 21 VA. ADMIN. CODE § 5-110-75(4); WASH. REV. CODE § 19.100.030(4)(b).

qualify for this exemption, a franchisor (or its parent)⁹⁵ must meet certain minimum net worth and experience requirements, which vary by state. Since, in our experience, this exemption is often a key part of an exemption based franchise compliance program for established franchisors, we attach, as Appendix 1 to this paper, a quick-reference, simplified summary table of the requirements in the various Registration States where the Seasoned / Large Franchisor Exemption is available. For more details on the Seasoned / Large Franchisor Exemption in each Registration State, see Appendix 3.

a. Net Worth

To meet the net worth requirement, a franchisor must have a minimum net worth of \$5,000,000 (for California, Illinois, Indiana, New York⁹⁶ and Washington), \$10,000,000 (for Maryland, North Dakota and Rhode Island), or \$15,000,000 (Virginia). The franchisor's most recent financial statements must evidence the minimum net worth.

If the franchisor cannot satisfy the requisite minimum net worth requirement, the franchisor can rely on its parent's financial statements provided that the franchisor has a net worth of at least \$1,000,000.⁹⁷ If the franchisor uses its parent's audited financials in California, Maryland, Rhode Island and Virginia, the parent will be required to unconditionally guarantee the franchisor's obligations.⁹⁸

b. Experience

With the exception of New York and, in some situations, Illinois, all states that offer the Seasoned / Large Franchisor Exemption also require a franchisor to have a minimum number of years of franchising or operational experience. If the franchisor wishes to rely on any parent entity's experience to meet any franchise exemption, in some states there is the possibility of, and requirements for, relying on a parent entity's experience to satisfy this exemption.

The state statutes vary significantly on the experience requirement for exemption. However, in many states, the requirement is that the franchisor have had at least 25 franchisees conducting business at all times during the five years preceding the offer or sale in a state. (Note, however, that in some states, this experience prong will be satisfied if the franchisor itself conducted the business being franchised during the prior five year period.)

⁹⁵ A "parent" is generally defined as a company that owns at least 80% of the franchisor. See, e.g., CAL. CORP. CODE § 31101.

⁹⁶ New York also has a "jumbo" a.k.a. "super-large" franchisor exemption, which requires the franchisor to have a \$15,000,000 minimum net worth. N.Y. GEN. BUS. LAW § 684(3)(a).

⁹⁷ If the franchisor relies on its parent's financials for New York's jumbo franchisor exemption, the franchisor must have a \$3,000,000 minimum net worth. N.Y. GEN. BUS. LAW § 684(3)(a)(i).

⁹⁸ CAL. CORP. CODE § 31101(a)(3); MD. CODE REGS. 02.02.08.10(D)(1)(a)(ii); R.I. GEN. LAWS § 19-28.1-6(1)(i); VA. REGS. § 5-110-75(4)(a)(1).

While “large franchisor” exemptions may offer considerable benefits, keep in mind certain limitations apply. This is an exemption from registration, but not an exemption from disclosure. At the federal level, the FTC Rule does not provide a similar exemption, which means that disclosure will be required under the FTC Rule even if the state exemption is available. Moreover, even when a franchisor qualifies for a Registration State’s Seasoned / Large Franchisor Exemption, state law still requires pre-sale disclosures, but the state required disclosures may be less extensive than what is required under the FTC Rule (this varies from state to state). Franchisors must also monitor their financial condition, as an exemption may become unavailable if there is a drop in the net worth of the franchisor (or its parent) so that the applicable state’s net worth requirement is no longer met.

2. Sophisticated / Large Franchisee

California, Illinois, Rhode Island, South Dakota, and Washington offer exemptions for “sophisticated” franchisees. Each state employs different criteria to determine who is a “sophisticated” franchisee, based on the franchisee’s experience, net worth, size or a combination of these factors.

California is the only state which offers an exemption based on the experience of the franchisee. To qualify for this exemption, the prospective franchisee must have a minimum of two years’ experience managing the financial and operational aspects of a business that is similar to the business being operated under the franchise agreement. The experience must have occurred within seven years of the sale. This exemption is subject to certain filing requirements in California.

Certain states have exemptions based on the net-worth of the prospective franchisee. The underlying rationale is that if such prospective franchisee has accumulated a certain level of wealth, he, she or it also has the sophistication to evaluate the merits of the investment without the assistance of the government. The minimum net worth requirements vary by state. Two states (Rhode Island and Washington) also offer an exemption based on minimum annual income.

South Dakota and Illinois offer a Sophisticated / Large Franchisee Exemption, also known as a Net Worth Exemption, for entities. The prospective franchisee (or its parent company or any affiliate) must have been in business for a minimum of 5 years and have a minimum net worth of \$5,000,000.⁹⁹

Rhode Island offers a similar exemption for prospective franchisees whose income exceeded \$200,000 for the prior 2 years.

The State of Washington mirrors certain securities laws and provides an exemption to sales to “accredited investors.” To qualify as an “accredited investor,” the prospective franchisee must have a net worth exceeding \$1,000,000 (alone or jointly

⁹⁹ S.D. CODIFIED LAWS § 37-5B-13(2); 815 ILL. COMP. STAT. 705/8(a)(2).

with a spouse) or, if the prospective franchisee is an entity, a net worth exceeding \$5,000,000 and had an income that exceeded \$200,000 (or joint income with his or her spouse that exceeds \$300,000) for the prior 2 years (and have a reasonable expectation of reaching the same income level in the current year).¹⁰⁰

For more detail on the Sophisticated / Large Franchisee Exemption in each Registration State, see Appendix 2.

3. Large Franchise Investment

Illinois, Maryland, Minnesota, South Dakota and Wisconsin have enacted exemptions based on the investment level that a franchisee must make.¹⁰¹ These exemptions are similar to the federal Large Franchise Investment exemption. The amount of the investment is a minimum of \$1,000,000 dollars (or \$750,000 in Maryland).

When relying on this exemption, a franchisor must be very careful and diligent to ensure that it meets any additional conditions (which vary widely) imposed by the particular state to follow the exemption.

South Dakota's additional conditions are very similar to the requirements of the FTC's Large Franchise Investment Exemption in that the investment cannot include the cost of unimproved land or include any franchisor assisted financing. South Dakota also requires the prospective franchisee to sign an acknowledgement verifying the grounds for the exemption.¹⁰² Illinois and Maryland require the franchisor to file for the exemption and provide each state with additional information.¹⁰³

Wisconsin has imposed a subjective additional condition that requires the franchisor to reasonably believe that the prospective franchisee has sufficient knowledge and experience in the type of business being operated under the franchise agreement, and is capable of evaluating the risks and merits of the investment. In addition, the investment amount cannot exceed 20% of the franchisee's net worth.¹⁰⁴

4. Insider

California, Illinois, Rhode Island, South Dakota and Washington provide an Insiders Exemption.¹⁰⁵ These individuals, through their capacity as an "insider" (e.g., officer or director) have obtained firsthand knowledge of the franchisor and the franchise

¹⁰⁰ WASH. REV. CODE § 19.100.030(5).

¹⁰¹ ILL. ADMIN. CODE tit.14, §§ 200.202(c)-(d); MD. REGS. CODE tit. 2 § 2.2.8.10(E); MINN. ADMIN. R. §§ 2860.8100-8300; S.D. FRANCHISE INVESTMENT ACT OF 2008, § 13(1); WIS. STAT. § 553.235.

¹⁰² S.D. FRANCHISE INVESTMENT ACT OF 2008, § 13(1).

¹⁰³ ILL. ADMIN. CODE tit.14, § 200.202(c)-(d); Md. Regs. Code tit. 2 § 2.2.8.10(E).

¹⁰⁴ WIS. STAT. § 553.235.

¹⁰⁵ CAL. CORP. CODE § 31106(a)(2) and § 31109; 815 Ill. Comp. Stat. 705/8(a)(3); R.I. GEN LAWS § 19-28.1-6(3); S.D. FRANCHISE INVESTMENT ACT OF 2008 § 13(4); WASH. REV. CODE § 19.100.030(5) and WASH. ADMIN. CODE § 460-80-108(5).

system and are capable of evaluating the investment without the assistance of the government. Each state varies as to who qualifies as an “insider.” Appendix 3 contains a list of each state’s requirements to qualify for the “insider” exemption.

5. Institutional Franchisee

Hawaii, Illinois, Maryland, Michigan, Minnesota¹⁰⁶, New York, South Dakota, Virginia, Washington and Wisconsin provide exemptions for “institutional franchisees.”¹⁰⁷ Institutional franchisees generally include large institutions such as banks, trust companies, insurance companies and in some cases, broker-dealers.¹⁰⁸

The underlying rationale of these exemptions is similar to the rationale of the federal Large Franchisee Exemption (as discussed in Section II.A.8 of this paper). There is a presumption that the institutional franchisee has the level of sophistication to obtain material information to evaluate the investment without the assistance of the government. The institutional franchisee must be purchasing the franchise for itself or in a fiduciary capacity and not for the purpose of re-sale.

In Maryland and Virginia, a franchisor must comply with each state’s filing requirements to qualify for this exemption.¹⁰⁹

6. Fractional Franchise

States that have enacted a Fractional Franchise Exemption apply the same rationale as the FTC – that is, in the fractional franchise context, the franchisee has sufficient experience to weigh the costs and benefits of entering into the franchise agreement, thereby mitigating the need for state regulation.

The following states have adopted a Fractional Franchise Exemption: California¹¹⁰, Illinois¹¹¹, Indiana¹¹², Michigan¹¹³, Minnesota¹¹⁴, New York¹¹⁵, Oregon¹¹⁶,

¹⁰⁶ Under the Minnesota Franchise Act, the exemption only applies to a “banking organization,” “financial organization” or “insurance corporation” as defined by MINN. STAT. § 345.31.

¹⁰⁷ HAW. REV. STAT. § 482E-4(7); ILL. ADMIN. CODE § 200.202(a); 815 ILL. COMP. STAT. 705; IND. CODE § 23-2-2.5-4; MD. CODE REGS. § 02-08-10(F)(1); MICH. COMP. LAWS § 445.1506(6)(1)(b); MINN. STAT. § 80C.03(c); N.Y. GEN. BUS. LAW § 684(3)(b); S.D. FRANCHISE INVESTMENT ACT 37-5B-14(2); VA. ADMIN. CODE § 5-110-75(4); WASH. ADMIN. CODE § 460-44A-501(1); WASH. REV. CODE § 19.100.030(3); WIS. ADMIN. CODE § 32.05(1)(c)(2).

¹⁰⁸ N.Y. GEN. BUS. LAW § 684(3)(b); VA. ADMIN. CODE § 5-110-75(4); VA. ADMIN. CODE § 5-110-75(4); WASH. REV. CODE § 19.100.030(3).

¹⁰⁹ MD. CODE REGS. § 02-08-10(F)(1) (In Maryland, must file Notice of Exemption 10 business days prior to sale, Consent to Service of Process, Undertaking to provide additional information and pay filing fee); VA. ADMIN. CODE § 5-110-75(4) (In Virginia, application and filing fee must be submitted 10 business days prior to offer or sale).

¹¹⁰ CAL. CORP. CODE § 31108.

¹¹¹ 815 ILL. COMP. STAT. 705/3.

¹¹² IND. CODE § 23-2-2.5-1(a)(3).

¹¹³ MICH. COMP. LAWS § 445.1506(1)(h).

¹¹⁴ MINN. STAT. §80C.03(f); MINN. STAT. § 80C.01, subdiv. 18.

¹¹⁵ N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(2).

¹¹⁶ OR. ADMIN. R. § 441-325-0030(1).

Rhode Island¹¹⁷, South Dakota¹¹⁸, Virginia¹¹⁹, and Wisconsin.¹²⁰ Note that Indiana, Illinois and Virginia specifically exclude fractional franchises from the definition of “franchise,” thereby completely excluding them from coverage by the state franchise act. As a result, fractional franchises in those states are excluded not only from the state disclosure and registration requirements, but also from all other provisions of the state franchise law, including the anti-fraud provisions. Similarly, the South Dakota Franchise Investment Act exempts fractional franchises from the law in its entirety.¹²¹ In the other states, fractional franchises fall within the definition of “franchise,” but the state franchise law provides an exemption from the disclosure and/or registration requirements under the state act; however, the remaining provisions of the state franchise law, including anti-fraud provisions and franchise renewal and termination requirements, still apply to fractional franchises. It is important to note that, even if a franchise meets the definition of a fractional franchise under the Michigan statute, if an FDD has been prepared for the franchisor pursuant to the federal law or another state law, the franchisor must provide the FDD to the prospective franchisee.¹²² Oregon is also unique in that it expressly exempts from disclosure requirements all franchises that are exempt from disclosure under the FTC Rule by referencing the FTC Rule in its statute.¹²³ Note, however, that the Oregon law is a disclosure-only statute and does not impose any registration requirements on franchisors.

While the definitions of “fractional franchise” in the states that offer this exemption are, in many respects, very similar, there are important differences, which can have a meaningful impact on whether or not a franchisor will qualify for this exemption. All of the state exemptions apply the 20% limit, similar to that applied by the FTC Rule; however, states vary as to the durational requirement of this limit. California, New York and Michigan, for example, require the franchise to meet the 20% test *every* year in order to qualify for this exemption, rather than only requiring the 20% test to be satisfied in the first year.¹²⁴ There is some inconsistency among the state laws as to who can satisfy the 2 year experience requirement. For example, Illinois requires an executive officer or director to have the experience, while Minnesota requires it to be a principal officer or director.¹²⁵ Michigan simply states that the experience must be with an individual that is directly responsible for the operation of the franchise or who is

¹¹⁷ R.I. CODE R. 11-7-2:5. Note that Rhode Island’s fractional franchise exemption was imposed pursuant to an exemption by rule or order.

¹¹⁸ S.D. CODIFIED LAWS § 37-5B-12(3).

¹¹⁹ VA. CODE § 13.1-559.

¹²⁰ WIS. STAT. § 553.22.

¹²¹ S.D. CODIFIED LAWS § 37-5B-12(3).

¹²² MICH. COMP. LAWS § 445.1506(2). Michigan’s Franchise Investment Law is unique in that it has a notice-only requirement, pursuant to which franchisors are simply required to make an annual filing (unless an exemption applies). The state does not provide a substantive review of the filing as is the case in registration states. Thus, exemptions may not be as crucial in the state of Michigan as they are in states that impose registration requirements that require a substantive review of the franchise relationship.

¹²³ OR. ADMIN. R. § 441-325-0030.

¹²⁴ CAL. CORP. CODE § 31108(d); N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(b)(4); MICH. COMP. LAWS § 445.1506(h)(ii).

¹²⁵ 815 ILL. COMP. STAT. 705/3; MINN. STAT. § 80C.01, subdiv. 18.

involved in the management of the franchise.¹²⁶ Virginia is unique because it does not impose the 2 year experience requirement.¹²⁷ New York and California impose an additional requirement that the officer or director meeting the experience requirement be employed by the potential franchise for the 2 year period.¹²⁸ Thus, in New York and California, an individual who has been in a similar business to a franchisor for 2 years cannot form a new entity for purposes of entering into the franchise agreement.

Additionally, under New York's and California's laws, the franchised business must be operated out of the *same* location as the existing business.¹²⁹ Similarly, Michigan requires that the fractional franchise become a component of the franchisee's existing business.¹³⁰ Note that the FTC Rule does not impose this requirement.

Another component under some state laws is the issue of control. Again, California and New York impose the additional requirement that the franchisee cannot be controlled by the franchisor.¹³¹

Except in California, New York and Rhode Island, the fractional franchise exemption is automatic and does not require any filing with the state franchise agency. California requires that the franchisor file a notice of exemption and pay a fee prior to the sale of a fractional franchise.¹³² In California, an annual blanket filing covering all fractional franchises that will be sold in that year is sufficient to satisfy the filing requirement. The notice should be submitted between July 1 and December 31 of the year preceding the calendar year in which the sale will occur.¹³³ California also requires that the filing be renewed every year. New York requires a specific notice filing for each fractional franchise, rather than a blanket filing as allowed under California law.¹³⁴ In Rhode Island, the franchisor must file a notice of exemption with the Department of Business Regulation and pay a filing fee in order to perfect the fractional franchise exemption.¹³⁵

When considering the state exemption, it is important to keep in mind that the New York Franchise Sales Act (the "New York Act") is broader and more expansive than any other franchise law. While the definition of "franchise" under most other state franchise laws requires the presence of 3 elements – a trademark, a franchise fee, and a marketing plan prescribed substantially by the franchisor, the New York Act requires

¹²⁶ MICH. COMP. LAWS § 445.1506(h)(iii).

¹²⁷ VA. CODE ANN. § 13.1-559. The Virginia act provides that a franchise does not include a contract or agreement by which a retailer of goods or services is granted 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 (sales under such a plan or system accounting for less than 20 percent of the retailer's gross sales being deemed incidental and ancillary).

¹²⁸ N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(b)(1); CAL. CORP. CODE § 31108(a).

¹²⁹ N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(b)(3); CAL. CORP. CODE § 31108(c).

¹³⁰ MICH. COMP. LAWS § 445.1506(h)(i).

¹³¹ N.Y. COMP. CODES R. & REGS. tit. 13, § 200.10(b)(5); CAL. CORP. CODE § 31108(e).

¹³² CAL. CORP. CODE § 31108(f); the Notice of Exemption Form can be found at CAL. CODE REGS. tit. 10, § 310.101.

¹³³ CAL. CODE REGS. tit. 10, § 310.101.

¹³⁴ N.Y. GEN. BUS. LAW § 200.10(2)(f).

¹³⁵ R.I. CODE R. 11-7-2:5.3; R.I. GEN. LAWS ANN. § 19-28.1-29(c).

only 2 elements: (1) a franchise fee, and (2) either a trademark or a marketing plan prescribed in substantial part by the franchisor.¹³⁶ Thus, a relationship that may not qualify as a franchise in any other state may fall within the definition of franchise under New York law, making an exemption even more important and useful in an overall franchise system.

7. Limited Number of Franchises

The exemption often referred to as the “single franchise” or “isolated sale” exemption, is intended to exempt situations in which a franchisor sells a limited number of franchises in the state. Most states limit the number of franchises sold in the state to one or two in order to qualify for this exemption. The requirements needed to satisfy this exemption vary from state to state. Some states place a prohibition on advertising in the state in order to be eligible for this exemption, while others do not. Although most states do not require any type of filing in order to apply this exemption, Minnesota, and in some instances, as noted below, New York, do require a notice filing with the state. In every state that offers this exemption, the exemption applies only to the state registration requirements; franchisors claiming this exemption must still comply with the applicable state relationship laws as well as the FTC Rule’s disclosure requirements.

The following states offer the Single Franchise or Isolated Sale Exemption: Indiana¹³⁷, Minnesota¹³⁸, New York¹³⁹ and Washington¹⁴⁰. Note, also, that, in Illinois, one of the requirements to obtain an Exemption by Order (discussed in Section II.B.14, below) is that the franchisor intends to sell only one or two franchises in Illinois during the next twelve (12) months.¹⁴¹ Thus, Illinois also offers this exemption by way of its Exemption by Order statutory provision.

The Indiana exemption applies only if the franchisor sells no more than one franchise in the state during any 2 year period.¹⁴² The Minnesota exemption applies when the franchisor makes only 1 sale in the state in a 1 year period; however, additional requirements must also be satisfied. Namely, the franchisor cannot have advertised the sale of the franchise to the general public, the franchise must escrow all franchise fees paid by the franchisee until all pre-opening obligations are satisfied, and the franchisor must provide the state with 10 days’ written notice of its intention to sell a franchise pursuant to this exemption.¹⁴³

Washington, like Minnesota, prohibits the franchisor from advertising in the state in order to claim the Isolated Sale Exemption. Washington also imposes an additional

¹³⁶ N.Y. GEN. BUS. LAW § 681(3). See also David K. Kaufmann, *What Is Franchising? A Look At New York’s Broad Definition*, N.Y. LAW JOURNAL, Feb. 28, 2013, at pp. 3 and 9.

¹³⁷ IND. CODE § 23-2-2.5-3.

¹³⁸ MINN. STAT. § 80C.03, subdiv. (e).

¹³⁹ N.Y. GEN. BUS. LAW § 684(3)(c).

¹⁴⁰ WASH. REV. CODE § 19.100.030(4)(b)(ii).

¹⁴¹ ILL. ADMIN. CODE tit. 14, § 200.201(b).

¹⁴² IND. CODE § 23-2-2.5-3.

¹⁴³ MINN. STAT. § 80C.03, subdiv. (e).

requirement that the franchisee be advised by an attorney or CPA. Washington allows the franchise to sell up to three franchises in the state and still be eligible for the Isolated Sale Exemption.¹⁴⁴ Note, also, that in Washington, this exemption applies only to registration, and there are other requirements (i.e., compliance with disclosure requirements, advertising restrictions, an escrow requirement, and notice to commissioner prior to offer or sale).¹⁴⁵

Under the New York General Business law, an offer directed by the franchisor to not more than two persons is exempt from registration and disclosure¹⁴⁶ if (i) the franchisor does not grant the franchisee the right to offer franchises to others, (ii) a commission or other remuneration is not paid directly or indirectly for soliciting a prospective franchisee in this state, and (iii) the franchisor is domiciled in New York or has filed a consent to service of process on the form prescribed by the New York Department of Law. The franchisor remains subject to the anti-fraud requirements under the New York Act.¹⁴⁷ A franchisor that is domiciled in New York is not required to file notice in order to qualify for this exemption; however, a franchisor that is not domiciled in New York must file its consent to service of process with the New York Department of Law.¹⁴⁸

8. Out of State Franchise

Although there are exceptions, most state statutes typically apply to offers or sales of franchises made in the state, when the business will be located in the state, or when the franchisee is domiciled or resides in the state. The following states have specific exemptions, either by statute or regulation, that address out of state sales: California¹⁴⁹, Hawaii¹⁵⁰, Maryland¹⁵¹, Michigan¹⁵², Minnesota¹⁵³, Rhode Island¹⁵⁴, Virginia¹⁵⁵, and Wisconsin¹⁵⁶. The state laws are not uniform, and some exemptions will only apply when both the franchisee's residence and the business will be located outside of the state. Under California law, the sale of a franchise to a resident of another state is exempt from registration and disclosure, provided that all locations from which sales, leases or other transactions between the franchised business and its customers are made, or goods or services are distributed, are physically located outside the state. However, even if an out of state sale is exempt from registration in a

¹⁴⁴ WASH. REV. CODE. § 19.100.030(4)(b)(ii).

¹⁴⁵ WASH. REV. CODE. § 19.100.030(4)(a).

¹⁴⁶ A franchise that is exempt from registration under New York law is also exempt from disclosure requirements. N.Y. GEN. BUS. LAW § 683(8) (“[a] franchise *which is subject to registration under this article* shall not be sold without first providing to the prospective franchisee, a copy of the offering prospectus, together with a copy of all proposed agreements relating to the sale of the franchise . . .” (emphasis added)).

¹⁴⁷ N.Y. GEN. BUS. LAW § 687.

¹⁴⁸ N.Y. GEN. BUS. LAW § 684(3)(c).

¹⁴⁹ CAL. CORP. CODE § 31105.

¹⁵⁰ HAW. REV. STAT. § 482E-4(a)(4).

¹⁵¹ MD. CODE REGS. 02.02.08.10(B).

¹⁵² MICH. COMP. LAWS § 445.1507a.

¹⁵³ MINN. STAT. § 80C.03(h).

¹⁵⁴ 19 R.I. GEN. LAWS § 19-28.1-7.

¹⁵⁵ VA. CODE § 13.1-559.

¹⁵⁶ WIS. ADMIN. CODE DFI-Sec § 32.05(1)(d).

particular state and regardless of whether the statute exempts disclosure, the franchisor is still required to comply with the FTC Rule.

The following states do not classify out of state sales as exempt; however, the state law definition or applicability section addresses such sales: Illinois¹⁵⁷, Indiana¹⁵⁸, New York¹⁵⁹, North Dakota¹⁶⁰, South Dakota¹⁶¹, Washington¹⁶². The franchise registration laws of Illinois, North Dakota and South Dakota are unique in that they do not apply if the franchisee is an out of state resident, even if the business will be operated in the state. Under the “applicability” provision of the Franchise Disclosure Act of 1987 (the “Illinois Act”), no franchisor may sell or offer to sell a franchise in the state of Illinois if (1) the franchisee is domiciled in the State of Illinois or (2) the offer of the franchise is made or accepted in Illinois and the franchise business is or will be located in Illinois, unless the franchisor has registered the franchise with the Administrator by filing such form of notification and disclosure statement as required under the Illinois Act.¹⁶³ For example, a Missouri franchisor could sell a franchise to a franchisee domiciled in Missouri to operate a franchise business that will be located in Illinois; and, provided, that the offer and sale occurred in Missouri, the franchisor could claim this exemption. If, however, the Missouri franchisor sent the sale documents to the Illinois location for the franchisee to sign, and the franchisee signed the documents in Illinois, then the “sale” would be deemed to have occurred in Illinois and would take the transaction outside the realm of this exemption. The exemption applies only to the registration and disclosure¹⁶⁴ requirement under Section 16 of the Illinois Act, but the franchisor must still comply with the anti-fraud provisions.¹⁶⁵

The Indiana Act applies only to the offer of a franchise if either (a) the franchisee is an Indiana resident, or (b) the franchised business will be operated in Indiana.¹⁶⁶ Thus, if the business will be operated in Indiana, the franchisor must register, even if the franchisee is domiciled elsewhere.

The New York law applies as follows: “An offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state.”¹⁶⁷

¹⁵⁷ 815 ILL. COMP. STAT. 705/10.

¹⁵⁸ IND. CODE § 23-2-2.5-2

¹⁵⁹ N.Y. GEN. BUS. LAW § 681(12).

¹⁶⁰ N.D. CENT. CODE § 51-19-02(14)(b).

¹⁶¹ S.D. CODIFIED LAWS § 37-5B-2.

¹⁶² WASH. REV. CODE § 19.100.020(3).

¹⁶³ 815 ILL. COMP. STAT. 705/10.

¹⁶⁴ Disclosure is only required when the franchisor is required to register under the Illinois Act. Thus, when a registration exemption is applicable, the franchisor is also exempted from the disclosure requirements. 815 ILL. COMP. STAT. 705/5(2).

¹⁶⁵ 815 ILL. COMP. STAT. 705/10 (stating that the franchisor is exempt from the notification and disclosure requirements under Section 16 of the Illinois Act). The fraudulent practices provision is found in Section 6 of the Illinois Act and remains applicable even if the out of state exemption applies.

¹⁶⁶ IND. CODE § 23-2-2.5-2

¹⁶⁷ N.Y. GEN. BUS. LAW § 681(12).

As a side note, although the precise language may differ somewhat, most Registration States do not consider an “offer” being made if it is made through (1) a bona fide newspaper or other publication of general, regular and paid circulation which has had more than two-thirds (2/3) of its circulation outside the state during the past twelve (12) months; or (2) a radio or television program originating outside the state which is received in the state.¹⁶⁸

9. Minimum Payment

California¹⁶⁹, Illinois¹⁷⁰, Maryland,¹⁷¹ Michigan,¹⁷² Minnesota¹⁷³, Rhode Island¹⁷⁴, South Dakota¹⁷⁵, Virginia¹⁷⁶, Washington¹⁷⁷, and Wisconsin¹⁷⁸ offer exemptions based upon the payment of nominal annual franchise fees. This Minimum Payment Exemption (also known as the Nominal Fee Exemption) is similar to the Minimum Payment Exemption under the FTC Rule (see Section II.A.2, above), with one key distinction. In calculating the nominal fee, nearly all of the states look at all fees paid by the franchisee during the course of the entire year, or in some states, during the entire term of the relationship. South Dakota is the only state that includes a 6-month time frame akin to the FTC Rule. South Dakota offers an exemption when the total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee’s business is less than \$500.¹⁷⁹

Some states include a minimum franchise fee in the franchise definition. For example, the third leg of the Illinois Act’s definition of “franchise” is that the person granted the right to engage in such business is required to pay to the franchisor or an affiliate of the franchisor, directly or indirectly, a franchise fee of \$500 or more.¹⁸⁰ Thus, if the franchise fee is less than \$500, the third prong of the franchise definition fails, and the relationship is excluded from coverage by the Illinois Act by virtue of failing to meet the definition of a “franchise.” In other states, the franchise definition includes payment of any franchise fee, no matter how minimal; however, some of those states provide an express exemption. For example, under the Michigan franchise statute, the third leg of the “franchise” definition is that the franchisee is required to pay, directly or indirectly, a franchise fee of any amount.¹⁸¹ However, there is a Nominal Fee Exemption in

¹⁶⁸ See, e.g., IND. CODE § 23-2-2.5-2

¹⁶⁹ CAL. CODE REGS. tit. 10, § 310.011.

¹⁷⁰ ILL. COMP. STAT. § 705/3(1)(c).

¹⁷¹ MD. CODE ANN., BUS. REG. § 14-203(a)(1); MD. CODE REGS. 02.02.08.10(B).

¹⁷² MICH. COMP. LAWS § 445.1506 (1)(c).

¹⁷³ MINN. STAT. § 80C.01 subdiv. 4(4)(c).

¹⁷⁴ R.I. GEN. LAWS §19-28.1-3(7)(i)(B).

¹⁷⁵ S.D. CODIFIED LAWS § 37-5B-12(5).

¹⁷⁶ VA. CODE § 13.1-559.

¹⁷⁷ WASH. REV. CODE § 19.100.030(4)(b)(iii) (exemption from registration).

¹⁷⁸ WIS. ADMIN. CODE DFI-Sec § 32.05(1)(b).

¹⁷⁹ S.D. CODIFIED LAWS § 37-5B-12(5).

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

¹⁸¹ MICH. COMP. LAWS § 445.1502(3)(c).

Michigan, which exempts franchises in which the franchise fee is \$500 or less.¹⁸² The \$100 minimum under the Maryland Franchise Law, for example, applies on an annual basis,¹⁸³ whereas Rhode Island looks at the fee over the entire term of the relationship.¹⁸⁴

The value of the “nominal fee” varies by state. California, Illinois, Michigan, Rhode Island, South Dakota, Virginia and Washington exempt the sale of franchises when the franchise fee on an annual basis does not exceed the sum of \$500. Maryland and Minnesota cap the fee at \$100, while Wisconsin has the highest cap, at \$1,000. California also provides that if, in addition to the \$500 fee, the franchisee is required to pay up to \$1,000 annually “on account of the purchase price or rental of fixtures, equipment or other tangible property to be utilized in, and necessary for, the operation of the franchised business,” and the price or rental so charged does not exceed the cost which would be incurred by the franchisee acquiring the item or items from other persons or in the open market, the franchise can still qualify for the Minimum Payment / Nominal Fee Exemption.¹⁸⁵

Another key to determining whether this exemption applies is the definition of “franchise fee”. Many states include a definition of “franchise fee” and provide specific exclusions from the definition as well. Under the Illinois Act, “franchise fee” is defined as the fee that a franchisee is required to pay directly or indirectly for the right to enter into a business or sell, resell, or distribute goods, services or franchises under an agreement, including, but not limited to, any such payment for goods or services. The following are excluded from the definition of a “franchise fee”:

(a) [T]he payment of a reasonable service charge to the issuer of a credit card by an establishment accepting or honoring such credit card; (b) amounts paid to a trading stamp company by a person issuing trading stamps in connection with the retail sale of merchandise or services; (c) the purchase or agreement to purchase goods for which there is an established market at a bona fide wholesale price; (d) the payment for fixtures necessary to operate the business; (e) the payment of rent which reflects payment for the economic value of the property; or (f) the purchase or agreement to purchase goods for which there is an established market at a bona fide retail price subject to a bona fide commission or compensation plan.¹⁸⁶

Under the Rhode Island Franchise Investment Act, “franchise fee” is defined to exclude (i) payments of a reasonable service charge to the issuer of a credit card by an establishment accepting the credit card; (ii) payments to a trading stamp company by a person issuing trading stamps in connection with a retail sale; or (iii) agreements to purchase at a bona fide wholesale price a reasonable quantity of tangible goods for

¹⁸² MICH. COMP. LAWS § 445.1506(c).

¹⁸³ MD. CODE REGS. § 02.02.08.10(C).

¹⁸⁴ R.I. GEN. LAWS § 19-28.1-3(9).

¹⁸⁵ See CAL. CODE REGS. tit. 10, § 310.011.1.

¹⁸⁶ 815 ILL. COMP. STAT. 705/3(14).

resale.¹⁸⁷ Franchisors are advised to pay particular attention to the definition of “franchise fee” in the state in which they are seeking the exemption, as the definitions from state to state are not uniform.

10. Sale by Judicial Officer

Several states offer an exemption for the sale of a franchise by a sheriff, marshal, receiver, executor or administrator of an estate, trustee in bankruptcy, guardian, conservator and other judicial officers. The statutory definition of “judicial officer” varies by state.

The following states offer the Judicial Officer Exemption: Hawaii¹⁸⁸, Maryland¹⁸⁹, Michigan¹⁹⁰, Minnesota¹⁹¹, Oregon¹⁹², Rhode Island¹⁹³, South Dakota¹⁹⁴, and Washington¹⁹⁵. Oregon, for example, requires that the individual be appointed by court order in order to qualify for this exemption.

As previously noted, under Michigan law, the franchisor will be required to provide an FDD to the franchisee, even if an exemption applies, if the franchisor has an FDD in place for compliance with the FTC Rule or another state’s laws. Similarly, under the Rhode Island statute, the exemption applies only to the registration requirements under the statute; however, the franchisor must still provide the prospective franchisee with an FDD.¹⁹⁶

11. Renewal, Extension, Amendment or Modification

Eleven of the Registration States - - specifically, California, Hawaii, Illinois, Indiana, Maryland, Michigan, New York, North Dakota, Rhode Island, Virginia and Wisconsin - - provide an exemption from registration for the extension or renewal of an existing franchise. This exemption is likely to be applicable in certain cases to start-up franchisors, large nationwide franchisors, and everything in between.

It is important to note that some states have qualifiers, in certain circumstances, for when this exemption may be used. For instance, Illinois requires that, for this exemption to apply, there must be no interruption in the operation of the franchised business by the franchisee.¹⁹⁷ North Dakota requires that, in addition to there being no

¹⁸⁷ R.I. GEN. LAWS § 19-28.1-3(9).

¹⁸⁸ HAW. REV. STAT. § 482E-4(a)(1).

¹⁸⁹ MD. CODE ANN., BUS. REG., § 14-214(b)(1).

¹⁹⁰ MICH. COMP. LAWS § 445.1506(1)(a).

¹⁹¹ MINN. STAT. § 80C.03(b).

¹⁹² OR. ADMIN R. § 441-325-030(5).

¹⁹³ R.I. GEN. LAWS § 19-28.1-6(7).

¹⁹⁴ S.D. CODIFIED LAWS § 37-5B-13(3).

¹⁹⁵ MICH. COMP. LAWS § 445.1506(1)(a).

¹⁹⁶ R.I. GEN. LAWS § 19-28.1-8(b) (providing that all prospective franchisees must receive an FDD unless the franchisor is exempt pursuant to a specified list of exemptions).

¹⁹⁷ 815 ILL. COMP. STAT. 705/7.

interruption in the operation of the business¹⁹⁸, that there be no material change in the franchise relationship.¹⁹⁹ Combining the qualifications in the last two sentences, Hawaii, Michigan, Rhode Island and Wisconsin require both (i) that there be no material interruption in the operation of the franchised business of the franchisee, and (ii) that there be no material change in the franchise relationship, in order for this exemption to apply. Finally, Oregon's state law (although not a Registration State, Oregon has a state franchise law and regulations regarding franchise-related disclosures) has even more restrictive qualifications for this exemption to apply, stating that this exemption only applies to disclosure, but only if there is: (x) no interruption in the operation of the franchise relationship; (y) no material change adverse to the franchisee in the franchise relationship; and (z) no material change adverse to the franchisee in the disclosure information previously furnished to the franchisee.²⁰⁰

So long as the particular state exemption requirements are satisfied, the franchisor can avoid both registration and disclosure in some situations under this exemption, and in others, only registration. See Appendix 3 for a detailed listing of requirements in each Registration State (where applicable) for the exemption applicable to renewal, extension, amendment or modification of a franchise.

12. Sale By Existing Franchisee

One of the most logical exemptions from the registration requirements is for the bona fide sale of a franchise by a franchisee to a third party purchaser. The Registration States all include an express exemption for such sales or transfers. This is an exemption that is likely to be relevant to both smaller, start-up franchisors and larger, more established franchisors, whenever a franchisee is seeking to exit by selling their franchised business to a third party.

For this exemption to be available, the sale by the franchisee cannot be "effected by or through" the franchisor. In this respect, the various states' laws differ as to whether a franchisor's mere right to approve or disapprove the purchaser, or the franchisor's collection of a transfer fee, is enough to make the sale "effected by or through" the franchisor. However, as a general matter, neither of those factors, nor both of those factors together, are typically considered enough to cause the franchisor to lose the exemption.²⁰¹

¹⁹⁸ See N.D. CENTURY CODE § 51-19-02(14)(a)(2)(defines "offer" and "offer to sell" so as to exclude the renewal or extension of an existing franchise, if there is no interruption of the operation of the franchised business by the franchisee).

¹⁹⁹ N.D. CENTURY CODE § 51-19-04(1)(d)(in the case of any material modification of an existing franchise, certain written disclosures to the franchisee are required, plus such additional information as the Commissioner may require by rule or order).

²⁰⁰ OR. ADMIN. R. 441-325-0030(2).

²⁰¹ Note, however, that in North Dakota, while franchisor approval does not disqualify the exemption, one must consult the applicable state's law for nuances in this regard. For example, North Dakota requires commissioner approval in some circumstances before a franchisor can rely on the exemption. (N.D. CENTURY CODE ANN. § 59-19-04.2.) New York requires that the franchisee make certain disclosures in order for this exemption to apply. (N.Y. GEN. BUS. LAW § 684(5).) And California may disqualify the transaction if the franchisor receives all or a substantial part of the purchase price. (CAL. CORP. CODE § 31102)

In addition, in certain states, for this exemption to be available, the sale must be an isolated sale, and/or must be for the franchisee's own account.

13. Sale By Franchisor to Existing Franchisee

In some states, there is an express statutory exemption from registration and/or disclosure for the sale of an additional franchise to a franchisee currently operating the same type of franchised unit. Most of the Registration States (California, Hawaii, Maryland, Michigan, Minnesota, New York, Rhode Island, South Dakota, Virginia, Washington and Wisconsin) provide a registration exemption for sales of additional franchises to existing franchisees.²⁰² See Appendix 3 for more detail on each state's exemption of this type. While this exemption varies by state, there are some common themes: (a) the sale is to the same franchisee (or, in some states, an owner of the existing franchised business); (b) the franchisee has a minimum amount of experience in the financial and operational aspects of the franchised business; and (c) the new franchised business is similar to the one currently operated by the franchisee. If this exemption is used in California or New York, the franchisor must file the required notice of the sale with the state.

14. Miscellaneous Exemptions

In addition to the exemptions explained in detail in the preceding sections of this paper, numerous other exemptions exist at the state level.

a. Exemption by Order

Some states offer an Exemption by Order (sometimes referred to as a "discretionary exemption"), whereby the state agency responsible for enforcing the state's franchise laws is authorized to grant an exemption to a franchisor when the typical risks of a franchise relationship are not at issue.²⁰³ Exemptions by Order are granted on a case-by-case basis and require the franchisor to present the specific details of the proposed franchise relationship and an explanation of why it should be granted an exemption. Typically, an Exemption by Order will be granted when the state agency is able to determine that the franchise law protections are not necessary to protect the public's interest or the potential franchisee.

The following states offer an Exemption by Rule or Order: California²⁰⁴, Hawaii²⁰⁵, Illinois²⁰⁶, Indiana²⁰⁷, Minnesota²⁰⁸, Maryland²⁰⁹, New York²¹⁰, North

²⁰² CAL. CORP. CODE § 31106; HAW. REV. STAT. § 482E-4(a)(6); MD. CODE ANN., BUS. REG. § 14-214(b)(2); MICH. COMP. LAWS § 445.1506(1)(g); MINN. R. 2860.1100, Subpt. 4; N.Y. GEN. BUS. LAW § 684(3)(d); R.I. GEN. LAWS § 19-28.1-6(5); S.D. CODIFIED LAWS § 37-5B-14(1); 21 VA. ADMIN. CODE § 5-110-75(3); WASH. REV. CODE § 19.100.030(6); WIS. ADMIN. CODE SEC. § 32.05(1)(e).

²⁰³ The following states allow an exemption from registration and/or disclosure by administrative order: California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, and Wisconsin.

²⁰⁴ CAL. CORP. CODE § 31100 (exemption by rule only).

²⁰⁵ HAW. REV. STAT. § 482E-4(b).

Dakota²¹¹, Rhode Island²¹², South Dakota²¹³, and Wisconsin²¹⁴. It has been noted that in California and Hawaii, it appears that the statute provides the commissioner authority to grant discretionary exemptions but as a matter of policy these states only offer exemptions through their respective rule making processes.²¹⁵ Although the Virginia statute states that exemptions from registration can be granted by order of the Commission,²¹⁶ there are no specific statutory provisions governing the procedures for obtaining an Exemption by Order.

The process for applying for an Exemption by Order varies by state. In order to obtain an Exemption by Order in Illinois, for example, the franchisor must submit an exemption application that includes (a) a cover letter describing the basis for the exemption, a list of administrative agencies that have issued or denied exemptions, and a statement of how many franchises the franchisor intends to sell in Illinois in the next 12 months; (b) a list identifying all Illinois franchise sales since the most recent FDD submitted with the exemption applicable; (c) an FDD; and (d) a certification page.²¹⁷ Furthermore, Illinois requires the franchisor to obtain a letter from the prospective franchisee's attorney stating that he has explained the franchise to his client, and the client does not object to issuance of the exemption.²¹⁸ Any franchisor that is exempted by order must still provide the prospective franchisee with an FDD disclosure document unless specifically excused from this requirement by the Administrator.²¹⁹

b. No Action Letter

Similar to Exemption by Rule or Order, Washington²²⁰, Illinois²²¹, and Rhode Island²²² have procedures under which a party may request an interpretive opinion as to whether registration is required or a “no-action” letter as to enforcement proceedings. In Washington, the letter must identify the issues at hand, the proposed resolution, and the precedents or other legal authority supporting that position. The Illinois regulations provide that a no action letter does not reach the merits of the issue but merely contains a statement that the Attorney General will not prosecute. The Rhode Island director may issue determinations that it will not institute enforcement proceedings against a

²⁰⁶ 815 ILL. COMP. STAT. 705/9.

²⁰⁷ IND. CODE § 23-2-2.5-5.

²⁰⁸ MINN. STAT. § 80C.03(g).

²⁰⁹ MARYLAND: MD. CODE REGS. 02.02.08.10.

²¹⁰ N.Y. GEN. BUS. LAW § 684(1).

²¹¹ ND. CENT. CODE § 51-19-04.

²¹² R.I. GEN. LAWS § 19-28.1-8(b).

²¹³ S.D. CODIFIED LAWS § 37-5B-15.

²¹⁴ WIS. STAT. § 553.25.

²¹⁵ Alan R. Greenfield, Theresa Leets and Karen B. Satterlee, *Franchise Disclosure Challenges for Large, Sophisticated or Multi-Brand Franchise Companies* ABA 31st ANNUAL FORUM ON FRANCHISING (2014), p.10.

²¹⁶ VA. CODE § 13.1-560.

²¹⁷ ILL. ADMIN. CODE tit. 14, § 200.201(a)(1).

²¹⁸ ILL. ADMIN. CODE tit. 14, § 200.201(b).

²¹⁹ ILL. ADMIN. CODE tit. 14, § 200.201(d).

²²⁰ WASH. ADMIN. CODE § 460-80-060.

²²¹ ILL. ADMIN. CODE tit. 14, § 200.200.

²²² R.I. GEN. LAWS § 19-28.1-27.

person for engaging in certain specified activities where the determination is consistent with purposes fairly intended by the policy and provisions of the Act.

c. Cooperative Organization

Some states exempt certain cooperative organizations from disclosure and/or registration requirements under state franchise law. A cooperative organization usually limits membership to people who directly benefit from the goods or services the organization provides, and members oftentimes own equal shares in the cooperative organization.

California, Michigan, North Dakota and Wisconsin each offer a Cooperative Organization Exemption, and an overview of each state's law is set forth below.

Under California's franchise registration law, nonprofit organizations operated on a cooperative basis by and for independent retailers that provided wholesale goods and services primarily to its retail members are excluded from the definition of "franchise" and therefore exempt from registration. In order to satisfy the exemption requirements, the organization must meet each of the following requirements: (1) member control and ownership is substantially equal; (2) membership is limited to those who will use services furnished by the organization; (3) transfer of ownership is prohibited or limited; (4) members receive no return on capital investment; (5) substantially equal benefits pass to the members on the basis of patronage of the organization; (6) limited liability of the members in the absence of a direct undertaking or authorization of the organization's liabilities by a member; (7) services of the organization are furnished primarily for the use of the members; (8) each member and prospective member is provided with an offering circular; (9) no part of the receipts, income, or profit of the organization is paid to any for-profit entity, except for arms-length payments for necessary goods and services, and members are not required to purchase goods or services from any designated for-profit entity.²²³ Although a qualifying cooperative organization is not a "franchise" under the California Franchise Investment law, one of the qualifications is that the members be provided with a franchise disclosure document, as noted in (8) above. Thus, this exemption applies to registration but not disclosure. No state filings are required.

Michigan's requirements to qualify for the Cooperative Organization Exemption are substantially similar to those of California. However, in Michigan, nonprofit cooperatives are completely exempted from the Michigan franchise statute.²²⁴

North Dakota, too, has a statute with language substantially similar to those of California and Michigan. The North Dakota exemption applies to a nonprofit corporation for the exclusive use and benefit of its own members, and the exemption applies to

²²³ CAL. CORP. CODE. § 31005(c).

²²⁴ MICH. COMP. LAWS 445.1504a.

registration; the franchisor is still subject to disclosure and the fraudulent and prohibited practices provisions of the Act.²²⁵

In addition, the cooperative organization's members must receive the most recent audited financials states of the cooperative, together with its governing documents. The entity is also required to have at least 25 franchises conducting business during the last 5 years or has conducted the business which is the subject of the franchise for the prior 5 years.²²⁶ In order to obtain the exemption, the franchisor must file a certification with the North Dakota Securities Commissioner certifying that it meets each of the required criteria to qualify for this exemption.²²⁷ Wisconsin's exemption simply states that an organization that is operated on a cooperative basis by and for independent retailers and that sells goods at wholesale, or furnishes services primary to its members, is exempt from the registration requirements.²²⁸ It does not include the laundry list of requirements that California, Michigan and North Dakota require.

d. Leased Department

Similar to the FTC Rule, some states offer an exemption to the franchise law for leased departments. This exemption is available when a franchisee is leasing space within a big box retailer, but payments to the primary retailer are limited to rent. Additionally, there must not be any requirement that the franchisee purchase goods or services from the primary retailer in order for this exemption to apply. Again, in some states "leased departments" are excluded from the definition of franchise altogether, thereby taking them outside the ambit of the state's franchise law, while other states provide an explicit exemption from the disclosure and/or registration requirements under the state's franchise act.

Illinois²²⁹, Minnesota²³⁰, Rhode Island²³¹, South Dakota²³², and Virginia²³³ offer Leased Department Exemptions, and a summary of each state's law is set forth below.

Note also, that a leased department may fall outside of the definition of "franchise" under both Hawaii and Michigan's statute if certain conditions are met. One of the three requirements of a "franchise" under the Hawaii and Michigan statutes is that the franchisee is required to pay, directly, or indirectly, a franchise fee.²³⁴ Under the Hawaii statute, the "purchase or lease or agreement to purchase or lease real property necessary to enter into the business or to continue the business under the franchise

²²⁵ N.D. CENT. CODE § 51-19-11.

²²⁶ N.D. ADMIN. CODE 73-03-01-01.

²²⁷ N.D. ADMIN. CODE 73-03-01-01.

²²⁸ WIS. STAT. § 553.22(3).

²²⁹ 815 ILL. COMP. STAT. 705/3(1)(i).

²³⁰ MINN. STAT. § 80C.01(b).

²³¹ R.I. GEN. LAWS § 19-28.1-6(9).

²³² S.D. CODIFIED LAWS § 37-5B-12(4); S.D. CODIFIED LAWS § 37-5B-1(15) (defining "leased department").

²³³ VA. CODE § 13.1-559.

²³⁴ HAW. REV. STAT. § 482E-2; MICH. COMP. LAWS § 445.1503.

agreement at the fair market value” is excluded from the definition of a “franchise fee.”²³⁵ Therefore, as long as the tenant is paying fair market value rent and is not paying any other fees to the franchisor that constitute “franchise fees,” the third element of the “franchise” definition will fail, and the lease department will therefore be excluded from coverage by the state’s franchise statute. The Michigan franchise statute offers an even broader exclusion from the “franchise fee” definition by providing that payments made in connection with the lease of a franchisee on the premises of a franchisor are not “franchisee fees” as long as the franchised business is incidental to the business conducted by the franchisor at such premises.²³⁶ Thus, it is possible that a leased department may fall outside of the “franchise” definition, provided that no other franchisee fees are paid by the franchisee to the franchisor.

Leased departments, like fractional franchises, are expressly excluded from coverage by the Illinois Act.²³⁷ Thus, leased departments are not required to comply with any provisions of the Illinois Act, including the registration, disclosure, and anti-fraud requirements.

Under Minnesota’s franchise statute, any business which is operated under a lease or license on the premises of the lessor or licensor is excluded from the definition of “franchise” provided that such business is incidental to the business conducted by the lessor or licensor on such premises, including, specifically, leased departments.²³⁸ Thus, leased departments are excluded from the definition of “franchise” and not required to abide by any provisions of the Minnesota franchise statute.

The Rhode Island franchise statute offers a Leased Department Exemption provided that the following requirements are met: the offer or sale of rights to a person to sell goods or services within, or adjacent to, a retail establishment as a department or division; provided, that the person is not required to purchase goods or services from the operator of the retail establishment.²³⁹ Note that some exemptions under Rhode Island law apply to both the disclosure and registration requirements under the Rhode Island Act, while others apply only to the registration requirements.²⁴⁰ The Leased Department Exemption applies only to the registration requirements. Thus, a franchisor utilizing this exemption would still be required to provide the prospective franchisee with the FDD and would be subject to the anti-fraud requirements under the Rhode Island statute.

Under the South Dakota franchise statute, leased departments are exempt from the applicability of entire statute.²⁴¹ “Leased department” is defined as any arrangement whereby a retailer licenses or otherwise permits a seller to conduct business from the

²³⁵ *Id.*

²³⁶ MICH. COMP. LAWS § 445.1503(1)(d).

²³⁷ 815 ILL. COMP. STAT. 705/3(1)(i).

²³⁸ MINN. STAT. § 80C.01(b).

²³⁹ R.I. GEN. LAWS § 19-28.1-6(9).

²⁴⁰ R.I. GEN. LAWS § 19-28.1-8(b).

²⁴¹ S.D. CODIFIED LAWS § 37-5B-12(4); S.D. CODIFIED LAWS § 37-5B-1(15) (defining “leased department”).

retailer's location where the seller purchases no goods, services, or commodities directly or indirectly from the retailer, a person the retailer requires the seller to do business with, or a retailer-affiliate if the retailer advises the seller to do business with the affiliate.

Under the Virginia franchise statute, a "franchise" does not include a contract or agreement by which a retailer of goods or services is granted the right to sell goods or services within, or appurtenant to, a retail business establishment as a department or division thereof, provided such retailer is not required to purchase such goods or services from the operator of such establishment.²⁴² Thus, leased departments do not constitute "franchises" under Virginia law, and are therefore excluded from coverage by Virginia's franchise statute.

e. Securities

In Minnesota, South Dakota, Washington, and Wisconsin, offers and sales of franchises that constitute securities are exempt from registration and disclosure.²⁴³

f. Other Exemptions

There are additional exemptions that some states offer, but, as a practical matter, they are of limited value to traditional franchisors, particularly in those cases where there is no corresponding exemption under the FTC Rule. Although not all-inclusive, the following is a list of some of the other exemptions that may be offered by one or more states:

- (1) sales to a bank, trust company or insurance company;²⁴⁴
- (2) distributors;²⁴⁵
- (3) bank credit card plans;²⁴⁶
- (4) cable telecommunications;²⁴⁷
- (5) franchises governed by the PMPA and state petroleum laws;²⁴⁸

²⁴² VA. CODE § 13.1-559.

²⁴³ See, e.g., S.D. CODIFIED LAWS 27-5A-14(3); WASH. REV. CODE § 19.100.030(5) (sale to an accredited investor is exempt from registration; see Section II.B.2 ("Sophisticated / Large Franchisee"), *supra*, for further detail); WIS. ADMIN. CODE DFI-Sec § 32.05(1)(f).

²⁴⁴ E.g., 815 ILL. COMP. STAT. 705/8(b); MICH. COMP. LAWS § 445.1506(1)(b); N.Y. GEN. BUS. LAW § 684(3)(b); S.D. CODIFIED LAWS § 37-5B-14(2); 21 VA. ADMIN. CODE § 5-110-75(5)(b).

²⁴⁵ DEL. CODE ANN. tit. 6 § 2551(2)(b).

²⁴⁶ E.g., CAL. CORP. CODE § 31103; N.Y. GEN. BUS. LAW § 684(6).

²⁴⁷ WIS. ADMIN. CODE DFI-Sec § 32.05(1)(a).

²⁴⁸ E.g., ARK. CODE ANN. 4-72-203; CAL. CORP. CODE § 31104; IOWA CODE 523H.1(3)(c), 537A.10(1)(c)(3); MINN. STAT. 80C.01; N.Y. GEN. BUS. LAW § 681(3)(b); R.I. GEN. LAWS § 6-50-9.

- (6) sale of motor vehicle dealership;²⁴⁹
- (7) franchise trade show promoters;²⁵⁰
- (8) internet offers;²⁵¹
- (9) door to door sales dealerships;²⁵²
- (10) farm machinery and vehicle franchises;²⁵³ and
- (11) insurance agency relationships.²⁵⁴

C. Do the Applicable Exemptions Relieve Only Registration Obligations, or Also Relieve Disclosure Obligations?

The reliance on a claimed exemption enables a franchisor to avoid a state's registration process. However, it does not necessarily enable a franchisor to avoid disclosure requirements. To avoid disclosure obligations, the franchisor must examine whether it must disclose under (1) federal law and (2) applicable state law.

As a starting point, a franchisor must determine whether it is able to rely on any exemptions from the FTC Rule. If there is no exemption from the federal disclosure laws, then the franchisor must always disclose under federal law (regardless of whether the franchisor qualifies for any state registration exemptions).

If the franchisor can rely on an exemption from the federal disclosure laws, the next step is to determine whether the franchisor can rely on a state exemption that does not require some form of disclosure. Again, a state exemption may relieve the franchisor from the registration process but NOT the disclosure requirements.

Large Franchisor Exemption – Many states that offer a Large Franchisor Exemption still require the franchisor to comply with their disclosure laws. In certain instances, the disclosure laws may be less extensive (as detailed in Appendix 3).

High Net Worth Franchisees – Generally, if a franchisor is relying on a Large Franchisee Exemption, then it does not need to comply with state disclosure laws.

²⁴⁹ *E.g.*, HAW. REV. STAT. § 482E-4(a) (3); WASH. REV. CODE § 19.100.010(6)(b)(iii).

²⁵⁰ ILL. ADMIN. CODE tit. 14, § 200.202(d).

²⁵¹ *E.g.*, CAL. CODE REGS. tit. 10, § 310.100.3; MD. CODE REGS. 02.02.08; N.Y. COMP. CODES R. & REGS. tit. 13, § 200.12; R.I. GEN. LAWS §19-28.1-6.10.

²⁵² ARK. CODE ANN. § 4-72-202(1)(B); R.I. GEN. LAWS § 6-50-9; WIS. STAT. § 135.07.

²⁵³ S.D. CODIFIED LAWS § 37-5A-11.

²⁵⁴ R.I. GEN. LAWS § 6-50-9; WIS. STAT. § 135.07.

Seasoned or Experienced Franchisees – California is the sole state that offers this exemption. If a franchisor qualifies for this particular exemption, it is not subject to California’s disclosure laws.²⁵⁵

Substantial Investment – Many states that offer a Substantial Investment Exemption still require the franchisor to comply with its disclosure laws. The only exception is South Dakota.²⁵⁶

Insiders – Generally, if a franchisor is relying on an Insider Exemption, then it does not need to comply with state disclosure laws. The only exception is California, which still requires disclosure.²⁵⁷

Institutional Franchisees – Most states that offer an Institutional Franchisee Exemption do not require the franchisor to comply with their disclosure laws. The exceptions are Maryland, South Dakota, and Virginia.²⁵⁸

D. Even If Exemptions Apply, When Would the Franchisor Want to Register and Disclose Anyway?

1. Why a Franchisor Might Opt Not to Take Advantage of Available Exemptions

Despite all that we have stated about the benefits of exemption-based franchising, there are reasons why some franchisors, in some circumstances, might opt not to take advantage of an exemption even when it is available.

One reason is that providing an FDD to a prospective franchisee may be a tool to help defend against fraud claims. An FDD is a lengthy, detailed document in which the franchisor provides a great deal of valuable information to the franchisee, in plain English (as required by law), and receives a signed receipt from the franchisee, confirming that they received the information (as required by law). If the franchisee later claims that they were not aware of certain costs, fees, responsibilities, or restrictions upon them, the FDD serves as “Exhibit A” in the litigation, where the franchisor can point to clear, written statements it made to the franchisee about those types of things.

In addition, some franchisors find that the process of preparing, providing, and retaining receipts for FDDs, benefits the franchisor in that it provides an organized, structured process for the franchisor to keep track of what it has disclosed and to whom. Furthermore, it provides an opportunity to do an annual “check-up” of its disclosures in the FDD. For example, items that may well change as time goes by, and hence, need to be updated in the FDD, include: company history (Item 1), officers and

²⁵⁵ CAL. CORP. CODE § 31106(a)(1) and 31106(b); CAL. CORP. CODE §31109.

²⁵⁶ S.D. FRANCHISE INVESTMENT ACT §13(1);

²⁵⁷ CAL. CORP. CODE § 31106(a)(2) and § 31109.

²⁵⁸ MD. CODE REGS. § 02-08-10(F)(1); S.D. FRANCHISE INVESTMENT ACT 37-5B-14(2); VA. ADMIN. CODE § 5-110-75(4).

directors (Item 2); initial and other fees (Items 5 and 6); total initial investment (Item 7), revenues from required franchisee purchases (Item 8); financing terms (Item 10); advertising and computer costs (Item 10); trademarks (Item 13); financial performance representations (Item 19); and changes in the contracts that the franchisor requires the franchisee to sign.

Furthermore, going through annual FDD filings prompts a franchisor to conduct the imperative exercise of regularly reviewing the provisions of the franchisor's form of franchise agreement and other contracts with franchisees, in light of best practices in the industry. Over time, doing so is crucial to avoid contract terms that are obsolete or out of touch with the realities of the franchisor's industry. Along these lines, it is also crucial to modify or add legal provisions in the agreements in light of changing laws, and going through the annual FDD updating process prompts the franchisor to do that as well. The same goes for modifying or adding business points to the franchisor's standard terms in light of changing competitive circumstances in the industry.

In addition, some franchisees, particularly the more sophisticated ones and those represented by an attorney, may be familiar with disclosure documents and may expect to receive one. The FDD contains valuable information that assists a prospect in making an investment decision, and provides a great deal of due diligence information that many franchisees would want to see, whether the franchisor is obligated to provide it or not.

Finally, some franchisors may not want to take the risk of getting it wrong about whether or not they are exempt from having to provide an FDD to a franchisee. In that case, the franchisor may wish to act as if it did not qualify for one or more exemptions, just to be on the safe side. Whether a prospective franchisee should be given an FDD is usually a judgment call, and the burden of proof as to whether a franchisee was exempt at the time of the sale typically falls on the franchisor. By utilizing a traditional franchise disclosure program, a franchisor can help minimize these risks.

2. Possible Applicability of Business Opportunity Laws

Twenty-six states²⁵⁹ have laws governing the sale of "business opportunities." A

²⁵⁹ Each of the following states has a business opportunity law in place: Alabama, Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, and New Hampshire. Such laws, though they generally reference "business opportunity" in their name, can also go under other names, such as referencing "seller-assisted marketing plans" or "distributorships."

Citations to these statutes are as follows: *Alabama Deceptive Trade Practices Act*, CODE OF ALABAMA, Title 8, Ch. 19, §§ 19-5(20); *Alaska Sale of Business Opportunities Laws*, ALASKA STATUTES § 45.66.010 *et seq.*; ARIZONA REV. STAT. §§ 44-1271 *et seq.*; *California Contracts for Seller Assisted Marketing Plans Law*, CALIFORNIA CIVIL CODE, Div. 3, Part 4, Title 2.7, §§ 1812.200 *et seq.*; *Connecticut Business Opportunity Investment Act*, CONNECTICUT GENERAL STATUTES, Title 36, Ch.662a, §§ 36-503 *et seq.*; *Florida Sale of Business Opportunities Act*, FLORIDA STATUTES, Ch. 559, §§ 559.80 *et seq.*; *Georgia Business Opportunity Sales Law*, OFF. CODE OF GEORGIA ANN., Title 10, Ch. 1, Art. 15, Part 3, §§ 10-1-410 *et seq.*; *Illinois Business Opportunity Sales Law*, ILLINOIS COMPILED STATUTES, Ch. 815, § 602/5 *et seq.*; *Indiana Business Opportunity Transactions Law*, INDIANA CODE, Title 24, Art. 5, Ch. 8, §§ 1 *et seq.*; *Iowa Business Opportunity Promotions Law*, IOWA CODE, Title XX, Ch. 523B, §§ 523B.1 *et seq.*; *Kentucky Sale of Business Opportunities Law*, KENTUCKY REV. STAT., Title XXIX, Ch. 367, §§ 367.801 *et seq.*; *Louisiana Business*

franchisor must be aware of these laws, especially outside of the 14 Registration States, because these laws can require their own forms of registration and/or disclosure to franchisees.

Most state business opportunity laws only tangentially cover the offer and sale of franchises. These laws were enacted in response to a wave of business opportunity fraud which became a widespread problem in the United States in the 1960's and 70's. Such frauds, many of which targeted those confined at home by virtue of illness, disability or old age, fleeced tens of thousands of individuals out of millions of dollars, promising vast rewards if the business opportunity purchaser did things such as stuffing envelopes at home or processing medical billing claims from home - - the type of business opportunities that are sometimes referred to as "seller-assisted marketing plans."

While most business opportunity laws do not expressly regulate franchising, because of the way "business opportunity" is broadly defined, these laws can technically encompass franchises within their scope. Such laws require registration and disclosure in much the same way as state franchise registration and disclosure statutes, but the specific disclosure requirements differ from the franchise-specific statutes. Severe penalties can attach to noncompliance. Therefore, it is important for a franchisor to be aware of these state laws. Where an exemption applies from state business opportunity laws, the exemption can save a franchisor the administrative burden of complying with this different registration and disclosure regime. Most franchisors qualify for statutory exemptions from business opportunity law coverage under one or both of the following categories:

- (1) The franchisor's compliance with federal or state franchise disclosure requirements. In some states there is an exemption stated in the business opportunity law for franchisors that comply with the FTC Rule.²⁶⁰

Opportunity Sellers and Agents Law, LOUISIANA REV. ST., Title 51, Ch. 21, §§ 51:1821 *et seq.*; *Maine Regulations of the Sale of Business Opportunities Law*, MAINE REV. STAT. ANN., Title 32, Ch. 69-B, §§ 4691 *et seq.*; *Maryland Business Opportunity Sales Act*, ANN. CODE OF MARYLAND, BUSINESS REGULATION, Title 14, §§ 14-101 *et seq.*; *Michigan Business Opportunities Law incorporated into Michigan Consumer Protection Act*, MICHIGAN COMPILED LAWS, §§ 445.901 *et seq.*; MINNESOTA STATUTES, Chapter 80C, § 80C.01(c); *Nebraska Seller-Assisted Marketing Plan Act*, REV. STAT. OF NEBRASKA, Ch. 59, Art. 17, §§ 59-1701 *et seq.*; *New Hampshire Distributorship Disclosure Act*, NEW HAMPSHIRE REV. STAT. ANN., Title XXXI, Ch. 358-E, §§ 358E:1 *et seq.*; *North Carolina Business Opportunity Sales Law*, GENERAL STATUTES OF NORTH CAROLINA, Ch. 66, Art. 19, §§ 66-94 *et seq.*; *Ohio Business Opportunity Purchasers Protection Act*, OHIO REV. CODE, Title 13, Ch. 1334, §§ 1334.01 *et seq.*; *Oklahoma Business Opportunity Sales Act*, OKLAHOMA STATUTES, Title 71, Ch. 4, §§ 801 *et seq.*; *South Carolina Business Opportunity Sales Act*, CODE OF LAWS OF SOUTH CAROLINA, Title 39, Chapter 57, § 39-57-10 *et seq.*; *South Dakota Business Opportunities Law*, SOUTH DAKOTA CODIFIED LAWS, Title 47, Ch. 37-25A, §§ 37-25A-1 *et seq.*; *Texas Business Opportunity Act*, TEXAS BUS. AND COMMERCE CODE, Title 4, Ch. 41, Art. 41.001 *et seq.*; *Utah Business Opportunity Disclosure Act*, UTAH CODE ANN., Title 13, Ch. 15, §§ 13-15-1 *et seq.*; *Virginia Business Opportunity Sales Act*, CODE OF VIRGINIA, Title 59.1, Ch. 21, §§ 59.1-262 *et seq.*; *Washington Business Opportunity Fraud Act*, REVISED CODE OF WASHINGTON, Title 19, Ch. 19.110, §§ 19.110.010 *et seq.*

²⁶⁰ Each of Florida, Kentucky, Nebraska, Texas and Utah offer franchisors exemptions from their business opportunity law to the extent a franchisor meets the definition of a franchise under, and/or is in compliance with, the FTC Rule. A question arises as to whether a franchisor that is exempt from the FTC Rule, and is therefore not obligated to prepare an FDD, can still take advantage of these states' business opportunity exemptions based on FTC Rule compliance. The issue should always be examined on a case-specific basis. However, as a general

or

- (2) The franchisor's offering is made in conjunction with a registered trademark or service mark. In some states, such exemption, as stated in the business opportunity law, requires that the trademark be federally registered, while in other states, it is not specified whether it must be federally registered or whether a state trademark registration would suffice (generally, it would suffice, but that can vary from state to state).

Franchisors should be careful to follow the specific exemption application requirements under some of the state business opportunity laws. For example, some states require a one-time filing and one-time application fee, such as Texas (and only require updates to any information that changes in the original application), while other states require not only the application and fee, but annual updates and renewal fees. Procedural requirements are sometimes found in the statutes but may also be found in applicable state agency regulations promulgated pursuant to a given state's law.

It is also worth noting that a business opportunity rule promulgated by the FTC, at the federal level, came into effect on March 1, 2012, and, in principle, can apply to franchisors.²⁶¹ Where applicable, the rule contains a requirement to disclose in writing five specific categories of information. This requirement involves much less information than an FDD involves. However, the FTC Business Opportunity Rule's scope and applicability to franchisors is limited, because if a franchisor must comply with the disclosure requirements of the federal and state franchise laws, then the franchisor is exempt from application of this rule.²⁶² But for franchisors relying largely on exemption-based franchising, it is important to take this rule into account. In particular, franchisors who rely on the Minimum Payment Exemption or the Oral Franchise Exemption (two exemptions which are in the FTC Rule, but are not in the FTC Business Opportunity Rule) should carefully review the FTC Business Opportunity Rule to determine whether they need to take any action to comply with its disclosure requirements.²⁶³

matter, it seems that only Nebraska may still require preparation of an FDD in such a case. Specifically, the business opportunity laws of Florida, Kentucky, Texas and Utah provide an exemption where the franchisor "meets the definition of a franchise" under the FTC Rule and/or is "in compliance with" / "has complied with" the FTC Rule – which wording does not necessarily require use of an FDD or any other specific disclosure. See UTAH CODE ANN., Title 13, Ch. 15, § 13-15-2(1)(b)(iii); KENTUCKY REV. STAT., Title XXIX, Ch. 367, § 367.807(1); FLORIDA STATUTES, Ch. 559, § 559.802(1)(a); TEXAS BUS. AND COMMERCE CODE, Title 4, Ch. 41, Art. 41.004(b)(8)(A). In contrast, Nebraska's business opportunity law states, in pertinent part, that the exemption "shall only apply if: (a) The Seller uses a disclosure document prepared in accordance with either the [FTC Rule]..." (NEB. REV. STAT. 59-1722; emphasis added) – which wording requires that the franchisor actually disclose its prospects with an FDD in order to take advantage of the business opportunity exemption. In such instance, a franchisor would need to decide whether to: (i) prepare an FDD (even if not required based on an exemption from the FTC Rule) so as to be able to take advantage of the franchisor exemption from the Nebraska business opportunity law or (ii) comply with the requirements of Nebraska's business opportunity law.

²⁶¹ 16 CFR 437 (2011).

²⁶² 16 CFR 437.8.

²⁶³ For further discussion of the FTC Business Opportunity Rule, see Beata Krakus, *Recent Changes to the FTC Business Opportunity Rule: A Trap for the Unwary*, INT'L JOURNAL OF FRANCHISING LAW, Vol. 10, Iss. 1 (2012), pp. 37-43.

III. Steps a Franchisor Should Take If It Loses the Qualifications for a Claimed Exemption

As discussed at length in this paper, a franchisor must meet certain criteria to qualify for an exemption. However, in many cases, the qualifications required to claim or qualify for an exemption must also be maintained for the entire year. For example, if, during the year, a franchisor's net worth dropped below \$5,000,000, then it would no longer be permitted to rely on an exemption that was based on the franchisor having a net worth of more than \$5,000,000.

Every franchise system that relies on exemptions should have a protocol in place which should be implemented in the event it loses the qualifications for a claimed exemption.

Step 1: MONITOR

If the franchisor is relying on any exemptions, the franchisor should have a system in place to monitor the franchisor's ongoing compliance with meeting the threshold qualifications to maintain any claimed exemptions. The franchisor should designate an individual or department to be responsible for monitoring the franchisor's ability to continue to meet the necessary qualification(s).

The monitoring system should also delineate clear channels of communication to ensure that it is effective. The entire organization should be made aware of who has been designated with the responsibility to monitor exemption compliance and it should be clear to everyone that information or questions regarding exemptions should be directed to such person. The designated person should also have a clear directive of who he or she should communicate with regarding any potential concerns or issues (e.g., the Chief Financial Officer or the Chief Executive Officer). The absence of clear channels of communication could undermine the effectiveness of a monitoring program if the relevant information is not being brought in a prompt fashion to the attention of the necessary parties who have the authority to act on such information.

Step 2: IDENTIFY THE IMPACT

If a franchisor loses its qualifications for an exemption, it must then identify the states in which the franchisor is claiming an exemption that is impacted by the change. For example, if the franchisor's net worth drops below \$5,000,000 during its fiscal year, the next step is for the franchisor to identify which state Large Franchisor Exemptions may be impacted by the change in the franchisor's net worth.

Step 3: IMMEDIATELY STOP SALES IN IMPACTED STATES

If a franchisor has identified that it no longer meets the qualifications for an exemption in any state(s), then it should immediately stop sales in such state(s). If the

franchisor proceeds with sales in such state(s), then it could be subject to the penalties of selling an unregistered franchise, since it no longer can claim the safe harbor of the exemption.

Step 4: REGISTER IN ANY IMPACTED STATES

The last step is for a franchisor to register its FDD with any impacted state(s). The franchisor should notify any impacted state that it no longer qualifies for the claimed exemption and is therefore submitting an initial application for registration. Once the FDD is properly registered in the impacted state, the franchisor can resume sales.

IV. Summary and Conclusion

In summary, in this paper we have attempted to lay out the current state of the major exemptions from franchise registration and disclosure, at both the federal and state level, and the key factors that franchisors should bear in mind as they navigate an exemption-based, or partially exemption-based, franchising program.

As we have noted, some of the available exemptions are more likely to be used by established franchisors with franchisees in many states and a relatively high net worth, while other exemptions are more likely to be relevant to start-up or mid-size franchisors. In addition, even if an exemption is available, it is not always the case that it should be used. The status of the franchisor, its business and deal pipeline with franchisees, and its mode of operating on the whole will all be decisive factors in exemption-based franchising in each case.

As the reader can see, while patterns and similarities in exemptions are clear across many states, the overall legal regime of exemptions is still fragmented by state, both in terms of the requirements to qualify for each exemption and the scope of each exemption (exemption from registration, disclosure, or both). As a result, there exists a somewhat complex patchwork of exemptions, the navigation of which takes significant care and attention to detail but the successful understanding of which can permit a franchisor to take advantage of substantial time and cost savings in complying with franchise registration and disclosure laws.

APPENDICES

The information contained in the Appendices should not be a substitute for a thorough review of the statutes, applicable laws and regulations in each case.

**APPENDIX 1
SEASONED / LARGE FRANCHISOR EXEMPTIONS
SIMPLIFIED SUMMARY TABLE**

Jurisdiction (Note 1)	Net Worth Requirement			Number of Franchisees	Years Operating
	Franchisor	Franchisor w/Parent Guarantor			
		Franchisor	80% Parent		
California	\$5,000,000	\$1,000,000	\$5,000,000	25	5
Illinois (See Note 2)	\$5,000,000	\$1,000,000	\$5,000,000	25	5
Illinois (See Note 2)	\$15,000,000	\$1,000,000	\$15,000,000	-	-
Indiana	\$5,000,000	\$1,000,000	\$5,000,000	25	5
Maryland	\$10,000,000	\$1,000,000	\$10,000,000	25	5
New York (See Note 3)	\$5,000,000	\$1,000,000	\$5,000,000	-	-
New York (See Note 3)	\$15,000,000	\$3,000,000	\$15,000,000	-	-
North Dakota	\$10,000,000	\$1,000,000	\$10,000,000	25	5
Rhode Island	\$10,000,000	-	\$10,000,000	25	5
Virginia	\$15,000,000	\$1,000,000	\$15,000,000	25	5
Washington (See Note 4)	\$5,000,000	\$1,000,000	\$5,000,000	25	5

Notes:

1. Large franchisor exemptions may be available in Hawaii "as the Director determines," in Minnesota "as the Commissioner determines," and in Wisconsin "as the Division determines." There are no comparable large franchisor exemptions available in other registration or notice states, the District of Columbia, U.S. territories and other states governed by the FTC Rule.
2. Illinois has a 2-tier exemption. The 2nd level does not require a filing with the state.
3. New York has a 2-tier exemption. The 2nd level does not require a filing with the state.
4. The Washington exemption also requires an initial investment by the franchisee of more than \$100,000.

APPENDIX 2

**SOPHISTICATED / LARGE FRANCHISEE EXEMPTIONS
SIMPLIFIED SUMMARY TABLE**

State	Statute/ Regulation	Financial Requirement	Other Requirements	Filing Required
California (1 st Exemption)	Cal. Corp. Code § 31106(a)(1) and 31106(b)	Not applicable	1 or more purchasers of at least 50% ownership in franchise must have 24 months (within past 7 years) experience conducting substantially similar business; 50% owner cannot be controlled by Franchisor.	Yes
California (2 nd Exemption)	Cal. Corp. Code §31109	Entity with total assets over \$5,000,000; OR Individual with net worth over \$1,000,000 or gross income that exceeds \$300,000 (or \$500,000 with spouse); Initial investment cannot exceed 10% of person's net worth	Franchisor "reasonably believes" that the prospective franchisee has capacity to evaluate risks and merits of investment; Franchise investment must be for the purchaser and not for resale.	Yes
Illinois	815 Ill. Comp. Stat. 705/8(a)(2)	Franchisee must be an entity with a minimum net worth of \$5,000,000	Prospective franchisee entity must have been in business for at least 5 years.	No
Rhode Island	R.I. Gen. Laws §19-28:1-6(4)	Net worth of at least \$1,000,000 or income (single or joint) in excess of \$200,000 per year in each of the two prior years.	Reasonable expectation of reaching same income level in current year; Has knowledge and experience to evaluate risks of	No

			investment	
South Dakota	S.D. Codified Laws § 37-5B-13(2)	Franchisee must be an entity with a minimum net worth of \$5,000,000	Prospective franchisee entity must have been in business for at least 5 years.	No
Washington	Wash. Rev. Code § 19.100.030(5)	The franchise purchaser must be an "accredited investor," defined as (i) an entity or trust with total assets in excess of \$5,000,000; OR (ii) an individual whose net worth (single or joint) exceeds \$1,000,000; OR (iii) an individual whose annual gross income exceeds \$200,000 per year in each of the two prior years, or whose annual joint gross income with that person's spouse exceeds \$300,000 in each of those years.	Reasonable expectation of reaching same income level in current year	No

APPENDIX 3

MAJOR EXEMPTIONS AVAILABLE IN EACH REGISTRATION STATE

CALIFORNIA

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exempt from registration and some disclosure (not required to provide an FDD but must provide similar information to what is in the FDD). Requires filing a notice of exemption and a fee.</p> <p>Requirements:</p> <p>(a) Net worth. The franchisor and, when necessary, a corporation owning at least 80 percent of the franchisor (parent) meet one of the following net worth requirements, according to financial statements for the fiscal year just ended. The franchisor and the parent, when necessary, may rely upon the immediately preceding fiscal year's audited financial statement for 15 months from that fiscal year end date.</p> <p style="padding-left: 40px;">(1) The franchisor has a net worth on a consolidated basis of not less than \$5,000,000, according to its audited financial statement.</p> <p style="padding-left: 40px;">(2) The franchisor has a net worth of not less than \$1,000,000 and its parent has a net worth of \$5,000,000, according to the audited financial statements of the franchisor and its parent, respectively.</p> <p style="padding-left: 40px;">(3) The franchisor has a net worth of \$1,000,000, according to its unaudited financial statement, and the parent has a net worth on a consolidated basis of not less than \$5,000,000, according to its audited financial statement, and the parent absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor under the franchise agreement should the franchisor become unable to perform its duties and obligations.</p> <p>(b) Experience. The franchisor or a corporation owning at least 80 percent of the franchisor (parent) complies with one or more of the following conditions throughout the five-year period immediately preceding the offer and sale of the franchise, or complies with one of the following conditions during part of the period and one or more of the following conditions during the balance of the period: (1) The franchisor has had at least 25 franchisees conducting business which is the subject of the franchise; (2) The franchisor has conducted business which is the subject of the franchise; (3) The parent has had at least 25 franchisees conducting business which is</p>	<p>CAL. CORP. CODE § 31101.</p>

<p>the subject of the franchise; (4) The parent has conducted business which is the subject of the franchise.</p> <p>Note: In the event of material modification of an existing franchise, certain disclosures are required.</p>	
<p>SOPHISTICATED FRANCHISEE</p>	<p>CITATION</p>
<p><u>First Exemption</u></p> <p>1 or more purchasers of at least 50% ownership in franchise must have 24 months (within past 7 years) experience conducting substantially similar business. The 50% owner cannot be controlled by Franchisor.</p>	<p>CAL. CORP. CODE § 31106(a)(1) and 31106(b)</p>
<p><u>Second Exemption</u></p> <p>Exemption from registration and disclosure.</p> <p>Applicable to an entity with total assets over \$5,000,000; OR an individual with net worth over \$1,000,000 or gross income that exceeds \$300,000 (or \$500,000 with spouse). The initial investment cannot exceed 10% of person’s net worth.</p> <p>Franchisor must “reasonably believe” that the prospective franchisee has capacity to evaluate risks and merits of investment;</p> <p>The franchise investment must be for the purchaser and not for resale.</p> <p>Must file Notice of Exemption and filing fee (currently \$450) before offer and sale under the exemption.</p>	<p>CAL. CORP. CODE §31109</p>
<p>LARGE INVESTMENT</p>	<p>CITATION</p>
<p>N/A</p>	<p>N/A</p>
<p>INSIDER</p>	<p>CITATION</p>
<p>Exempt from registration and disclosure to for any offer or sale to one or more purchasers who own a minimum of 50% ownership interest of the franchise being offered for sale, provides that such owner(s) had (within the past 60 days) 24 months’ experience as either (1) a director, officer, general partner, or managing agent or (2) an owner of at least 25% ownership interest in the franchise company. The owner(s) may not be controlled by the franchisor.</p>	<p>CAL. CORP. CODE §31106(a)(2).</p>

Must file a Notice of Exemption and filing fee within 15 calendar days after the sale.	
INSTITUTIONAL FRANCHISEE	CITATION
N/A	N/A
FRACTIONAL FRANCHISE	CITATION
Exempt from registration and CA-specific disclosure; Requires filing of notice and fee; franchisee or its directors/officers have been in same type of business for at least 2 years and sales on an annual basis not expected to be more than 20% of total dollar volume of sales from business, must be operated from same location, franchisee must not be controlled by franchisor, and must meet other requirements.	CAL. CORP. CODE §31108.
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Exempt if non-resident and transactions between franchised business and its customers are made, or goods or services are distributed, outside of state.	CAL. CORP. CODE §31105.
MINIMUM PAYMENT	CITATION
Annual franchise fee cannot exceed \$500.	CAL. CODE REGS. tit. 10, § 310.011.
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration and disclosure (because excluded from definition of “sale” or “offer”), in the case of renewal or extension of an existing franchise, with no interruption in operation of the franchises business by the franchisee, and no material modification of the existing franchise. No filing required.	CAL. CORP. CODE §31018.
SALE BY EXISTING FRANCHISEE	CITATION
Exemption from disclosure. Sale cannot be effected by or through the franchisor, but the franchisor can reserve a right to approve or disapprove the choice of new franchisee.	CAL. CORP. CODE §31102.
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exemption from registration and disclosure, but not from the anti-fraud provisions of the California Franchise Investment Law.	CAL. CORP. CODE §31106.

<p>Sale must be to an existing franchisee, or to an entity in which franchisee is an officer, director, managing agent or owner of at least a 25% interest, and franchisee or qualifying person must have at least 24 months experience in substantially similar business. Must file a notice of exemption and pay a fee.</p>	
<p>EXEMPTION BY ORDER</p>	<p>CITATION</p>
<p>If transaction found not to be within the purposes of the law and the registration of which is not necessary or appropriate in the public interest or for the protection of investors.</p>	<p>CAL. CORP. CODE §31100.</p>

HAWAII

SEASONED/LARGE FRANCHISOR	CITATION
N/A	N/A
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
Exempt from registration and disclosure for any offer or sale to a bank, insurance company, trust company or broker dealer (provided the buyer is acting for its own behalf or in a fiduciary capacity). No filing required.	HAW. REV. STAT. § 482E-4(7).
FRACTIONAL FRANCHISE	CITATION
N/A	N/A
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Exempt if franchisee is not domiciled and business not operated in the state.	HAW. REV. STAT. § 482E-4(a)(4).
MINIMUM PAYMENT	CITATION
N/A	N/A
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exempt from registration and disclosure, if (i) existing franchise is extended or renewed; (ii) 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 no material change in the franchise relationship. No filing or fee required.	HAW. REV. STAT. § 482E-4(a)(5).
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from disclosures, as well as books and records requirements, jurisdictional, and service of process requirements. Sale must be by existing franchisee for franchisee's own benefit and	HAW. REV. STAT. § 482E-4(a)(7).

must be an isolated sale and not part of a plan of distribution of franchises.	
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exempt from disclosures, books, and records requirements, jurisdictional, and service of process requirements. Exempts the offer or sale of an additional franchise to an existing franchisee of the same franchisor.	HAW. REV. STAT. § 482E-4(a)(6).
EXEMPTION BY ORDER	CITATION
If disclosure found to not be material to franchisee's prospects for success and whether exemption in public interest.	HAW. REV. STAT. § 482E-4(b).

ILLINOIS

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing a letter to the Illinois attorney general explaining how the requirements are met, a consent to service of process, and a certification page, along with payment of a fee. However, the exemption only requires a filing and fee if the franchisor is qualifying under the lower of the two tiers of this exemption, as set forth below:</p> <ol style="list-style-type: none"> 1. The lower exemption tier requires a filing with the state. For this lower exemption tier, it is required that the franchisor: <ol style="list-style-type: none"> a. Has a net worth on a consolidated basis according to its most recent audited financial statement of not less than \$10,000,000; or the franchisor has a net worth according to its most recent financial statement of not less than \$1,000,000 and is at least eighty percent owned by a corporation which has a net worth on a consolidated basis according to its most recent audited financial statement of not less than \$10,000,000; and b. Has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale; or has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale; or if any corporation which owns at least eighty percent of the franchisor has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale; or such corporation has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale. 2. The higher exemption tier does not require a filing with the state. For this higher exemption tier, the franchisor must have a net worth of at least \$15,000,000 (or at least \$1,000,000, if its parent has a net worth of at least \$15,000,000). 	<p>ILL. COMP. STAT. § 815: 705/8(a)(1);</p> <p>ILL. ADMIN. CODE tit. 14, § 200.202(e)</p>
SOPHISTICATED FRANCHISEE	CITATION
<p>Exemption from registration only, applicable to an entity with total assets over \$5,000,000; Or an individual with net worth over \$1,000,000 or gross income that exceeds \$300,000 (or \$500,000 with spouse). The Initial investment cannot exceed 10% of the person's net worth.</p> <p>Franchisor must "reasonably believe" that the prospective</p>	<p>815 ILL. COMP. STAT. 705/8(a)(2)</p>

<p>franchisee has capacity to evaluate risks and merits of investment;</p> <p>The Franchise investment must be for the purchaser and not for resale.</p> <p>No filing requirement.</p>	
LARGE INVESTMENT	CITATION
<p>Minimum investment level must exceed \$1,000,000.</p> <p>Exempt from registration only. Filing is required, but no filing fee.</p> <p>Must submit the following documentation:</p> <p>Cover letter describing basis for exemption, list of any other states of the FTC that have issued or denied similar exemptions, and number of franchises that Franchisor intends to sell in Illinois for the next 12 months.</p> <p>Registration Application Page and Consent to Service of Process</p> <p>Two copies of FDD (which must be current within 120 days of submission)</p> <p>A list of sales made in Illinois since most recent FDD was submitted</p> <p>Sales Agent disclosure forms.</p> <p>Auditor's consent.</p>	<p>ILL. ADMIN. CODE tit. 14, § 200.202(c)</p>
INSIDER	CITATION
<p>Exempt from registration only for any offer or sale to an individual that has had (within the past 60 days) 2 years' experience as either (1) a director, officer, general partner, or otherwise had management responsibility for franchise sales or the administration of the franchised network or (2) an owner of at least 25% ownership interest in the franchise company.</p> <p>No filing required.</p>	<p>815 ILL. COMP. STAT. 705/8(a)(3)</p>
INSTITUTIONAL FRANCHISEE	CITATION
<p>Exempt from registration for any offer or sale to a bank (as defined by Section 3(a)(2) of the Securities Act of 1933.</p> <p>No filing is required.</p>	<p>815 ILL. COMP. STAT. 705</p>
FRACTIONAL FRANCHISE	CITATION
<p>Exclusion <i>not</i> exemption; Franchisee or its directors/officers have been in same type of business for at least 2 years and sale for at least one year not expected to be more than 20% of total dollar volume of sales from business.</p>	<p>815 ILL. COMP. STAT. 705/3.</p>

LIMITED NUMBER OF FRANCHISES	CITATION
1 or 2 sales in 12 months. Must deliver FDD and obtain letter from franchisee’s attorney stating he or she explained Act to his or her client. Exempt from registration and IL-specific disclosure.	ILL. ADMIN. CODE tit.14, § 200.201(b).
OUT OF STATE FRANCHISE	CITATION
IL law applies if franchisee is domiciled in the state or the offer is made or accepted in the state, and the business is operated in the state. NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.	815 ILL. COMP. STAT. 705/10.
MINIMUM PAYMENT	CITATION
Franchise fee cannot exceed \$500.	815 ILL. COMP. STAT. 705/3(1)c).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exempt from registration and disclosure, in the case of an offer or sale that is an extension or renewal of an existing franchise or an exchange or substitution of a modified or amended franchise agreement, that includes no interruption of the operation of the franchised business. No state filing or fee is required.	815 ILL. COMP. STAT. 705/7.
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration and disclosure. Sale cannot be effected by or through the franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee and may charge a reasonable transfer fee.	815 ILL. COMP. STAT. 705/6.
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
N/A	N/A
EXEMPTION BY ORDER	CITATION
State may grant exemptions from registration and disclosure if enforcement is not necessary (1) in the public interest, or (2) for the protection of any class of prospective franchisees, or (3) by reason of the investment involved, or (4) because of the limited character of the offering.	815 ILL. COMP. STAT. 705/9.

INDIANA

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration, and some (but not all) disclosure.</p> <p>No filing is legally required (although state will provide a confirmation letter if a filing is made, including the FDD and a fee).</p> <p>Requires that franchisor:</p> <p>(a) has a net worth:</p> <p style="padding-left: 20px;">(1) on a consolidated basis according to current financial statements certified by independent certified public accountants, of not less than five million dollars (\$5,000,000); or</p> <p style="padding-left: 20px;">(2) according to current financial statements certified by independent certified public accountants of not less than one million dollars (\$1,000,000) and is at least eighty percent (80%) owned by a corporation which has a net worth on a consolidated basis, according to current financial statements certified by independent certified public accountants, of not less than five million dollars (\$5,000,000);</p> <p>(b) has:</p> <p style="padding-left: 20px;">(1) had at least twenty-five (25) franchisees conducting business at all times during the five (5) year period immediately preceding the offer or sale; or</p> <p style="padding-left: 20px;">(2) conducted the business which is the subject of the franchise continuously for not less than five (5) years preceding the offer or sale; or if any corporation which owns at least eighty percent (80%) of the franchisor has had at least twenty-five (25) franchisees conducting business at all times during the five (5) year period immediately preceding the offer or sale, or such corporation has conducted the business which is the subject of the franchise continuously for not less than five (5) years preceding the offer or sale.</p>	<p>IND. CODE § 23-2-2.5-3</p>
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A

INSTITUTIONAL FRANCHISEE	CITATION
N/A	N/A
FRACTIONAL FRANCHISE	CITATION
Exclusion not exemption.	IND. CODE § 23-2-2.5-1(a)(3).
LIMITED NUMBER OF FRANCHISES	CITATION
1 franchise sale in 2 years. No filing required.	IND. CODE § 23-2-2.5-3.
OUT OF STATE FRANCHISE	CITATION
IN law applies to an offer unless franchisee is non-resident and business will not be operated in IN NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.	IND. CODE § 23-2-2.5-2
MINIMUM PAYMENT	CITATION
N/A	N/A
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration and disclosure because excluded from definition of “offer” under the statute. No filing required in case of renewal or extension of existing franchise if there is no interruption in the operation of the franchised business by the franchisee.	IND. CODE § 23-2-2.5-1(g)
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration and disclosure. Sale cannot be effected by or through a franchisor, but a franchisor can reserve a right to approve or disapprove the choice of new franchisee.	IND. CODE § 23-2-2.5-4
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
N/A	N/A
EXEMPTION BY ORDER	CITATION
State may grant exemption if offer or sale is found not to be comprehended within the purposes of the law and the registration of which is not necessary or appropriate in the public interest or for the protection of investors.	IND. CODE §§ 23-2-2.5-5, 6

MARYLAND

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exempt from registration;</p> <p>Requires filing notice of exemption, consent to service of process, financial statements, a representation that the franchisor meets the experience requirement, and an undertaking to supply any additional information requested, as well as paying a fee;</p> <p>Requires that franchisor has:</p> <p>(a) A net equity, according to its most recently audited financial statements, of not less than:</p> <p style="padding-left: 40px;">(i) \$10,000,000 on a consolidated basis, or</p> <p style="padding-left: 40px;">(ii) \$1,000,000 and is at least 80 percent owned by a corporation or entity that has a net equity, on a consolidated basis, according to its most recently audited financial statements, of not less than \$10,000,000, which 80 percent owner guarantees the performance of the franchisor's obligations; and</p> <p>(b) Had at least 25 franchisees conducting the same franchised business at all times during the 5-year period immediately preceding the offer or sale.</p>	<p>MD. CODE REGS. 02.02.08.10</p>
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
<p>Minimum investment level must exceed \$750,000.</p> <p>Exempt from registration only. Filing is required along with filing fee (currently, \$250).</p> <p>Must submit the following:</p> <p>Exemption application (must be submitted 10 business days before the offer or sale)</p> <p>Consent to Service of Process</p> <p>One copy of current FDD</p> <p>An undertaking agreeing to supply any additional information requested.</p>	<p>MD. REGS. 02.02.08.10(E)</p>
INSIDER	CITATION

N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
Exempt from registration for any offer or sale to a bank, trust company, insurance company, investment company, other financial institution or broker dealer provided (1) the buyer is acting for its own behalf or in a fiduciary capacity) and (2) the franchise is not being purchased for the purpose of re-sale. No filing is required.	MD. REGS. 02.02.08.10(F)(1)
FRACTIONAL FRANCHISE	CITATION
N/A	N/A
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Exempt if offer or sale is made to a non-resident who will not operate business in the state. No filing required.	MD. CODE REGS. 02.02.08.10(B) and 02.02.08.10(H)
MINIMUM PAYMENT	CITATION
Annual franchise fee cannot exceed \$100.	MD. REGS. 02.02.08.10(C)
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration and disclosure (because excluded from application of statute) for renewal or extension of an existing franchise if there is no interruption in operation of the franchised business. No filing required.	MD. CODE ANN., BUS. REG. (Maryland Franchise Law) § 14-203(c)
SALE BY EXISTING FRANCHISEE	CITATION
Exemption from registration (although, pursuant to certain Advisory Opinion 98-1, where registration is not required, reduced disclosure may also be permitted). No filing is required. Exempt where there is an offer to sell, or the sale of, a franchise by a franchisee for the franchisee's own account, or the <i>entire</i> area franchise owned by a subfranchisor for the subfranchisor's own account. If franchisor has significant involvement in the sale, should not assume that this exemption will apply.	MD. CODE ANN., BUS. REG. (Maryland Franchise Law) § 14-214(c)(1)
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION

<p>Exemption from registration (although, pursuant to certain Advisory Opinion 98-1, where registration is not required, reduced disclosure may also be permitted). No filing is required. Exempt where there is an offer to sell, or sale of, a franchise that is substantially similar to a franchise already owned by the offeree or the buyer is exempt under § 14-214(b)(2).</p>	<p>MD. CODE ANN., BUS. REG. (Maryland Franchise Law) § 14-214(b)(2)</p>
<p>EXEMPTION BY ORDER</p>	<p>CITATION</p>
<p>State may grant exemption if transaction not within the purposes of the law and the registration of which is not necessary or appropriate in the public interest or for the protection of investors. Filing required.</p>	<p>MD. CODE REGS. 02.02.08.10(G), (H)</p>

MICHIGAN

SEASONED/LARGE FRANCHISOR	CITATION
N/A	N/A
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
Exempt from registration and disclosure for any offer or sale to a bank, insurance company, investment company or broker dealer (provided the buyer is acting for its own behalf or in a fiduciary capacity.	MICH. COMP. LAWS § 445.1506(1)(b).
FRACTIONAL FRANCHISE	CITATION
Franchisee already in same type of business and individual responsible for operation has been engaged in same type of business for at least 2 years and component of larger franchise business with no more than 20% of businesses gross sales.	MICH. COMP. LAWS § 445.1506(h).
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Applies if franchisee not domiciled in and business will not be operated in MI. Exempt from registration and MI-specific disclosures.	MICH. COMP. LAWS § 445.1506(1)(d).
MINIMUM PAYMENT	CITATION
Franchise fee cannot exceed \$500.	MICH. COMP. LAWS § 445.1506(1)(c).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from filing FDD and from disclosure, if it is an extension or renewal of an existing franchise or the exchange or substitution of a modified or amended franchise agreement, as long as there is	MICH. COMP. LAWS § 445.1506(e),

no interruption in the operation of the business, and no material change in the franchise relationship. However, if the franchisor has a disclosure statement compliant with either the FTC rule or any state laws, then the franchisor must provide the disclosure statement to the prospective franchisee, with a notice as required in § 445.1508(3) of the statute, and a copy of all proposed agreements relating to the franchise sale. No filing is required to claim this exemption.	1506(2), and 1508.
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from notice filing requirement, and disclosure requirement. Sale must be by existing franchisee for franchisee's own benefit and must be an isolated sale. Franchisee must provide prospective purchaser with full access to franchise books and records in possession of the franchisee.	MICH. COMP. LAWS § 445.1506(6)(1)(f).
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exempt from notice filing and disclosure. Sale must be to a franchisee who has actively operated the franchise for the immediately preceding 18 months and the franchisee must purchase for purposes of investment and not for resale.	MICH. COMP. LAWS § 445.1506(6)(1)(g).
EXEMPTION BY ORDER	CITATION
N/A	N/A

MINNESOTA

SEASONED/LARGE FRANCHISOR	CITATION
N/A	N/A
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
Not an exemption. Permits franchisors to provide less disclosures (subject to the FTC Rule) when the initial investment exceeds \$200,000.	MINN. R. 2860.8100-8300.
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
Exempt from registration for any offer or sale to a bank, life insurance company or financial organization.	MINN. STAT. § 345.31
FRACTIONAL FRANCHISE	CITATION
Franchisee and or directors/officer been in business for 2 years and sale not expected to be more than 20% of total dollar volume of sales.	MINN. STAT. §§ 80C.03(f) and 80C.01, subdiv. 18.
LIMITED NUMBER OF FRANCHISES	CITATION
Not more than 1 sale in 12 months and not advertised to general public (3230.03). Exempt from registration and MN-specific disclosures.	MINN. STAT. § 80C.03, subdiv. (e).
OUT OF STATE FRANCHISE	CITATION
Exempt if offer/sale made to non-resident who is not domiciled in or actually present in MN and franchise will not be operated in MN, and the sale of the franchise is not in violation of any law of the foreign state, territory or country concerned.	MINN. STAT. § 08C.03(h).
MINIMUM PAYMENT	CITATION
Annual franchise fee cannot exceed \$100.	MINN. STAT. § 80C.01 subdiv. 4(4)(c).

RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration and disclosure in case of renewal or extension, if it does not vary substantially from the existing franchise. Franchisor may not require, as condition for extension or renewal, unfair and inequitable terms. No exemption filing required.	MINN. R. 2860.1100, subpt. 4.
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration. Sale cannot be effected by or through a franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee. Franchisee seller cannot make more than one sale during any 12 month period.	MINN. STAT. § 80C.03(a).
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exemption from registration and disclosure. No filing required. Exemption applies where a franchisor offers to grant an additional franchise to an existing franchisee, unless the additional franchise varies substantially from the existing franchise. Additional requirement for this exemption: there must be no condition for the extension, renewal or grant of such additional franchise that the franchisee conform to any agreement the provisions of which are "unfair and inequitable" as defined in the Minnesota regulations (at Minn. R. 2860.4400).	MINN. R. 2860.1100, subpt. 4.
EXEMPTION BY ORDER	CITATION
If found not to be within purposes of the franchise law and that registration is not necessary or appropriate in the public interest.	MINN. STAT. § 80C.03(g).

NEW YORK

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing -- in the case of the lower tier exemption only – an exemption application and consent to service of process, and fee.</p> <p>There are two tiers of this exemption.</p> <p style="padding-left: 40px;">(1) The lower tier, which requires filing with the state and is still subject to the discretion of the regulator even when the requirement is met, requires that:</p> <p style="padding-left: 40px;">The franchisor has a net worth on a consolidated basis, according to its most recently audited financial statement, of not less than five million dollars; or the franchisor has a net worth, according to its most recently audited financial statement, of not less than one million dollars and is at least eighty percent owned by a corporation which has a net worth on a consolidated basis, according to its most recently audited financial statement, of not less than five million dollars.</p> <p style="padding-left: 40px;">(2) The higher tier does not require a filing with the state, and requires that:</p> <p style="padding-left: 40px;">The franchisor has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than fifteen million dollars; or the franchisor has a net worth, according to its most recent audited financial statement, of not less than three million dollars and is at least eighty percent owned by a corporation which has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than fifteen million dollars.</p>	<p>N.Y. GEN. BUS. LAW § 684.2-3</p>
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A

INSTITUTIONAL FRANCHISEE	CITATION
Exempt from registration for any offer or sale to a bank, trust company, insurance company, investment company, other financial institution or broker dealer (provided the buyer is acting for its own behalf or in a fiduciary capacity. No filing required.	N.Y. GEN. BUS. LAW § 684(3)(b).
FRACTIONAL FRANCHISE	CITATION
Franchisee or existing officer/director/managing agent holding position for the last 24 months, has been engaged in business offering products or services substantially similar or related during the past 24 months; new product or service must be substantially similar or related to the product or service then being offered by franchisee; parties anticipate in good faith that sales will represent 20% or less of franchisee's total sales in dollar volume on annual basis; business to be operated from same location; franchisee not controlled by franchisor. Must file notice and pay fee.	N.Y. COMP. CODE R. & REGS. Tit. 13, Ch. VII, § 200.10(2).
LIMITED NUMBER OF FRANCHISES	CITATION
Single sale exempt from registration if not offered to more than 2 persons and no right to offer to others is granted and no commission or remuneration paid directly or indirectly to solicit a prospective franchisee, and franchisor domiciled in NY and files consent to service of process.	N.Y. GEN. BUS. LAW § 684(3)(c).
OUT OF STATE FRANCHISE	CITATION
Applies when offer to sell of a franchise occurs in the state; however, law does not apply unless franchisee is domiciled in New York and the business will be operated in New York. An offer to sell is made in NY if it originated in NY or is directed by offeror to this state. Offer is accepted in the state is it is communicated to offeror in the state. NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.	N.Y. GEN. BUS. LAW § 681(12).
MINIMUM PAYMENT	CITATION
N/A	N/A
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration and disclosure. Requirements: there must be no interruption or change in the operation of the franchised business by the franchisee. But note: if	N.Y. GEN. BUS. LAW § 681(11).

<p>the franchisee is required to sign the franchisor's then-current form of franchise agreement and such terms differ from the previous form, then this exemption may not apply. Pragmatically, in such cases the franchisor should have the FDD registered and deliver the then-current FDD to the franchisee. No filing is required for this exemption.</p>	<p>See <i>also</i> Rich Food Svcs., Inc. v. Rich Plan Corp., 98 F App'x 206, 209 (4th Cir. 2004).</p>
SALE BY EXISTING FRANCHISEE	CITATION
<p>Exempt from registration. Sale cannot be effected by or through a franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee. Must be an isolated sale and franchisee must provide prospective purchaser with full access to franchise books and records in possession of the franchisee.</p>	<p>N.Y. GEN. BUS. LAW § 684(5).</p>
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
<p>Exempt from registration. Must file notice of sale to an existing franchisee, along with fee. Sale must be to a franchisee who has actively operated the franchise for the immediately preceding 18 months and the franchisee must purchase for purposes of investment (operating the business) and not for resale.</p>	<p>N.Y. GEN. BUS. LAW § 684(3)(d); N.Y. COMP. CODE R. & REGS., Tit. 13, Ch. VII, §§ 200.10(1).</p>
EXEMPTION BY ORDER	CITATION
<p>Exempt if the department finds that such action is not inconsistent with the public interest or the protection of prospective franchisees.</p>	<p>N.Y. GEN. BUS. LAW §§ 684(1), (4).</p>

NORTH DAKOTA

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing notice of exemption, and fee.</p> <p>Requires that the franchisor:</p> <p>a. Has a net worth on a consolidated basis according to its most recent audited financial statement of not less than \$10,000,000; or the franchisor has a net worth according to its most recent financial statement of not less than \$1,000,000 and is at least eighty percent owned by a corporation which has a net worth on a consolidated basis according to its most recent audited financial statement of not less than \$10,000,000; and</p> <p>b. Has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale; or has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale; or if any corporation which owns at least eighty percent of the franchisor has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale; or such corporation has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale.</p> <p>Also note: In the case of an existing franchisee, the franchisor must provide a writing identifying material modifications proposed to the franchise agreement and such additional information as may be required by rule or order of the commissioner.</p>	<p>N.D. CENT. CODE § 51-19-04.</p>
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
N/A	N/A
FRACTIONAL FRANCHISE	CITATION

N/A	N/A
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Applies if franchisee not domiciled in ND and business will not be operated in ND. NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.	N.D. CENT. CODE § 51-19-02(14)(b).
MINIMUM PAYMENT	CITATION
N/A	N/A
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exempt from registration (and, where applicable, disclosure). No filing required. However, note that if there is any material modification to the franchise relationship, then certain written disclosures are required.	N.D. CENT. CODE §§ 51-19-02(14)(a)(2) and 51-19-04(1)(d).
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration. Sale cannot be effected by or through a franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee. Note: administrative agency has statutory authority to require franchisee to provide agency and prospective purchaser with certain disclosures.	N.D. CENT. CODE § 51-19-04(2).
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
N/A	N/A
EXEMPTION BY ORDER	CITATION
Commissioner may exempt if not comprehended within the purposes of the law and the registration of which is not necessary or appropriate in the public interest or for the protection of investors	N.D. CENT. CODE §§ 59-19-04(3).

RHODE ISLAND

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing an annual notice of exemption and paying a fee.</p> <p>Requires that:</p> <p>(1) either the franchisor's most recent audited financial statements show a net worth of at least \$10,000,000 or the franchisor is at least 80% owned by a person that unconditionally guarantees the franchisor's performance, that consents to service of process in this state and whose most recent audited financial statements show a net worth of at least \$10,000,000; and</p> <p>(2) the franchisor or person owning at least 80% of the franchisor had and currently has at least 25 franchisees that have conducted substantially the same franchised business to be offered or sold at no fewer than 25 locations for the entire five-year period immediately preceding the offer or sale of the franchise.</p>	<p>R.I. GEN. LAWS § 19-28.1-6</p>
SOPHISTICATED FRANCHISEE	CITATION
<p>Exemption from registration for the offer or sale of a franchise to person with a net worth of at least \$1,000,000 or income (single or joint) in excess of \$200,000 per year in each of the two prior years.</p> <p>The buyer must have a reasonable expectation of reaching same income level in current year. The buyer must also have sufficient knowledge and experience to evaluate risks of investment.</p> <p>No filing required.</p>	<p>R.I. GEN. LAWS §19-28.1- 6(4).</p>
LARGE INVESTMENT	CITATION
<p>N/A</p>	<p>N/A</p>
INSIDER	CITATION
<p>Exemption from registration only of the offer and sale of a franchise to an individual or entity which has been, for a minimum of 2 years, an officer, director, partner or affiliate of the franchisor and the sale must be for such insiders own account.</p>	<p>R.I. GEN. LAWS §19-28.1- 6(3).</p>

No filing is required.	
INSTITUTIONAL FRANCHISEE	CITATION
N/A	N/A
FRACTIONAL FRANCHISE	CITATION
N/A	N/A
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Exempt if offer or sale is to a non-resident, and business will be operated wholly outside of RI, and offeree was not actually present during any offer or sale.	R.I. GEN. LAWS § 19-28.1-7.
MINIMUM PAYMENT	CITATION
Franchise fee to franchisor or affiliate cannot exceed \$500.	R.I. GEN. LAWS §19-28.1-3(7)(i)(B).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration, if it is a renewal, extension, modification or amendment of an existing franchise agreement, there is no interruption in the operation of the franchised business and there is no material change in the franchise relationship. No state filing is required.	R.I. GEN. LAWS § 19.28.1-6(f)
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration. No filing required. Sale cannot be effected by or through franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee, or to require payment a reasonable transfer fee. Exemption also applies to the offer or sale of a master franchise if entire master franchise is sold. Other requirements: the franchisee who is doing the selling/offering must not be an affiliate of the franchisor; must be for the franchisee's own account; must be selling the franchisee's entire franchise.	R.I. GEN. LAWS § 19.28.1-6(2)
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exempt from registration.	R.I. GEN. LAWS

<p>No filing required. Additional franchise must be substantially the same as the franchise that the franchisee has operated for at least 2 years.</p>	<p>§ 19.28.1-6(5).</p>
<p>EXEMPTION BY ORDER</p>	<p>CITATION</p>
<p>Discretionary exemption only applies to registration and not disclosure when director determines that registration not necessary or appropriate in public interest or for protection of prospective franchisees</p>	<p>R.I. GEN. LAWS §19-28.1-6(10).</p>

SOUTH DAKOTA

SEASONED/LARGE FRANCHISOR	CITATION
N/A	N/A
SOPHISTICATED FRANCHISEE	CITATION
<p>Exempt from registration and disclosure.</p> <p>Franchisee must be an entity with a minimum net worth of \$5,000,000 and must have been in business for a minimum of 5 years.</p> <p>No filing required.</p>	S.D. CODIFIED LAWS § 37-5B-13(2).
LARGE INVESTMENT	CITATION
<p>Exempt from registration and disclosure for any offer or sale when the initial investment is a minimum of \$1,000,000, (excluding the cost of unimproved land and any financing received from the franchisor or its affiliate).</p> <p>Franchisee must sign an acknowledgement to verify the basis of the exemption.</p> <p>No filing required.</p>	S.D. CODIFIED LAWS § 37-5B-13(1).
INSIDER	CITATION
<p>Exempt from registration and disclosure to for any offer or sale to one or more purchasers who own a minimum of 50% ownership interest of the franchise being offered for sale, provides that such owner(s) had (within the past 60 days) 2 years' experience as either (1) a director, officer, general partner, or otherwise had management responsibility for franchise sales or the administration of the franchised network or (2) an owner of at least 25% ownership interest in the franchise company.</p> <p>No filing required.</p>	S.D. CODIFIED LAWS § 37-5B-13(4).
INSTITUTIONAL FRANCHISEE	CITATION
<p>Exempt from registration for any offer or sale to a bank, life insurance company, or other financial institution.</p> <p>No filing is required.</p>	S.D. CODIFIED LAWS § 37-5B-14(2).
FRACTIONAL FRANCHISE	CITATION
<p>Franchisee or any current directors/officers or any current directors/officer of parent or affiliate has more than 2 years'</p>	S.D. CODIFIED LAWS §§ 37-5B-

experience in same type of business and parties have reasonable basis to anticipate that sales from relationship will not exceed 20% of franchisee's total dollar volume of sale during the first year of operation.	1(10) and 37-5B-12(3).
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Applies if the franchise is offered or sold to a resident of this state and the franchise is to be operated in this state, or, if the franchisee is domiciled in this state when the franchised business is or will be operated in this state. NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.	S.D. CODIFIED LAWS § 37-5B-2.
MINIMUM PAYMENT	CITATION
Franchise fee within first 6 months cannot exceed \$500.	S.D. CODIFIED LAWS § 37-5B-12(5).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
N/A	N/A
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration and disclosure. No filing is required. For this exemption to apply, the offer/sale cannot be effected by or through the franchisor (no "significant involvement" with the franchisee). The franchisor may reserve a right to approve or disapprove the choice of new franchisee without triggering the "significant involvement" factor; however, it is unclear what exactly would constitute "significant involvement."	S.D. CODIFIED LAWS §§ 37-5B-1(16)(regarding such offers) and 37-5B-1(28)(regarding such sales).
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exemption from the notice filing requirement, but not from disclosure. No filing is required. Exemption applies where the additional franchise being offered to an existing franchisee is substantially the same as the franchise that the franchisee has operated for at least two years at the time of the offer or sale.	S.D. CODIFIED LAWS § 37-5B-14(1).
EXEMPTION BY ORDER	CITATION

<p>Director may by rule or order exclude offer and sale from notice filing and disclosure if it determines that filing or disclosure is not necessary or appropriate in the public interest or for protection of prospective franchisees.</p>	<p>S.D. CODIFIED LAWS § 37-5B-15.</p>
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VIRGINIA

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing a notice of claim of exemption, financial statements to show compliance, FDD, consent to service of process, other documentation requirements, and paying a fee.</p> <p>Requires that:</p> <p>(1) The franchisor has a net equity, according to its most recently audited financial statements, of not less than \$15,000,000 on a consolidated basis, or \$1,000,000 on an unaudited basis and is at least 80% owned by a corporation or entity that has a net equity, on a consolidated basis, according to its most recently audited financial statements, of not less than \$15,000,000, and the 80% owner guarantees the performance of the franchisor's obligations;</p> <p>(2) The auditor's report accompanying the audited financial statements [described in (1) above] does not contain an explanatory paragraph expressing doubt as to the entity's ability to continue as a going concern; and</p> <p>(3) The franchisor or any 80% owner of the franchisor or the franchisor's predecessor, or any combination thereof, has had at least 25 franchisees conducting the same franchise business to be offered or sold for the entire five-year period immediately preceding the offer or sale.</p>	<p>21 VA. ADMIN. CODE §§ 5-110-75.4, 5-110-75.6.b, and 5-110-75.7</p>
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
<p>Exempt from registration only for any offer or sale to a bank, insurance company, trust company, investment company, other financial institution or broker dealer (provided the buyer is acting for its own behalf or in a fiduciary capacity).</p> <p>Requires filing a notice of claim of exemption, financial statements</p>	<p>21 VA. ADMIN. CODE § 5-110-75.4.</p>

to show compliance, FDD, consent to service of process, other documentation requirements, and paying a fee.	
FRACTIONAL FRANCHISE	CITATION
Exempt from law if (i) marketing plan or system promotes sale or distribution of goods or services incidental and ancillary to the principal business of the retailer (sales under such a plan or system accounting for less than 20 percent of the retailer's gross sales being deemed incidental and ancillary); or (ii) to sell goods or services within, or appurtenant to, a retail business establishment as a department or division thereof provided such retailer is not required to purchase such goods or services from the operator of such establishment.	VA. CODE § 13.1-559(B).
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
Law does not apply if franchisee will not establish or maintain a place of business within VA.	VA. CODE § 13.1-559(B).
MINIMUM PAYMENT	CITATION
Franchise fee cannot exceed \$500.	VA. CODE § 13.1-559(A)(3).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration, if it is 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. No required state filing.	21 VA. ADMIN. CODE § 5-110-75.2.
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration. Sale cannot be effected by or through the franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee and may charge a reasonable transfer fee. Franchisee's entire franchise must be sold or transferred.	21 VA. ADMIN. CODE § 5-110-75.1.
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION

<p>Exempt from registration. No filing is required. Franchise being sold must be for the franchisee's own account, must be substantially the same as the franchise that the franchisee has operated for at least 2 years, and original sale must have been made in accordance with Virginia law.</p>	<p>21 VA. ADMIN. CODE § 5-110-75.2.</p>
<p>EXEMPTION BY ORDER</p>	<p>CITATION</p>
<p>N/A</p>	<p>N/A</p>

WASHINGTON

SEASONED/LARGE FRANCHISOR	CITATION
<p>Exemption from registration.</p> <p>Requires filing a notice of claiming the exemption, with audited financial statements, and payment of a fee.</p> <p>Requires that the franchisor:</p> <p>(A) Has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than five million dollars or who has a net worth, according to its most recent audited financial statement, of not less than one million dollars and is at least eighty percent owned by a corporation which has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than five million dollars; and</p> <p>(B) Has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale or has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale or if any corporation which owns at least eighty percent of the franchisor, has had at least twenty-five franchisees conducting business at all times during the five-year period immediately preceding the offer or sale or such corporation has conducted business which is the subject of the franchise continuously for not less than five years preceding the offer or sale; and</p> <p>(C) Requires an initial investment by the franchisee of more than one hundred thousand dollars.</p> <p>Also requires no finding of violation of state or federal franchising or consumer protection laws within the prior 7 years.</p>	<p>WASH. REV. CODE §§ 19.100.030(4)(a), (4)(b)(i)(A) – (C), (4)(b)(iii), and 4(c).</p> <p>WASH. ADMIN. CODE § 460-80-100.</p>
SOPHISTICATED FRANCHISEE	CITATION
<p>Exempt from registration and disclosure requirements.</p> <p>The franchise purchaser must be an “accredited investor,” defined as (i) an entity or trust with total assets in excess of \$5,000,000; OR (ii) an individual whose net worth (single or joint) exceeds \$1,000,000; OR (iii) an individual whose annual gross income exceeds \$200,000 per year in each of the two prior years, or whose annual joint gross income with that person’s spouse</p>	<p>WASH. REV. CODE. §§ 19.100.030(5)</p>

<p>exceeds \$300,000 in each of those years.</p> <p>The franchise purchaser must have a reasonable expectation of reaching same income level in the current year.</p> <p>No filing required.</p>	
LARGE INVESTMENT	CITATION
N/A	N/A
INSIDER	CITATION
<p>Exempt from registration and disclosure to for any offer or sale to a director, executive officer, or general partner of the franchisor.</p> <p>No filing required.</p>	<p>WASH. ADMIN. CODE § 460-80-108(5).</p>
INSTITUTIONAL FRANCHISEE	CITATION
<p>Exempt from registration and disclosure for any offer or sale to a bank, trust company, insurance company, investment company, other financial institution or broker dealer (provided the buyer is acting for its own behalf or in a fiduciary capacity).</p> <p>No filing required.</p>	<p>WASH. REV. CODE. §§ 19.100.030(3)</p> <p>WASH. ADMIN. CODE § 460-44A-501(1).</p>
FRACTIONAL FRANCHISE	CITATION
N/A	N/A
LIMITED NUMBER OF FRANCHISES	CITATION
<p>Exempt if no more than 3 franchises to be situated in WA if (a) no outstanding franchises granted for business located or to be located outside WA; (b) no publication of advertising or general solicitation; and (c) prospect represented or advised by independent legal counsel or CPA.</p>	<p>WASH. REV. CODE. §§ 19.100.030(4)(B)(II) AND 19.100.030(4)(A).</p>
OUT OF STATE FRANCHISE	CITATION
<p>Applies if offeree is a resident of WA, if business will be located in WA, or if an offer originating from this state is accepted and violates the franchise or business opportunity law of the state or foreign jurisdiction in which it is accepted</p> <p>NOTE: Not an actual exemption, but rather as specified in definition or applicability section of the state law.</p>	<p>WASH. REV. CODE § 19.100.020(3).</p>

MINIMUM PAYMENT	CITATION
Franchise fee cannot exceed \$500.	WASH. REV. CODE § 19.100.030(4)(b)(iii)
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
N/A (However, a renewal is arguably a sale to an existing franchisee and therefore may be subject to any otherwise applicable exemption.)	N/A
SALE BY EXISTING FRANCHISEE	CITATION
Exempt from registration, and from disclosure (based on WASH. REV. CODE § 19.100.070(1) which only requires disclosure where a franchisor is registered or required to be registered). Sale cannot be effected by or through the franchisor, but the franchisor may reserve a right to approve or disapprove the choice of new franchisee and may charge a reasonable transfer fee.	WASH. REV. CODE § 19.100.030(1).
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exempt from registration, and from disclosure (based on WASH. REV. CODE § 19.100.070(1) which only requires disclosure where a franchisor is registered or required to be registered). No filing is required. Franchise being sold must be for franchisee's own account, must be substantially the same as the franchise that the franchisee has operated for at least 2 years, and original sale must have been made in accordance with Washington law.	WASH. REV. CODE § 19.100.030(6).
EXEMPTION BY ORDER	CITATION
N/A	N/A

WISCONSIN

SEASONED/LARGE FRANCHISOR	CITATION
N/A	N/A
SOPHISTICATED FRANCHISEE	CITATION
N/A	N/A
LARGE INVESTMENT	CITATION
<p>Exemption from registration only. A minimum cash payment of \$100,000 must be due by the franchisee at time of purchase. The payment amount may not exceed 20% of the franchisee's net worth (excluding the franchisee's personal residence, furnishing and automobiles). Franchisor must reasonably believe that the franchisee has sufficient knowledge and experience to evaluate the merits and risks of the investment.</p> <p>No filing is required.</p>	<p>WIS. STAT. § 553.235.</p>
INSIDER	CITATION
N/A	N/A
INSTITUTIONAL FRANCHISEE	CITATION
<p>Exempt from registration only for any offer or sale to a bank, trust company, or credit union. No filing is required.</p>	<p>WIS.ADMIN. CODE DFI-Sec §32.05(1)(c)(2).</p>
FRACTIONAL FRANCHISE	CITATION
<p>Exclusion not exemption. Franchisee or current directors or executive officers have been in same business for 2 years and franchise business will be a component of a larger business with not more than 20% of total gross sales arising from the franchise relationship.</p>	<p>WIS. STAT. § 553.22.</p>
LIMITED NUMBER OF FRANCHISES	CITATION
N/A	N/A
OUT OF STATE FRANCHISE	CITATION
<p>Exempt if (a) franchisee is not domiciled in WI; (b) business will not be operated in WI; and (c) franchisor complies with law of state where business will be operated. No notice required.</p>	<p>WIS. ADMIN. CODE DFI-Sec § 32.05(1)(d).</p>
MINIMUM PAYMENT	CITATION

Annual payment in excess of the wholesale prices for products and services cannot exceed \$1,000.	WIS. ADMIN. CODE § 32.05(1)(b).
RENEWAL, EXTENSION, AMENDMENT OR MODIFICATION	CITATION
Exemption from registration, if it is a 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. No state filing is required, but if a written approval of the exemption is desired, must pay a fee and provide a self-addressed, stamped envelope.	WIS. ADMIN. CODE §§ 32.05(1)(g) and 35.01(1)(a).
SALE BY EXISTING FRANCHISEE	CITATION
No filing is required, except where it is a sale to the franchisor and a “material event or material change” (defined in Sec. 31.01(2) of the Division of Securities’ regulations) occurs that affects the franchisees or franchisor (in that case, a notice filing is required). This exemption applies where the following condition is met: Sale cannot be effected by or through the franchisor. However, the franchisor may reserve a right to approve or disapprove the choice of new franchisee and may charge a reasonable transfer fee.	WIS. STAT. § 553.23.
SALE BY FRANCHISOR TO EXISTING FRANCHISEE	CITATION
Exempt from registration. No filing is required. Additional franchise must be the same as a franchise that the franchisee is operating at the time of the offer or sale.	WIS. ADMIN. CODE § 32.05(1)(e)
EXEMPTION BY ORDER	CITATION
Division may by rule or order exempt from registration if registration not necessary or appropriate in public interest or for protection of investors. Must pay filing fee, describe how franchisor meets conditions for use of the exemption; and include a copy of FDD.	WIS. STAT. § 553.25.