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Franchising: The Basics

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Franchising in the United States is regulated by the Federal Trade Commission (“FTC”) and various state statutes and regulations. This article will review the franchise definition under federal and state laws, along with other basic laws and requirements associated with owning and operating a franchise in the United States.

At the federal level, franchising is governed principally by the FTC’s Franchise Rule (the “FTC Rule”), which serves as the baseline presale disclosure regime for franchise offers and sales in the United States. The FTC Rule originally took effect on October 21, 1979. In 2007, the FTC approved amendments to the FTC Rule (“Amended Rule”). The Amended Rule has many similarities with state franchise

registration statutes and requires certain disclosures be made to prospective franchisees and a cooling off period before the franchise can actually be sold.¹

The FTC Rule is designed to promote transparency by requiring franchisors to furnish prospective franchisees with a Franchise Disclosure Document (“FDD”) containing standardized information about the franchisor, the franchise system, the fees and investment required, the parties’ legal rights and obligations, and, if made, any financial performance representations. However, two notable differences exist: (1) there is no federal government registration requirement under the FTC Rule and (2) there is no private right of action if the FTC Rule is violated.² Only the FTC can bring civil or criminal actions if a franchisor fails to comply with the FTC Rule.³

State franchise laws and regulations frequently go beyond the FTC Rule and vary considerably by jurisdiction. Some states require franchisors to register or file their FDDs before offering or selling franchises, impose state-specific disclosure timing and content requirements, and provide administrative, civil, or criminal remedies for noncompliance. In addition, a number of states regulate the ongoing franchisor-franchisee relationship through statutes governing matters such as termination, nonrenewal, transfer, and notice and cure rights. Accordingly, franchise regulation in the United States is a layered system in which the FTC Rule establishes the federal floor, while state law often imposes additional and sometimes materially different obligations.

Franchise: Defined

To define a “franchise” we must look at both federal and state laws that govern franchising. Under federal law, the FTC Rule and most state registration laws define a franchise as comprising three key elements: (1) The franchisor and franchisee are mutually associated with a common trademark, logo, or trade name; or, separate and apart from requiring association with a trademark, there is a marketing plan that governs the use thereof; (2) The franchisor provides the franchisee with significant

¹ See 16 C.F.R. §§ 436.1–436.9 (2007); *see also* 72 Fed. Reg. 15,445 (Mar. 30, 2007) (Statement of Basis and Purpose for the Amended Rule).

² See 72 Fed. Reg. at 15,452 (noting no federal registration requirement); *see also* 16 C.F.R. § 436.9(c) (“The provisions of this part ... shall not create any private right of action.”).

³ See 15 U.S.C. § 45 (FTC enforcement authority); 16 C.F.R. § 436.9(c).

assistance, and/or imposes significant controls over the franchisee's operation of the franchised business; and (3) The franchisee is required to pay a fee.⁴ Although state-law definitions of "franchise" vary in certain respects, the differences generally are not substantial. Some states do not require all three elements—for example, New York—while others employ a similar three-part framework but define the requisite showing for each element differently.

The Trademark Element

The trademark element is central to the franchise relationship because the franchisee is granted the right to operate under the franchisor's marks and to capitalize on the consumer recognition and goodwill those marks represent. Obtaining a federally registered trademark is generally critical for franchisors. While trademark registration is not required to franchise in the United States, nor to obtain common law rights in a trademark (such rights are earned by use of the trademark), the owner of a common law trademark only earns exclusive rights to use the trademark in the area of use and the likely zone of expansion.⁵ This means that another business, even the same type of business, may be able to use the mark without infringing as long as it is in a separate geographic area. Commerce on the internet/social media has blurred the definition of what it means to use a trademark in a certain area, which could make it difficult to determine who has the rights to the mark and where those rights apply. To prevent problems like this from arising, franchisors should speak to counsel about clearing their marks for use and registration by ensuring that the mark is legally protectable, available, and does not infringe on someone else's trademark. Franchisors should seek to register their trademarks.

Federal trademark registration on the Principal Register, which is maintained by the U.S. Patent and Trademark Office ("USPTO"), entitles the owner of a mark to numerous benefits that help protect the mark, including a presumption of validity,

⁴ 16 C.F.R. § 436.1; *see, e.g.*, Cal. Corp. Code § 31005 (West 2014); 815 Ill. Comp. Stat. 705/3(1); Ind. Code § 23-2-2.5-1(a); Md. Code Ann., Bus. Reg. § 14-201(e); Minn. Stat. § 80C.01, subdiv. 4(a); N.Y. Gen. Bus. Law § 681(3); N.D. Cent. Code § 51-19-02; R.I. Gen. Laws § 19-28.1-3(7); S.D. Codified Laws § 37-5B-1(11); Va. Code Ann. § 13.1-559; Wash. Rev. Code § 19.100.010; Wis. Stat. § 553.03.

⁵ *See United Drug Co. v. Theodore Rectanus Co.*, 248 U.S. 90, 100 (1918); *Hanover Star Milling Co. v. Metcalf*, 240 U.S. 403, 415–16 (1916).

ownership, and exclusive nationwide use of the mark in connection with the type of goods or services for which it was registered.⁶ Owners of a federal registration may also use the Lanham Act to pursue trademark infringement claims in federal court. The Lanham Act provides for statutory remedies that would be otherwise unavailable to trademark owners, including damages for infringement that are separate from what the franchisor may be able to claim against a rogue franchisee for breach of the franchise agreement.⁷ Another benefit of federal registration is that it serves as constructive notice of the right holder's claim of ownership.⁸ After a mark is registered for at least five years, the owner of the mark can seek incontestable status.⁹ Incontestable status prevents the mark from being challenged on certain grounds related to it being merely descriptive.¹⁰ If a franchisor does not have a registered trademark, it must disclose the absence of such a registration and the risks associated therewith in Item 13 of its Franchise Disclosure Document ("FDD").¹¹

Even where a state's franchise definition does not expressly mandate trademark association as a separate or exclusive requirement, the concept frequently remains present when the state statute prescribes a marketing plan or system as this ordinarily assumes the franchisee's operation under the franchisor's marks and the goodwill associated with them.

The Assistance and Control Element

As noted earlier, substantively, state registration laws describe the definitional aspects of franchises in a similar manner, although the wording may appear quite different. Rather than talking in terms of "significant assistance" or "significant control," most state statutes require that the franchisee be required to follow a

⁶ See 15 U.S.C. § 1057(b).

⁷ See *id.* § 1114.

⁸ See *id.* § 1072.

⁹ See *id.* § 1065.

¹⁰ See *Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 196, 205 (1985); 15 U.S.C. § 1065.

¹¹ 16 C.F.R. § 436.5(m).

prescribed or suggested marketing plan, or that a continuity of interest exist between the franchisee and the franchisor.¹²

In essence, the definitional differences between the FTC Rule and state statutes or regulations are usually not that significant, although certain exceptions exist. By way of example, New York's definition of a franchise departs significantly from the FTC's definition. Namely, New York does not require a franchisor to have a "significant degree of control" over the franchisee's method of operation for a franchise to be created. Rather, a franchise relationship is technically formed where the franchisee is granted the right to sell goods substantially associated with the franchisor's trademarks or other symbols that designate the franchisor—in other words, a trademark license.¹³ Conversely, a franchise cannot be created under the FTC's definition without the franchisor exercising a significant degree of control over or providing significant assistance to the franchisee.¹⁴

The difference between a trademark licensing relationship and a franchise relationship often turns on the amount of assistance or control that a franchisor provides to or exerts over a franchisee. Generally, the more assistance or control, the more likely the relationship may be considered a franchise, but the lines of demarcation are quite gray.¹⁵ Determining whether a licensing relationship is a franchise

¹² See, e.g., 815 Ill. Comp. Stat. 705/3(1) ("marketing plan or system prescribed in substantial part by a franchisor"); Ind. Code § 23-2-2.5-1(a) (same); Md. Code Ann., Bus. Reg. § 14-201(e)(1) (same); N.D. Cent. Code § 51-19-02(1) (same); Wash. Rev. Code § 19.100.010(11)(a) ("marketing plan prescribed or suggested in substantial part by the grantor"); Minn. Stat. § 80C.01, subdiv. 4(a)(ii) ("community of interest in the marketing of goods or services"); Haw. Rev. Stat. § 482E-2 (same).

¹³ See N.Y. Gen. Bus. Law § 681.

¹⁴ 16 C.F.R. § 436.1(h)(2).

¹⁵ Compare *Safe Step Walk in Tub Co. v. CKH Industries, Inc.*, 242 F.Supp.3d 245, 257–259 (S.D.N.Y. 2017) (finding plausible franchise relationship based on contractual provisions allowing trademark holder to set minimum sales requirements, assist in developing a marketing plan, direct the other party to make changes to its business model, require training, mandate periodic financial reporting, and prohibit the sale of competing products) with *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118, 121–122 (D. Conn. 1999) (finding arrangement did not constitute a franchise because defendant did not control plaintiff's hours

relationship requires a fact-specific analysis of each contractual obligation of a proposed relationship, as well as the totality of such obligations.

Generally, indicia of significant control include: (1) requiring site approval for unestablished businesses; (2) implementing site design or appearance requirements; (3) controlling hours of operation; (4) mandating production techniques and supplier controls; (5) mandating accounting practices or personnel selection or policies; (6) requiring franchisee participation or financial contribution to promotional campaigns; and (7) restricting customers, locale, or area of operation.¹⁶

Indicia of significant assistance include: (1) providing formal sales, repair, or business training programs; (2) establishing accounting systems; (3) furnishing management, marketing, or personnel advice; (4) furnishing system-wide networks and website; and (5) furnishing a detailed operating manual.¹⁷

Generally, the following items do not constitute significant control or assistance: (1) implementing trademark controls designed solely to protect the trademark owner's legal ownership rights in the mark under state or federal trademark laws (such as display of the mark or right of inspection); (2) furnishing a distributor with point-of-sale advertising displays, sales kits, product samples, and other promotional materials intended to help the distributor in making sales; (3) providing advertising in various media; (4) implementing health or safety restrictions required by federal or state law or regulations; (5) assisting distributors in obtaining financing to be able to transact business.¹⁸

Assessing whether the parties have satisfied the significant assistance or control element is not an exact science, and often turns on the specific facts and circumstances of each relationship and the amount of control or assistance being provided by the franchisor.

and days of operation, did not inspect plaintiff's premises, and did not audit plaintiff's financial records, among other factors).

¹⁶ See Fed. Trade Comm'n, *Franchise Rule Compliance Guide 2-4* (2008), available at www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf; see also 44 Fed. Reg. 49,966, 49,968 (Aug. 21, 1979) (Interpretive Guides to the FTC Franchise Rule).

¹⁷ See Fed. Trade Comm'n, *Franchise Rule Compliance Guide 2-4* (2008).

¹⁸ *Id.*

The Franchise Fee Element

A “franchise fee” need not be labeled or defined as such in the agreement. Courts have broadly construed a variety of payments from the franchisee to the franchisor or its affiliates to qualify as a franchise fee for the purposes of determining whether a franchise relationship exists.¹⁹ A franchisor should therefore carefully review the nature of the payment, rather than how it may be characterized, to ascertain whether the payment will likely be deemed a franchise fee under applicable law.

Both the FTC and all of the registration states have interpreted the term franchise fee broadly to include almost all revenue received by the franchisor or its affiliates from the franchisee, whatever the source.²⁰ However, the term franchise fee has also been interpreted to exclude revenues derived from the sale of reasonable amounts of inventory in the ordinary course of business at bona fide wholesale prices.²¹ Thus, the traditional distributor who simply buys inventory from the manufacturer will not typically be deemed a franchisee. On the other hand, if the distributor is required to pay an up-front fee, purchase excessive amounts of inventory, pay inflated prices for inventory, or purchase other items or services from the manufacturer or its affiliates, such as repair equipment or training, the federal and state regulations may deem these franchise fees.

Avoiding the “Surprise Franchise”

The easiest way to avoid the “franchise” definition, i.e., the “Surprise Franchise”, is to make sure your relationship agreement does not contain one of the three elements of the franchise definition. But, the broad nature of franchise legislation can mean that

¹⁹ See, e.g., *Hamade*, 721 N.W.2d at 241 (Mich. Ct. App. 2006) (minimum purchase requirements may constitute a franchise fee); see also *Blanton v. Mobil Oil Corp.*, 721 F.2d 1207, 1220 (9th Cir. 1983) (mandatory product purchases constituted payment of a franchise fee).

²⁰ See 16 C.F.R. § 436.1(g) (defining “required payment” broadly); Fed. Trade Comm’n, *Franchise Rule Compliance Guide* 4–6 (2008).

²¹ 16 C.F.R. § 436.1(g); see also, e.g., N.D. Cent. Code § 51-19-02(5)(a) (excluding “purchase or agreement to purchase goods at a bona fide wholesale price”); S.D. Codified Laws § 37-5B-1(27) (excluding “purchase of reasonable amounts of inventory at bona fide wholesale prices for resale”).

other business relationships, such as license agreements, could technically meet the requirements for regulation under franchise laws.²² Indeed, distribution arrangements are also often subject to state franchise registration laws and the FTC Rule.²³ While the trademark requirement is not usually the definitional aspect that creates legal issues for license or distribution arrangements, the fee and control elements can create controversy as to whether the relationship will be classified as a franchise.²⁴ Usually a distributor, unlike the classic franchisee, pays nothing up front to obtain his distribution rights, and the revenues from which the manufacturer will make his profit come solely from product markups. But frequently, the brand owner makes demands on its licensees and distributors to control how they use the brand, and this may cross the line on the control element.

The “Business Opportunity” May Be Subject to Federal and State Regulations

Even if a relationship does not meet the definition of a franchise, it could be considered a business opportunity.²⁵ A business opportunity is a continuing commercial relationship in which the seller arranges for the purchaser to obtain a supply of goods, commodities, or services, and secures for the purchaser retail outlets or accounts for the goods, commodities, or services. The business opportunity may also arise when the seller secures for the purchaser locations or sites for vending machines, rack displays, or any other product sales displays used in the offer or distribution of goods, commodities, or services.²⁶

²² See, e.g., N.Y. Gen. Bus. Law § 681(3) (defining “franchise” with only two elements, such that any trademark license involving a fee could qualify).

²³ See 16 C.F.R. § 436.1(h); see also Fed. Trade Comm’n, *Franchise Rule Compliance Guide* 2–6 (2008) (explaining that distribution arrangements may satisfy the franchise definition).

²⁴ See Fed. Trade Comm’n, *Franchise Rule Compliance Guide* 4–6 (2008); see also Douglas C. Berry, David M. Byers & Daniel J. Oates, *State Regulation of Franchising: The Washington Experience Revisited*, 32 Seattle U. L. Rev. 811, 840–41 (2009).

²⁵ See 16 C.F.R. § 437.1(c).

²⁶ See *id.*

Federal law and twenty-five states regulate the sale of business opportunities, which are defined differently under each state statute.²⁷ The state law definitions are often expansive enough to include traditional franchises or distributorships, as well as agreements to service and supply vending machines and rack displays. Accordingly, these statutes must be taken into account when setting up any franchise or distributorship arrangement.

Types of Franchise Structures

Franchises may be offered and sold under several common structural models, depending on the franchisor's growth strategy and the franchisee's experience and financial resources.

The most basic format is a *single-unit franchise*, under which a franchisee is granted the right to develop and operate one franchised location pursuant to a single franchise agreement.

Some systems may offer *multi-unit franchise arrangements*, which allow a franchisee to own and operate multiple franchised locations. These arrangements are frequently structured as area development programs, pursuant to which the franchisor and franchisee enter into a development agreement granting the franchisee the right—and obligation—to develop a specified number of units within a defined territory over a designated period of time. The development agreement is executed in addition to individual franchise agreements, which are signed as each unit is opened and govern the operation of each specific franchised location.

Some franchisors, particularly outside the United States, employ a *master franchise* structure, under which a master franchisee is granted the right to develop units and subfranchise to third parties within a defined territory. However, master franchising is not a typical model in the United States because a master franchisee selling subfranchises would generally be required to comply independently with federal and state disclosure and registration requirements. Moreover, the added layer of the master franchisee between the franchisor and individual franchisees can dilute the franchisor's

²⁷ See Bus. Franchise Guide (CCH) ¶¶ 5500–5599 (compiling state business opportunity statutes); see also Beata Krakus & Alexander G. Tuneski, *Caught in the Web of Federal and State Business Opportunity Laws: Managing and Avoiding the Entanglement of Regulations*, in 36th Annual Forum on Franchising, W-7 (Am. Bar. Ass'n, Orlando, Fla., Oct. 16–18, 2013).

operational control and materially diminish the franchisor's overall return on investment.

Franchise Sales Laws and Regulations

Franchise sales are regulated at both the state and federal level. Today, 15 states have franchise laws requiring presale disclosures, including California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.²⁸ Unlike the other 13 states that require prior state review and approval of the FDD, Michigan is a notice filing state (i.e., it does not conduct any review of the FDD when it is filed along with a short form and fee), and Oregon requires neither registration nor filing.²⁹

Although each state registration law has its own peculiarities, the statutes are for the most part similar, and all: (1) contain definitions of the term franchise; (2) require the franchisor's presale disclosure document to be registered with designated state officials before a franchise is offered for sale; (3) require certain disclosures be made to prospective franchisees; and (4) require a cooling-off period before the franchise offer may be accepted by a prospective franchisee.³⁰

²⁸ See Cal. Corp. Code §§ 31000 et seq.; Haw. Rev. Stat. §§ 482E-1 et seq.; 815 Ill. Comp. Stat. 705/1 et seq.; Ind. Code §§ 23-2-2.5-1 et seq.; Md. Code Ann., Bus. Reg. §§ 14-201 et seq.; Mich. Comp. Laws §§ 445.1501 et seq.; Minn. Stat. §§ 80C.01 et seq.; N.Y. Gen. Bus. Law §§ 680 et seq.; N.D. Cent. Code §§ 51-19-01 et seq.; Or. Rev. Stat. §§ 650.005 et seq.; R.I. Gen. Laws §§ 19-28.1-1 et seq.; S.D. Codified Laws §§ 37-5B-1 et seq.; Va. Code Ann. §§ 13.1-557 et seq.; Wash. Rev. Code §§ 19.100.010 et seq.; Wis. Stat. §§ 553.01 et seq.

²⁹ See Mich. Comp. Laws § 445.1507a; Or. Rev. Stat. § 650.015.

³⁰ See, e.g., Cal. Corp. Code §§ 31100, 31110, 31119; Md. Code Ann., Bus. Reg. §§ 14-214(a), 14-223; Minn. Stat. §§ 80C.02, 80C.03; N.Y. Gen. Bus. Law §§ 681(3), 683; Wis. Stat. §§ 553.21, 553.27.

Each statute provides for civil and criminal remedies in the event a franchisor violates the statute.³¹ The civil remedies may be enforced either by designated state officials or by the affected franchisee.³²

Connecticut, Georgia, Louisiana, Maine, North Carolina, and South Carolina require pre-sale disclosure where a franchisor does not have a federally registered trademark.³³ Owning a state trademark registration can alleviate this disclosure requirement if a federal trademark registration is unattainable. Connecticut, Florida, Kentucky, Nebraska, South Dakota, Texas, and Utah require a simple notice filing if a franchisor owns a federally registered mark and/or satisfies the FTC Rule's definition of "franchise".³⁴

In states without franchise sales statutes, franchisors must comply with just the FTC Rule when selling franchises.

How Does the FTC Rule Coexist with State Franchise Registration Statutes?

In general, the FTC Rule preempts state laws only when state laws provide less protection to franchisees.³⁵ Consequently, when a franchisor is offering to sell franchises in a state that mandates franchise registration, the franchisor will need to follow both the FTC Franchise Rule and that state's applicable laws governing the

³¹ See, e.g., Cal. Corp. Code §§ 31300–31302; N.Y. Gen. Bus. Law §§ 687, 689; Md. Code Ann., Bus. Reg. §§ 14-227 to 14-229; Wis. Stat. §§ 553.51, 553.52.

³² See, e.g., Cal. Corp. Code § 31302 (private right of action); N.Y. Gen. Bus. Law § 691 (attorney general enforcement); Md. Code Ann., Bus. Reg. § 14-227 (private civil action); Minn. Stat. § 80C.17 (civil liability).

³³ See Conn. Gen. Stat. §§ 36b-60 et seq.; Ga. Code Ann. § 10-1-410; La. Rev. Stat. Ann. § 51:1821 et seq.; Me. Rev. Stat. Ann. tit. 32, § 4691 et seq.; N.C. Gen. Stat. § 66-94 et seq.; S.C. Code Ann. § 39-57-20.

³⁴ See Conn. Gen. Stat. § 36b-62; Fla. Stat. § 559.803; Ky. Rev. Stat. Ann. § 367.801 et seq.; Neb. Rev. Stat. § 87-403; S.D. Codified Laws § 37-5B-20; Tex. Bus. & Com. Code § 51.003; Utah Code Ann. § 13-51-201.

³⁵ See 16 C.F.R. § 436.10 ("The Commission does not intend to preempt the franchise practices laws of any state ... except to the extent of any inconsistency with [the FTC Rule]."); 72 Fed. Reg. at 15,527.

offer and sale of franchises.³⁶ Since most of the registration statutes afford greater protection to prospective franchisees, many of the problems created by dual federal and state regulation have been eliminated.

States have also done their part to attempt to make most of their regulations more consistent with the requirements imposed by the FTC Rule; however, many states have retained their own idiosyncrasies that impose additional or different requirements on franchisors.³⁷

Exemptions and Exclusions from the Requirements of the FTC Rule and/or State Statutes

Both the FTC and the states have exempted or excluded certain activities or persons from the scope of regulation. The FTC Rule, for example, contains the following exemptions from the disclosure requirements of the FTC Rule: (1) large franchisee exemption (franchisee or an affiliate is an entity that has been in business for at least five years and has a net worth of at least \$7,348,000);³⁸ (2) large franchise investment exemption (where at least one individual contributes a minimum of \$1,469,000);³⁹ (3) exemption for franchise sales to insiders;⁴⁰ (4) exemption for department store leasing arrangements;⁴¹ (5) fractional franchise exemption for

³⁶ See 72 Fed. Reg. at 15,520 n.772 (noting that franchisors exempt from disclosure under the Amended Rule may still need to comply with state franchise laws).

³⁷ Compare 16 C.F.R. § 436.2(a) (requiring disclosure of the FDD “at least 14 calendar days” before the franchisee signs any binding agreement or pays any money) with N.Y. Gen. Bus. Law § 683(8)(a)–(c) (requiring disclosure of the FDD at the earlier of: (i) the first in-person meeting, (ii) ten business days before signing, or (iii) 10 days before taking any consideration). See also Cal. Code Regs. tit. 10, § 310.100.2 (requiring that a franchisor must disclose a summary of negotiated terms with other franchisees within the last 12 months, where there is no comparable requirement under the FTC Rule). See generally 72 Fed. Reg. 15,445 (Mar. 30, 2007) (Statement of Basis and Purpose for the Amended Rule) (discussing state by state variations and inconsistencies with the FTC Rule).

³⁸ 16 C.F.R. § 436.8(a)(5)(ii).

³⁹ *Id.* § 436.8(a)(5)(i).

⁴⁰ *Id.* § 436.8(a)(6).

⁴¹ *Id.* § 436.8(a)(3).

franchisees that have more than two years of experience in a line of business, and sales from the new franchise line of business make up less than 20% of the business's overall sales;⁴² (6) minimum payment exemption where the required payment to the franchisor is less than \$735 within the first six months;⁴³ (7) exemption for oral agreements for which there is no written evidence of a material term of the franchise relationship;⁴⁴ and (8) exemption for petroleum marketers and resellers covered by the Petroleum Marketing Practices Act ("PMPA").⁴⁵ The monetary thresholds for the large franchisee exemption, large franchise investment exemption, and minimum payment exemption are adjusted every fourth year based on the Consumer Price Index for all urban consumers [CPI-U] published by the Department of Labor and were last adjusted in 2024.⁴⁶

In addition to federal exemptions from disclosure, there are state exemptions and exclusions from disclosure and/or registration. A franchise sale may be exempt from disclosure requirements at the state level, but not at the federal level, and vice versa. One should consult the FTC Rule and the various state franchise laws for applicable exemptions/exclusions and the conditions for claiming them. The following is a list of several of the more common types of exemptions or exclusions, along with a short description (there may be others available in a particular jurisdiction):

- Bank Credit Card Plans: Some states exempt bank credit card plans from registration and disclosure.⁴⁷
- Cooperative Organizations: The cooperative organization exemption or exclusion varies by jurisdiction. It normally applies to organizations where

⁴² *Id.* § 436.8(a)(2).

⁴³ *Id.* § 436.8(a)(1).

⁴⁴ *Id.* § 436.8(a)(7).

⁴⁵ *Id.* § 436.8(a)(4); *see also* 15 U.S.C. §§ 2801 et seq. (Petroleum Marketing Practices Act).

⁴⁶ 16 C.F.R. § 436.8(b)(1) (providing for quadrennial CPI adjustment); Franchise Rule; Inflation-Adjusted Monetary Thresholds, 89 Fed. Reg. 57,708 (July 12, 2024) (amending 16 C.F.R. § 436.8).

⁴⁷ *See, e.g.*, Cal. Corp. Code § 31103 (West 2014); N.Y. Gen. Bus. Law § 684(6).

members own equal shares in the organization and directly benefit from the goods/services the organization provides.⁴⁸

- Discretionary Exemptions: Upon submitting a written request, a discretionary exemption may be granted by the state agency responsible for enforcing the state's franchise laws if certain conditions are met.⁴⁹
- Institutional Franchisee: The institutional franchisee exemption applies when a franchisee is an organization like a bank, trust company, insurance company, or broker-dealer and is purchasing the franchise for itself or in a fiduciary capacity.⁵⁰
- Internet Offers: Some states exempt offers through the internet from registration and/or advertising filing requirements if the offers are not targeted at a person in that state.⁵¹
- Isolated Sale/Single Sale: Specific conditions vary, but the isolated sale/single sale exemption generally applies to the sale of only a few franchises in a set period of time, and other conditions may apply.⁵²

⁴⁸ See, e.g., Cal. Corp. Code § 31005 (West 2014); Mich. Comp. Laws § 445.1502(1); N.D. Cent. Code § 51-19-04(1)(g).

⁴⁹ See, e.g., N.Y. Gen. Bus. Law § 684(1); Md. Code Ann., Bus. Reg. § 14-214(b); Minn. Stat. § 80C.03, subdiv. (g).

⁵⁰ See, e.g., 21 Va. Admin. Code § 5-110-75(5)(b); N.Y. Gen. Bus. Law § 684(3)(b); 815 Ill. Comp. Stat. 705/8.

⁵¹ See, e.g., N.Y. Comp. Codes R. & Regs. tit. 13, § 200.10; Minn. R. 2860.0100; see also NASAA Statement of Policy Regarding Offers of Franchises on the Internet (May 3, 1998), available at https://www.nasaa.org/wp-content/uploads/2011/08/12-Internet_Offers_Franchises.pdf.

⁵² See, e.g., N.Y. Gen. Bus. Law § 684(3)(c); Ind. Code § 23-2-2.5-1(b)(3); Md. Code Ann., Bus. Reg. § 14-214(b)(2).

- Judicial Officer Sale: The judicial officer sale exemption applies to sales by marshals, sheriffs, receivers, guardians, conservators, trustees in bankruptcy, executors or administrators of an estate, or other judicial officers.⁵³
- Large/Sophisticated Franchisee: The large/sophisticated franchisee exemption is based on the franchisee's net worth and experience meeting minimum thresholds. Other conditions, such as filing an exemption notice, may apply.⁵⁴
- Offer While Renewal or Amendment Application Is Pending: A limited number of states permit offers made while a renewal or amendment is pending, so long as the franchisors comply with certain additional requirements each state sets out.⁵⁵
- Offer/Sale to Existing Franchisees: The offer/sale to existing franchisees exemption usually applies to the sale of an additional franchise to an existing franchisee who owns the same type of franchise as long as it is on substantially the same terms as the existing franchisee and additional conditions are met. The exemption may apply to registration and disclosure or to registration only.⁵⁶
- Out-of-State Sales: Some states have explicit exemptions about out-of-state sales. Most of these exemptions apply when the business will not be located in the state and the franchisee is not residing in the state, even if the offer was made or accepted in the state.⁵⁷

⁵³ See, e.g., Minn. Stat. § 80C.03, subdiv. (b); Wash. Rev. Code § 19.100.030(2); Mich. Comp. Laws § 445.1506(d).

⁵⁴ See, e.g., Cal. Corp. Code § 31109 (West 2014); Wis. Stat. § 553.235; N.Y. Gen. Bus. Law § 684(2)(a)(net worth).

⁵⁵ See, e.g., Cal. Corp. Code § 31107 (West 2014); N.Y. Gen. Bus. Law § 684(3)(a).

⁵⁶ See, e.g., Cal. Corp. Code § 31106 (West 2014); N.Y. Gen. Bus. Law § 684(3)(d); Mich. Comp. Laws § 445.1506(h).

⁵⁷ See, e.g., Cal. Corp. Code § 31105 (West 2014); Wis. Admin. Code DFI § 32.05(1); Minn. Stat. § 80C.03, subdiv. (h).

- Renewal or Extension of Existing Franchise: This exemption or exclusion applies to the renewal or extension of an existing franchise as long as there is no interruption in the business. Other conditions may apply.⁵⁸
- Sale by Existing Franchisee: The sale by existing franchisee exemption covers the franchisee's sale of a franchise to a third party. Additional conditions may apply.⁵⁹

The Required Franchise Disclosures to a Prospective Franchisee

If a relationship meets the applicable state or federal definition of a franchise, the franchisor or its counsel must prepare an FDD. The FDD includes certain disclosures mandated by the FTC Rule and state statutes. While the form of the FDD is similar among the various states, counsel should note that each state has its own peculiarities, and the document used to sell franchises in each registration state may be different in certain respects from that used in other jurisdictions. Typically, these state peculiarities are addressed in the form of addenda to the FDD and related agreements so that a single FDD may be used in all 50 states and some U.S. territories.

An FDD includes 23 sections called Items, and numerous exhibits. The body of a typical FDD can range from 50 to 100 or more pages. The entire FDD, including exhibits, often will be over 200 pages. Information relating to the franchise that must be disclosed in the FDD includes, among other things: (1) background information on the franchisor and its key management, officers, and directors; (2) the amount of initial and subsequent franchise fees to be paid to the franchisor and its affiliates; estimated initial investment costs covering pre-opening and a reasonable start-up period; (3) any requirements that the franchisee must purchase certain items from the franchisor or its affiliates or otherwise do business with designated suppliers and/or in accordance with franchisor's specifications; and (4) a summary of certain material provisions of the franchise agreement (such as the term, renewal rights, restrictions on in-term and post-

⁵⁸ See, e.g., Cal. Corp. Code § 31018 (West 2014); N.Y. Gen. Bus. Law § 681(11); Minn. R. 2860.1100, subpt. 2.

⁵⁹ See, e.g., Cal. Corp. Code § 31102 (West 2014); N.Y. Gen. Bus. Law § 684(5); Ind. Code § 23-2-2.5-1(b)(7).

term competition, and territorial rights granted to the franchisee).⁶⁰ Any agreements that are relevant to the franchise opportunity, such as the franchise agreement or development agreement, must be included as exhibits to the FDD.⁶¹

Audited financial statements of the franchisor must also be included in the FDD, although the FTC Rule allows a phase-in period during which a start-up franchisor does not need to include audited financial statements.⁶² However, counsel should note that certain registration states impose more stringent requirements during the phase-in period which may require a franchisor to obtain audited financial statements.⁶³

Claims About a Franchisee's Potential Earnings – Item 19

A franchisor may make claims about a franchisee's potential earnings if the information is included in Item 19 of the FDD.⁶⁴ Item 19 includes financial performance representations ("FPRs") that a franchisor wishes to make about its franchise opportunity. A franchisor is not required to include any FPRs in its FDD, although a majority of franchisors do so because this is an effective way to show prospective franchisees the potential earnings of the franchise.

However, with limited exceptions, a franchisor and its sales representatives may not make any other FPRs to a prospective franchisee about the earnings of other franchisees, projected earnings of franchisees, or sales information, unless the FPRs are included in Item 19.⁶⁵ Thus, if a franchisor does not include financial data in its FDD, the franchisor is unable to answer questions regarding a franchisee's potential income or earnings.⁶⁶

⁶⁰ See generally 16 C.F.R. § 436.5.

⁶¹ 16 C.F.R. § 436.5(v).

⁶² *Id.* at § 436.5(u)(2).

⁶³ See, e.g., Cal. Corp. Code § 31119; Md. Code Ann., Bus. Reg. § 14-216; Minn. R. 2860.1400.

⁶⁴ 16 C.F.R. § 436.5(s).

⁶⁵ *Id.* § 436.9(a).

⁶⁶ *Id.*

FPRs included in Item 19 may be projections or based on historical results of existing outlets.⁶⁷ In practice, the overwhelming majority of FPRs present data from existing outlets rather than projections. Data from subsets of outlets may be used if appropriate disclosures are included that allow the franchisee to understand how representative the subset may be compared to the rest of the outlets in the system.⁶⁸ If the franchisor does not yet have any franchised outlets, it may provide historical results from any units owned by the franchisor or its affiliate.⁶⁹ There must be a reasonable basis for all claims made in Item 19, and a franchisor must be able to produce the data that was used to make the representations and to substantiate the claims made.⁷⁰

The North American Securities Administrators Association (“NASAA”) Franchise Commentary on FPRs went into effect in 2018 and provides guidance on the requirements of presenting an Item 19 in an FDD.⁷¹

When Must a Franchisor Provide an FDD to a Prospective Franchisee?

Under the FTC Rule, a franchisor must provide its FDD to a prospective franchisee at least 14 calendar days before entering into any binding agreement with or receiving any payment from the franchisee.⁷² State rules may differ. For example, in New York, the FDD must be provided at the earlier of the first personal meeting with the franchisee or 10 business days before the franchisee signs a binding agreement with, or makes a payment to, the franchisor.⁷³ In Michigan, the FDD must be provided 10

⁶⁷ *Id.* § 436.5(s)(3).

⁶⁸ *Id.* § 436.5(s)(3)(ii)(C).

⁶⁹ *Id.* § 436.5(s)(3)(ii)(B).

⁷⁰ *Id.* § 436.5(s)(3)(ii)(A).

⁷¹ NASAA Franchise Commentary: Financial Performance Representations (effective May 7, 2017; amended 2018), *available at* www.nasaa.org. NASAA is the association of state securities regulators, and its franchise statements of policy and commentaries are widely relied upon by state franchise examiners in reviewing franchise registration applications and providing related guidance.

⁷² 16 C.F.R. § 436.2(a).

⁷³ N.Y. Gen. Bus. Law § 683(8); *see also* N.Y. Comp. Codes R. & Regs. tit. 13, § 200.2.

business days before the franchisee signs a binding agreement with, or makes a payment to, the franchisor.⁷⁴

Franchise Registration: The Process

California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin require registration of the FDD, which can be a difficult and often lengthy task that necessitates advanced planning by the franchisor and its legal counsel. The franchisor or its counsel must submit the FDD and various forms to the appropriate state officials. The entire package is referred to as the registration application. Registration applications must be accompanied by the applicable registration fee, which ranges from \$250 to \$1,865, and varies from state to state.⁷⁵ Registrations are effective for one year and generally must be renewed before their expiration date, along with any updates to the FDD. Renewal fees are usually less, ranging from \$100 to \$1,245.⁷⁶ Most states also impose an electronic filing fee of \$50 or \$100.⁷⁷

Except in Indiana, Michigan, South Dakota, and Wisconsin (where the formal review process has been eliminated), the state examiners review the registration application and furnish comments to the franchisor. The franchisor must then respond to these comments, either by making the suggested changes, or by overcoming the examiner's concerns. While deficiencies can often be corrected with only one revision, it is not unusual for a franchise registration application to be revised two or more times before the state will register the offering and for the entire registration process to take two to four months from the date the registration application is first submitted for review. When the registration process is successfully completed, an order declaring the registration effective is issued by the state. The order does not indicate that the registration has been endorsed by the state, and any representation to that effect can be a criminal offense.

⁷⁴ Mich. Comp. Laws § 445.1508.

⁷⁵ See, e.g., Cal. Corp. Code § 31111; N.Y. Gen. Bus. Law § 694; Md. Code Ann., Bus. Reg. § 14-216; Minn. Stat. § 80C.04. Specific fees vary by state and are updated periodically.

⁷⁶ See same statutes cited *supra* (setting renewal-specific fee amounts lower than initial registration fees).

⁷⁷ See NASAA E-Filing Portal, www.nasaa.org (setting state-specific electronic filing fees).

States Apply Different Standards of Review

The review process by each state has traditionally been independently conducted. Because of other variations in state regulations, the different training programs given to franchise registration examiners, and in some cases the differing philosophies of state officials toward the review process, the registration process can take different turns in each jurisdiction, thereby increasing the likelihood that the offering documents will be different in each state.

All states can require that initial fees paid to the franchisor (e.g., all fees paid by franchisee concurrently with signing the franchise agreement, such as the initial fee, training fee, and technology set-up fee) be subject to “financial assurances” which essentially require the escrow, impound, or deferral of the initial fees until the prospective franchisee’s business opens and/or the franchisor has completed its pre-opening obligations.⁷⁸ States also give franchisees the option of providing financial assurance by purchasing a surety bond.⁷⁹ However, not all states will require financial assurances, even in identical factual settings. In many registration jurisdictions, franchise sales literature must be cleared by the state in advance.⁸⁰ Again, different standards of review may be applied. The bottom line is that the offering documents and the registration process can vary considerably from state to state, making franchise-selling a cumbersome and expensive process.

Penalties for Noncompliance under the FTC Rule

Failure to comply with the FTC Rule can have severe results. Government agencies with enforcement authority may bring actions to enforce franchising laws.⁸¹ For violations of the FTC Rule, the Federal Trade Commission, through the U.S. Department of Justice, can bring an action to obtain injunctive relief as well as recovery

⁷⁸ See, e.g., Cal. Corp. Code § 31113; Md. Code Ann., Bus. Reg. § 14-216; Minn. Stat. § 80C.03, subdiv. (e).

⁷⁹ See, e.g., Cal. Corp. Code § 31113; 815 Ill. Comp. Stat. 705/15; S.D. Codified Laws § 37-5B-27.

⁸⁰ See, e.g., Cal. Corp. Code § 31156; Md. Code Ann., Bus. Reg. § 14-220; N.Y. Gen. Bus. Law § 683(11).

⁸¹ See 15 U.S.C. § 45(a) (FTC Act); 16 C.F.R. § 436.9(c).

of substantial civil penalties.⁸² Under the FTC Rule, the current penalty per violation is currently \$53,088.⁸³ Other remedies include equitable remedies, assessment of damages incurred by the public, and criminal sanctions.⁸⁴

Because of budget limitations and other factors, the FTC has not taken an aggressive role in prosecuting FTC Rule violations. As a general rule, the FTC seriously investigates situations only when the franchisor has not provided disclosure or has made FPRs in an unlawful manner, when the FTC Rule has been flagrantly flouted, or when widespread harm has been inflicted on the public.

When the FTC has taken on franchisors, it has been aggressive in seeking relief. It has imposed pre-judgment freezes on the assets of the franchisor and its principal officers.⁸⁵ It has also imposed hefty fines on some FTC Rule violators.⁸⁶ As for minor or technical violations, the FTC has addressed this problem by implementing a program under which offenders may agree to participate in a remedial program rather than face prosecution.⁸⁷ Under this program, the franchisor's management must participate in programs designed to assure that the franchisor is aware of its responsibilities under the FTC Rule, and the FTC will indirectly monitor the franchisor's sales activities for a limited time, typically three years.⁸⁸ All things considered, participation in this program is clearly a far more lenient and less expensive alternative than defending an action brought by the FTC, even when the franchisor is

⁸² See 15 U.S.C. §§ 45(l), 53(b) (authorizing injunctions and civil penalties for FTC Act violations).

⁸³ See 16 C.F.R. § 1.98 (adjusted civil penalty amounts); FTC, Adjustment of Civil Monetary Penalty Amounts, 90 Fed. Reg. 5,582 (Jan. 17, 2025) (amending 16 C.F.R. § 1.98).

⁸⁴ See 15 U.S.C. §§ 45(l), 53(b) (equitable remedies, damages); 15 U.S.C. § 45(m) (criminal sanctions in certain cases).

⁸⁵ See, e.g., *FTC v. Minuteman Press Int'l, Inc.*, No. CV-93-2094 (E.D.N.Y. 1993); *FTC v. Int'l Profit Assocs.*, No. 08-CV-5071 (N.D. Ill. 2008).

⁸⁶ See, e.g., *FTC v. Denny's Inc.*, No. 93-1316 (consent order imposing civil penalties for FTC Rule violations); see also FTC annual enforcement reports.

⁸⁷ See Fed. Trade Comm'n, *Franchise Rule Compliance Guide 25–26* (2008) (describing the FTC's remedial compliance program for minor violations).

⁸⁸ *Id.*

arguably in the right. Further, if a franchisor participates in this program, it is relieved of its requirement to make an FDD disclosure about the alleged violation.⁸⁹

Notably, there is no private right of action under the FTC Franchise Rule.⁹⁰ The absence of a right in an aggrieved franchisee to pursue a claim considerably reduces the risks of lawsuits resulting from FTC Rule violations. However, many states have adopted so-called Little FTC Acts which, in essence, give franchisees causes of action for FTC Rule violations.⁹¹ Franchisees may also have state actions available for fraud or unfair or deceptive practices that violate the FTC Rule.⁹²

Penalties for Noncompliance under State Registration Laws

The consequences for violations of state registration laws can also be dire. The remedies generally include civil penalties, including fines, provable damages, recovery of investigation costs and attorneys' fees, rescission and restitution, and injunctive relief.⁹³ Criminal penalties, which may include fines or imprisonment, are also possible.⁹⁴ State statutes grant franchisees the right to pursue their remedies by themselves, and in most states, grant franchisees the right to rescind their franchise

⁸⁹ *Id.* The FTC's compliance program relieves participants from Item 3 disclosure of the underlying franchise law violation.

⁹⁰ 16 C.F.R. § 436.9(c).

⁹¹ *See, e.g., KC Leisure, Inc. v. Haber*, 972 So. 2d 1069 (Fla. Dist. Ct. App. 2008) (FTC Rule violation supporting state Little FTC Act claim).

⁹² *See, e.g., Cal. Bus. & Prof. Code § 17200 et seq.; see also Satterlee & Curran, Exemption-Based Franchising: Are You Playing in a Minefield?*, 28 Franchise L.J. 191, 192 (2009).

⁹³ *See, e.g., Cal. Corp. Code §§ 31300–31302; N.Y. Gen. Bus. Law § 691; Md. Code Ann., Bus. Reg. §§ 14-227 to 14-229; Minn. Stat. § 80C.17.*

⁹⁴ *See, e.g., Cal. Corp. Code § 31410 (criminal penalties); N.Y. Gen. Bus. Law § 689 (criminal violations); Wis. Stat. § 553.52 (criminal penalties).*

purchases, even if they have suffered no provable damages.⁹⁵ Some states have also adopted remedial programs that are similar to the FTC.⁹⁶

While the possibility of FTC enforcement has not been much of a deterrent, state enforcement is viewed with a higher level of fear by legitimate franchisors. Relatively speaking, most states have comparatively devoted more resources than the FTC to enforcing their acts, especially when the violation is the failure of the franchisor to register. However, when a franchisee claims that the franchisor has misrepresented what is being sold, the state may be more reluctant to bring its enforcement powers to bear, absent compelling evidence verifying the aggrieved franchisee's position. Also, isolated technical violations of state law, if handled properly, generally do not bring about the state's full wrath, absent clearly demonstrable damage resulting from the violation.

Franchise Relationship Statutes

The federal government does not regulate franchise relationships generally. There are two exceptions to this statement—federal laws do regulate franchise relationships involving petroleum dealers and automobile dealers. The relationship between retailers and parties at higher levels in the petroleum distribution structure are regulated under the Petroleum Marketing Practices Act (“PMPA”), which imposes restrictions on the termination, renewal, and transfer of petroleum franchises.⁹⁷ The Automobile Dealer Franchise Act, more commonly known as the “Automobile Dealer Day-In-Court Act,” governs the manufacturer-dealer relationship in the automotive industry.⁹⁸ This statute requires automobile manufacturers to deal in good faith—that is, to refrain from coercing or intimidating, and from threatening to coerce or intimidate.⁹⁹

There are other federal laws—for example, the antitrust laws and the Racketeer Influenced and Corrupt Organizations (“RICO”) Act—that can affect franchise

⁹⁵ See, e.g., Cal. Corp. Code § 31300; Md. Code Ann., Bus. Reg. § 14-227; Minn. Stat. § 80C.17, subdiv. 2.

⁹⁶ See, e.g., N.Y. Gen. Bus. Law § 684 (discretionary exemption authority); cf. Fed. Trade Comm'n, *Franchise Rule Compliance Guide* 25–26 (2008) (describing similar federal program).

⁹⁷ 15 U.S.C. § 2801 et seq.

⁹⁸ *Id.* § 1221 et seq.

⁹⁹ See generally *id.*

relationships.¹⁰⁰ However, these statutes are not aimed specifically at the franchise arena, but instead at general commercial practices.

State Laws Regulating Franchise Relationships

In contrast to the federal government, 19 states have regulations governing franchise relationships generally: Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Washington, and Wisconsin. Puerto Rico and the Virgin Islands also have franchise relationship laws. In addition, there are many state statutes regulating franchise relationships in specific industries such as beer, wine, and farm and heavy construction equipment.

Scope of Franchise Relationship Laws

While there has been a considerable effort to standardize, from state to state, regulation of the franchise sales process, there is no well-discerned pattern of state franchise relationship regulations. Aspects of the franchise relationship that may be covered by these statutes include terminations, renewals, transfers, encroachment, freedom of association, and purchasing restrictions, but no two statutes are substantially identical, except Rhode Island's and Wisconsin's.¹⁰¹ Most of them focus on only one or a few of these areas, and in many instances, the regulatory approach among the states is dramatically different. The result is a complicated regulatory scheme.

Regulation of Franchisee Terminations under State Laws

Most franchise relationship statutes require a franchisor to have good cause before terminating a franchisee.¹⁰² Good cause is usually defined to include the failure of a

¹⁰⁰ See 15 U.S.C. §§ 1–7 (Sherman Act); 15 U.S.C. §§ 12–27 (Clayton Act); 18 U.S.C. §§ 1961–1968 (RICO).

¹⁰¹ Compare R.I. Gen. Laws § 19-28.1-14, with Wis. Stat. § 135.03. See generally Bus. Franchise Guide (CCH) ¶¶ 3000–3700 (compiling state franchise relationship laws).

¹⁰² See, e.g., Cal. Bus. & Prof. Code § 20020; Ind. Code § 23-2-2.7-1(7); Minn. Stat. § 80C.14, subdiv. 3; Wis. Stat. § 135.03.

franchisee to adhere to the provisions of the franchise agreement.¹⁰³ In addition, most statutes require the franchisor to give the franchisee notice of a breach or default and an opportunity to cure.¹⁰⁴ This notice requirement is generally not applicable to certain types of defaults such as bankruptcy, insolvency, or abandonment.¹⁰⁵

Today, in practice the good cause pre-requisites of these statutes usually have little effect on the termination process, for it is more common than not for a franchise agreement to contain provisions that substantially parallel the statutory requirements. This is probably due to a desire to maintain uniformity in the administration of the franchise system as well as the fact that courts in many jurisdictions have a predilection to prevent forfeitures, absent compelling circumstances, even though freedom of contract is the general rule in the U.S. judicial system. Thus, most franchisors follow these termination procedures, in large measure, even in states where terminations have remained unregulated. However, certain of these state statutes require longer opportunities to cure/notices of termination than are incorporated under a standard franchise agreement. For example, in addition to having good cause to terminate, a franchisor terminating a franchisee in California must also give written notice to the franchisee at least 60 days in advance of termination and provide a 60 day opportunity to cure defaults (except for certain defaults expressly carved out such as upon a franchisee bankruptcy).¹⁰⁶ As a result, it is important for franchisors to review applicable state relationship laws prior to exercising their contractual termination rights.

Regulation of Franchise Renewals under State Laws

In franchising, mandatory renewal rights are typically granted to franchisees, provided the franchisees meet certain franchisor-imposed conditions to renew. There are, however, some very well-known chains (McDonald's, for example) in which

¹⁰³ *See, e.g.*, Wis. Stat. § 135.02(4) (defining good cause); Cal. Bus. & Prof. Code § 20020 (same).

¹⁰⁴ *See, e.g.*, Cal. Bus. & Prof. Code § 20020; Ind. Code § 23-2-2.7-1(7); Minn. Stat. § 80C.14, subdiv. 3(b); Wis. Stat. § 135.04.

¹⁰⁵ *See, e.g.*, Cal. Bus. & Prof. Code § 20021 (listing defaults not subject to cure period); Wis. Stat. § 135.03 (similar carve-outs).

¹⁰⁶ Cal. Bus. & Prof. Code § 20020.

renewals are granted only at the franchisor's discretion. Some franchise relationship statutes are designed to deal with these situations.

In some states, such as Wisconsin, non-renewals are not permitted absent good cause.¹⁰⁷ This, in effect, may require a franchisor to continue a relationship beyond the bargained-for period. Other states, such as Missouri, simply impose procedural requirements upon the franchisor (e.g., 180 days advance notice of a decision not to renew).¹⁰⁸ A third group of statutes imposes various burdens on the franchisor if it elects not to renew. For example, the franchisor may have to compensate the franchisee under Washington law,¹⁰⁹ and in Iowa, the franchisor must agree not to enforce the post-term noncompetition provision of the franchise agreement.¹¹⁰

Non-Traditional Franchisee Ownership Structures

There are several entity forms that can be used to establish and operate franchised units. Most typically, they take on the traditional forms of entity ownership – corporations, limited liability companies, general partnerships, limited partnerships, and (rarely) sole proprietorships. In some cases, these franchisee entities have parent entities to further shield individuals from the franchisee entity liability. And, in the case of multiple unit ownership, all of the multiple units may be owned by one entity, whereas in other instances (in order to create greater shields and segregation of liability), each unit may be owned by a separate entity. There are also situations in which the franchisee entity has inherent restrictions or special needs, resulting in one of the following non-traditional structures:

- Private Equity Owned Franchisees: A new entity formed by a private equity fund to acquire and operate franchise units (e.g. Dominus Capital, which owns Heartland Automotive Services, the largest Jiffy Lube franchisee). Pro: Access to significant capital for rapid growth and acquisitions. Con: Highly leveraged with no track record, and typically short-term in focus and driven solely by financial returns.

¹⁰⁷ See Wis. Stat. § 135.03.

¹⁰⁸ Mo. Rev. Stat. § 407.405.

¹⁰⁹ Wash. Rev. Code § 19.100.180(2)(j).

¹¹⁰ Iowa Code § 523H.6(1).

- Publicly Held Franchisees: A franchisee that goes public or is acquired by a public entity (e.g., Host Hotels & Resorts, Inc., a publicly traded Marriott franchisee). Pro: Well capitalized and able to build, renovate, and consolidate units at scale. Con: Subject to public stockholder pressure and demands for dividends and capital gains.
- Trust Ownership of the Franchise Business: A franchisee entity held within a trust structure to facilitate estate and succession planning (e.g., Sterling Investment Partners, which owns Southern California Pizza Company, a Pizza Hut franchisee). Pro: Can reduce or avoid taxes, avoid probate, and ensure smooth generational transitions. Con: May create rigidity in decision-making and limit the ability to respond quickly to operational needs.
- Not-for-profit Entities: A tax-exempt organization operating a franchise as a revenue source (e.g., YWCA of Greater Pittsburgh operating a Nathan's Famous from its facility). Pro: Offers a large prospective pool of franchisees and new sources of funding and income. Con: Increased risk of inconsistent brand positions or misalignment of political or social views with the franchisor.
- Employee Stock Ownership Plans: An employee contribution plan that invests in company stock of the franchisee entity. Pro: Significant tax advantages and opportunities for corporate finance and employee retention. Con: Complex regulatory compliance requirements and potential concentration of employee retirement risk in a single asset.
- Joint Ventures: A franchisee entity jointly owned by the franchisor and franchisee, where each contributes money, assets, or know-how. Pro: Shared risk and combined expertise from both parties. Con: Potential for conflicts in governance and decision-making between joint venture partners.

Where Franchisors Can Go for Assistance

Because developing a franchise system involves legal compliance, operational build-out, and sales execution, franchisors commonly rely on outside professionals in addition to internal management resources. Depending on the franchisor's stage of growth and goals, the following sources of assistance are frequently used:

- Franchise Legal Counsel: Franchisors typically retain experienced franchise counsel to help prepare and update the core legal documents for offering and operating the franchise, including the franchise agreement, the FDD, and

related agreements (such as development agreements or other ancillary contracts).

- Franchise Business Consultants: Many franchisors engage franchise-focused business consultants to help develop key operational documents and infrastructure, including an operations manual and other system standards and support materials. Consultants are also commonly used to assess and benchmark initial fees, royalties, and other charges by evaluating what comparable franchise systems are charging in the marketplace.

Franchise Brokers: Franchisors may engage franchise brokers or franchise sales organizations to help identify and recruit prospective franchisees and to support the sale of franchises (including area representative programs, where used).

Conclusion

For the company planning to franchise or enter into distribution or licensing arrangements in the United States, care must be taken to consider the applicability of federal and state franchise and business opportunity laws and regulations. Compliance requires management of time and financial resources, as well as close association with competent counsel familiar not only with the published statutes and regulations, but with the unwritten “folklore” of franchising, the registration process, and, in some instances, the state administrators themselves. Once a franchise system is up and running, franchisors must be cognizant of state regulations that supersede a franchisor’s freedom of contract. Designed to remedy early abuses in franchise relationships, these statutes may result in franchisors being limited in how they deal with franchisees in certain situations, such as terminations, non-renewals, transfers, and freedom of association. While the regulatory framework can be cumbersome, given that franchising has continued to flourish, it appears that a proper balance has been struck between the needs of franchisees for protection against franchisors and franchisors’ need to protect their brands and successfully expand their franchise businesses.



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