The FTC Franchise Registry: Its Time Has Come

Keith Kanouse

The state franchise registration process, virtually unchanged for nearly forty years, is archaic, time-consuming, and extremely costly for franchisors; offers little protection for prospective franchisees; and fails to take advantage of current computer technology. The time has come for a twenty-first-century solution.

Keith Kanouse

This article proposes replacing the current process with a single filing of the Franchise Disclosure Document (FDD) with the Federal Trade Commission (FTC) and a comprehensive review of the franchise offering by FTC staff to ensure full compliance with the FTC Franchise Rule. The FDD would be posted on a website and made available to the public, including all prospective franchisees, without further registration and review by any state. This measure would be consistent with the Obama administration's desire to have business laws that are modern, efficient, and reflective of a positive business environment, as well as address transparency in both the government and business institutions.[1]

A BRIEF HISTORY OF FRANCHISE LAWS

No specific federal or state law regulated the sale of franchises until 1970. As franchising became increasingly popular as a method of distribution in the 1950s and 1960s, aggrieved franchisees or would-be franchisees invariably sued franchisors, making claims under federal and state securities laws. However, the courts correctly concluded that federal and state securities laws do not apply to an active investment like franchising.[2] Securities regulators, believing that some action should be taken to prevent fraud and abuse in the sale of franchises, prompted California to become the first state to enact a franchise disclosure and registration law in 1970, i.e., the California Franchise Investment Law (CFIL).[3] Since January 1, 1971, a franchisor seeking to offer a franchise to a California resident or to be located in California must file a disclosure document with the Department of Corporations and receive approval before the offer, sale, or grant can occur. California concluded that a franchisor should provide a prospective franchisee with the information necessary to make an informed and intelligent investment decision.

In 1975, the Midwest Securities Commissioners Association, in reaction to their states' inability to regulate franchising under existing securities laws, developed a franchise disclosure and registration format called the Uniform Franchise Offering Circular (UFOC) and the UFOC Guidelines.[4] Between 1975 and 1980, fifteen states adopted the same or a similar version of the UFOC.[5] Franchisors offering franchises in any of these states had to file two copies of the UFOC, along with other franchise registration documents, that were usually sent via overnight courier. In addition to the expense of compliance, the review period lasted up to several months. Moreover, other states with business opportunity sales registration and disclosure laws also required franchisors to register as business opportunity sellers unless they were exempted.[6]

In response to the California Franchise Investment Law, the FTC initiated proceedings for the promulgation of a trade regulation rule on franchise presale disclosure. The proceedings were announced on November 11, 1971, and hearings began on February 14, 1972, but the FTC did not issue its franchise disclosure rule until December 21, 1978. The FTC Franchise Rule, which became effective in October 1979, required franchise sellers to furnish prospective purchasers with disclosures about the franchisor, the franchised business, and the terms of the franchise agreement.[7]

The FTC did not assume responsibility for the review and approval of a franchise offering. The FTC Franchise Rule did not include a requirement for filing the disclosure document with the FTC. Furthermore, because the UFOC Guidelines provided for greater disclosure to prospective franchisees than required by the FTC Franchise Rule, the federal requirements did not preempt state franchise registration and disclosure laws. This resulted in dual regulation and led to considerable confusion. A franchisor was free to use one of two disclosure formats: either an FTC Disclosure Statement or a UFOC. Because the registration states would not accept an FTC Disclosure Statement for registration in their states, a franchisor seeking to franchise nationally would prepare a multistate UFOC at the beginning of its franchise program. In addition, the FTC Franchise Rule did not regulate the franchise relationship or provide a private right of action.

WHAT IS REQUIRED IN 2009?

The FTC Franchise Rule was amended (New FTC Franchise Rule) effective July 1, 2008. Among other things, it eliminated both the FTC Disclosure Statement format and the UFOC format by requiring all franchisors to use a new form of disclosure document called a Franchise Disclosure Document (FDD). The FDD is substantially similar to the UFOC with certain additional disclosure obligations imposed on the franchisor.[8] The FTC

Keith Kanouse is in the Boca Raton, Florida, firm of Kanouse & Walker, P.A.

failed to mandate registration of the FDD with the agency, thereby perpetuating the problems caused by the patchwork of state franchise/business opportunity registration and disclosure laws.

The fifteen registration states amended their laws to conform to the New FTC Franchise Rule. The North American Securities Administrators Association, Inc. (NASAA), the successor group to the Midwest Securities Commissioners Association, recently adopted the 2008 Franchise Registration and Disclosure Guidelines, which are, in effect, amended and restated UFOC Guidelines. New uniform registration forms were created that must be filed in the franchise registration states.

A summary of the actions a franchisor or a subfranchisor must take in dealing with each of the fifty states plus the District of Columbia and the U.S. territories appears on pages 20–21. In certain states, a franchisor whose principal mark is not registered with the U.S. Patent and Trademark Office and/or in a state or that makes certain representations may be required to register as a business opportunity seller.

In twenty-four states (indicated by *none* on the chart), as well as the District of Columbia and the U.S. territories, registration is not required, but the New FTC Franchise Rule must be followed. Therefore, the level of protection for prospective franchisees depends on where they live and is not uniform throughout the country. Franchisees that are residents in any of these nonregistration states or areas receive an FDD that has not been reviewed by any federal or state agency.

The hodgepodge of state registration laws creates financial and administrative havoc for franchisors. Franchisors may pay up to a total of $7,000 for initial filing fees plus considerable attorney fees and other registration costs. It takes several months for the franchisor to be registered in all these states. Thereafter, there are additional filing fees and attorney fees and costs for filing an amendment in many of these states whenever there is a material change to the FDD, as well as the filing of an annual update. The renewal dates also vary among the registration states. In many states, that date is on the anniversary date of the initial registration. In others, such as Minnesota, New York, and Rhode Island, it is within 120 days of the end of the franchisor's fiscal year.

Another drawback is the likely possibility that examiners in various states may give different and sometimes conflicting responses to franchisors. This can lead to nonsubstantive changes to the FDD, causing further amendments to be filed in states where the franchise offering is already approved. It is also easy for the franchisor to make an unlawful sale to someone in a state when the franchisor is not currently registered, exposing the franchisor to liability (rescission or damages) and possibly exposing its attorneys to liability for malpractice. Theoretically, the laws of three different states may apply to one transaction if the franchisor is in one registration state, the prospective franchisee is in another registration state, and the proposed franchised business is to be located in a third registration state.

In addition, the status of the franchisor's trademark registrations may affect where the franchisor must be registered. For example, in *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin*,[9] a law firm was found to have committed malpractice by failing to register a weight-loss franchisor as a Connecticut business opportunity seller because the federal trademark registration was still pending and not registered on the Principal Register of the U.S. Trademark Office. The Connecticut banking commissioner ordered the franchisor to cease offering franchises; imposed a substantial fine; and ordered the franchisor, which was headquartered in Connecticut, to offer rescission to all franchisees no matter where they were located. The franchisor went out of business. Although the determination of legal malpractice was affirmed on appeal, the damage award of $15.9 million was overturned because the franchisor failed to prove lost profits to a reasonable certainty.

COORDINATED FRANCHISE REVIEW

In 2000, the states, via NASAA, attempted to streamline the registration process by adopting the Coordinated Review Process for franchise registrations in multiple states.[10] The procedure was designed to expedite the franchise registration process by funneling communication and comments on registration applications through a lead state chosen to coordinate the review. To be eligible, a franchisor had to file applications in two or more participating states and provide audited financial statements with its registration application. The franchisor had to file an initial registration application in each participating state. There was no additional fee for coordinated review; however, the franchisor still had to pay the applicable registration fees for each state in which it was registering. Maryland was selected as the initial lead state for coordinated review.[11] Effective July 31, 2007, the franchise coordinated review program was suspended until further notice because of the difficulties that would be faced by the lead state in becoming familiar with the New FTC Franchise Rule and coordinating both the old and new formats. The suspension was still in place as of July 2009.

CURRENT ECONOMIC CRISIS

Compounding an already difficult situation is the fact that many state registration and review agencies are understaffed, overworked, and underfunded. In some states, most notably California and Illinois but certainly others, the number of qualified personnel has been reduced and those remaining must take unpaid furloughs several days each month. The impact on franchisors is obvious. Without approval from the necessary state regulators, they cannot do business in that state. Many renewals filed in May 2009 have yet to be reviewed.

A PRACTICAL SOLUTION

Create an FTC Franchise Registry

The FTC Act and the FTC Franchise Rule should be amended to preempt state franchise disclosure and registration laws with the creation of an FTC Franchise Registry. State franchise relationship laws would not be preempted by this amendment. Any franchisor wanting to offer, sell, or grant a franchise as defined by the FTC Franchise Rule in any of the United States or its territories would be required to file with the FTC an FDD and all exhibits, including all state-mandated addenda, before any offer, sale, or grant is made. Electronic filing would be permitted, thereby eliminating the expense of printing and mailing a voluminous application. The FTC's costs would be covered by a reasonable initial filing fee of, say, a few thousand dollars, as well as reasonable renewal fees and amendment fees. A member of the FTC's franchise review staff would review and comment on the FDD to ensure full compliance with the FTC Franchise Rule.

Posting FDDs on FTC Franchise Registry

Once the review has been completed and the registration approved, the FDD would be posted on an FTC Franchise Registry and made accessible (and downloadable) by the public and state regulators. The New FTC Franchise Rule requires a franchisor to update its FDD and include its audited financial statements within 120 days of the end of its recent fiscal year. The annual update would occur within this time period. For franchisors with fiscal year end of December 31, the deadline would be April 30. The annual renewal would be deemed to be automatically effective upon timely filing, thereby allowing franchisors to continue to sell franchises before the renewal is reviewed and approved. This would reduce the impact of backlogs at any one time on an already overworked regulatory agency. Once a comment letter is received, the franchisor must promptly and completely respond; otherwise, the filing may be rejected and the franchise offering removed from the FTC Franchise Registry. A franchisor would also have to file supplements to the FDD on a quarterly basis reflecting any material changes since the FDD or most recent supplement was prepared. No franchisor could offer or sell a franchise during any period in which the FDD is not posted on the FTC Franchise Registry.

A franchisor would not have to deliver the FDD to a prospective franchisee if the prospective franchisee downloads and prints the document from the FTC Franchise Registry and completes and returns the Item 23 receipt to the franchisor. This will negate the franchisor's need to have a person within its organization or its counsel responsible for delivering the FDD and save associated copying and mailing costs. Of course, if the prospective franchisee does not have computer access, the franchisor could always provide a hard copy.

No State Registrations

There would be no additional registration in any state. The states having franchise and/or business opportunity registration laws would amend their laws to provide an exemption from registration for any franchise offering that has been approved by FTC and posted to the FTC Franchise Registry. Those state employees currently engaged in the registration process would be offered an opportunity to work for FTC (remotely from a home office or in Washington, D.C., at their election) because they have the most experience in the review and approval process. Alternatively, these employees would be assigned to state enforcement to ensure that franchisors are not engaged in unfair and deceptive trade practices under each state's Little FTC Act.

HOW THE REGISTRY WOULD WORK

Effective May 1, 2010, all existing franchisors would be required to file a current FDD with the FTC Franchise Registry. An existing franchisor's FDD would be deemed approved upon filing and would be posted on the registry's website. Franchise sales would not be interrupted. Prospective franchisees, regardless of the state of residency or location of the franchise, would be able to access, download, and print the franchisor's FDD. If a prospective franchisee is interested in the franchise, the franchisor would ask the prospective franchisee to sign the receipt and mail it back to the franchisor. This would prove delivery of the FDD and compliance with the fourteen-day rule. The franchisor would send at least two execution copies of the franchise agreement and the agreements to be signed by the prospective franchisee in compliance with the seven-day rule.

An FTC Franchise Registry should be created to preempt state franchise disclosure and registration laws.

Upon review of the FDD by staff, the staff may send a comment letter pointing out perceived deficiencies in the filing. The franchisor would have thirty days in which to respond to the comment letter. If the franchisor fails to respond or comply with the deficiency letter, the franchisor's FDD could be removed from the registry. No further franchise sales could occur until the deficiencies are corrected and approved by the FTC.

Start-up franchisors could not offer or sell a franchise until the FDD is registered, approved, and posted on the registry. Upon review of the FDD, the FTC staff may send a comment letter pointing out perceived deficiencies in the filing. The franchisor would have thirty days in which to respond to the comment letter. If the franchisor fails to respond or comply, the franchisor's FDD would not be posted on the registry, and no franchise sales could occur until the deficiencies are corrected and approved by the FTC.

CONCLUSION

An FTC Franchise Registry and a simpler and coordinated set of rules would achieve the goal in today's era of creating a more efficient and less burdensome government. This idea should be broadly supported by both franchisors and franchisees alike. It is an idea whose time has certainly come. A national registry would eliminate unnecessary and expensive administrative requirements that do nothing to protect existing and prospective franchisees, eliminate the need for state regulations, and promote the healthy growth of the franchise industry.

STATE FRANCHISE REGULATIONS

State	Filing Fee	Franchisors Regulated	Required Documents
Alabama[1]	None	None	None
Alaska[2]	None	None	None
Arizona[3]	None	None	None
Arkansas[4]	None	None	None
California[5]	$675	All Franchisors	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; Authorization of Disclosure of Financial Records; Notice of Exemption for Interstate Advertisements if franchisor has a website; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Colorado[6]	None	None	None
Connecticut[7]	$400	Franchisors without a federally registered trademark must be registered as sellers of business opportunities	Hard copy of FDD and Exhibits; CT BOIA-1 Application to Register a Business Opportunity Investment Form; CT BOIA-2 Consent to Service of Process; Connecticut Cover Page; list of salespersons; advertising or promotional materials directed to prospective franchisees and extensive state-specific addenda to FDD and FA.
Delaware[8]	None	None	None
Florida[9]	$100	All Franchisors	Business opportunity law provides exemption for franchisors that have a federally or state registered trademark. A safe-harbor exemption for franchisors is obtained by an annual filing of an Annual Franchise Notice of Exemption from Sale of Business Opportunities Act.
Georgia[10]	$10	Franchisors without a federally registered trademark or state registered trademark must be registered as sellers of business opportunities	Consent to Service of Process
Hawaii[11]	$125	All Franchisors	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Idaho[12]	None	None	None
Illinois[13]	$500	All Franchisors and Area Representatives (as subfranchisors)	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form. Brokers must also register separately.
Indiana[14]	$500	All Franchisors	Indiana Franchise Registration Application; Notice of Intent; Consent to Service of Process; and FDD and Exhibits on CD-ROM.
Iowa[15]	None	None	None
Kansas[16]	None	None	None
Kentucky[17]	None	All Franchisors	Business opportunity law provides exemption for franchisors that are in compliance with the FTC Franchise Rule and for which a Notice of Exemption Affidavit and copy of FDD and Exhibits have been filed.
Louisiana[18]	$10	Franchisors without a federally registered trademark must be registered as sellers of business opportunities	Consent to Service of Process; $50,000 surety bond and copy of FDD and Exhibits
Maine[19]	$25	Franchisors without a federally registered trademark must be registered as sellers of business opportunities	FDD and Exhibits including a Maine cover page, state-specific addenda to FDD and FA; list of salespersons, and advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA
Maryland[20]	$500	All Franchisors	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Massachusetts[21]	None	None	None
Michigan[22]	$250	All Franchisors	File Notice of Intent. Must also include 3-page Notice for Prospective Franchisees Required by the State of Michigan in FDD.
Minnesota[23]	$400	All Franchisors	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Mississippi[24]	None	None	None
Missouri[25]	None	None	None
Montana[26]	None	None	None

See chart endnotes on page 22.

STATE FRANCHISE REGULATIONS

State	Filing Fee	Franchisors Regulated	Required Documents
Nebraska[27]	$100	Franchisors whose franchise offering involves the use of phrases such as buy back, secured investment, or the like.	Notice of Exemption
Nevada[28]	None	None	None
New Hampshire[29]	$50	Franchisors whose franchise offering involves vending machines, racks, display cases, or similar devices	Registration Application; Certificate of Appointment; Corporate Certificate of Resolution; Applicant's Affidavit/Affirmation; FDD and Exhibits; and Cover Page; and advertising or promotional materials directed to prospective franchisees.
New Jersey[30]	None	None	None
New Mexico[31]	None	None	None
New York[32]	$750	All Franchisors	Hard copy FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
North Carolina[33]	$10	Franchisors without a federally registered trademark must be registered as sellers of business opportunities	FDD and Exhibits and North Carolina Cover Page
North Dakota[34]	$250	All Franchisors	Hard copy FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Ohio[35]	None	None	None
Oklahoma[36]	None	None	None
Oregon[37]	None	None	None
Pennsylvania[38]	None	None	None
Rhode Island[39]	$250	All Franchisors	FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA on a CD-ROM containing these documents in pdf form.
South Carolina[40]	(1) None (2) $100	(1) Franchisors with U.S. or state trademark registration (2) Franchisors without U.S. or state trademark registration	(1) Affidavit of Business Opportunity Exemption (2) Application of Business Opportunity; FDD and Exhibits including the South Carolina Cover Page and South Carolina Addendum to Franchise Agreement; and Consent to Service of Process and Corporate Acknowledgment.
South Dakota[41]	$250	All Franchisors	Notice of Intent; Consent to Service of Process and FDD and Exhibits
Tennessee[42]	None	None	None
Texas[43]	$25	All Franchisors	Annual Franchise Notice of Exemption from Sale of Business Opportunities Act (one-time filing, except if address changes)
Utah[44]	(1) $100 (2) $200	(1) Franchisors with U.S. or state trademark registration (2) Franchisors without U.S. or state trademark registration	(1) Notice of Exemption (2) FDD and Exhibits including Utah Cover Page and Utah Addendum to FDD and Utah Addendum to Franchise Agreement.
Vermont[45]	None	None	None
Virginia[46]	$500	All Franchisors	Hard copy of FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state-specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
Washington[47]	$600	All Franchisors	Hard copy FDD and Exhibits; Uniform Franchise Registration Application; Franchisor's Costs and Sources of Funds; Uniform Consent to Service of Process; Franchise Seller Disclosure Forms; Guarantee of Performance (if required); Consent of Accountant; advertising or promotional materials directed to prospective franchisees and state specific addenda to FDD and FA. In addition, a CD-ROM containing these documents in pdf form.
West Virginia[48]	None	None	None
Wisconsin[49]	$400	All Franchisors	Notice of Intent
Wyoming[50]	None	None	None
District of Columbia[51]	None	None	None
Puerto Rico[52]	None	None	None
U.S. Virgin Islands[53]	None	None	None