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NEWSLETTER

Franchise Registration: It's Time To Renew

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For most franchisors, April marks more than the beginning of spring. It also is the time to update Franchise Disclosure Documents (FDDs) and renew franchise registrations and exemptions. As franchisors begin to contemplate renewal, it might be useful to review some basics regarding the registration and renewal process.

FDD Update

Pursuant to the Federal Trade Commission (FTC) Franchise Rule, an FDD must be updated within 120 days after the franchisor's fiscal year end. Since most companies, including franchisors, have a fiscal year that ends on or near December 31, that means the FDD must be updated before the end of April. A franchisor may, however, continue to make sales in a registration state using an FDD that is validly registered in that state, but not updated, until the earlier of:
(1) the date that the state completes registration of the updated FDD; or (2) the date that the franchisor's prior registration has expired. With respect to non-registration states and any state in which the applicable registration has expired, the franchisor may only use an updated FDD after the expiration of the 120-day period.

Registration Renewal

In addition to the requirements of the FTC Rule, 14 states have franchise registration laws-California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. Before offering to sell or selling franchises in these 14 states, a franchisor must apply to the appropriate state agency to register the franchise and, typically, submit the FDD (along with any required forms and fees) to the state administrator for approval. Generally, until the state administrator has approved the FDD, the franchisor cannot offer to

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sell franchises that will be located within that state or to a resident of that state.

If a franchisor does not file its renewal application and, if necessary, obtain approval of the FDD in a registration state prior to the applicable expiration date, the franchisor will "go dark" in that state-*i.e.,* the franchisor cannot offer to sell franchises in that state until the franchisor has filed the application and, if necessary, obtained approval from the state. If the prior registration has expired, the franchisor may be required to file an initial application or a reinstatement application.

While the remaining states (commonly referred to as "non-registration states") do not have registration statutes, the franchisor must nevertheless prepare an FDD in order to comply with the FTC Franchise Rule before it can offer to sell franchises in those states. In the non-registration states, once the FDD has been drafted (or, once the FDD has been updated), the franchisor may immediately provide the FDD to prospective franchisees.

Registration Periods

A franchise registration generally is valid for a one-year period, and, in 10 states, franchisors, in fact, get that full year. However, the remaining four registration states (California, Hawaii, Minnesota and New York) tie the registration period to the franchisor's fiscal year and provide that the registration expires 120 (Minnesota and New York), 110 (California), or 90 (Hawaii) days after fiscal year end. For a variety of reasons-not the least of which are reducing costs and the administrative burden, most franchisors want to use one FDD that covers both the 36 non-registration states and the 14 registration states, rather than multiple state-specific FDDs. In order to do that, a franchisor must file all of its renewal applications at the same time, even if one or more state registrations are not expiring. Not surprisingly, once all of the state renewals are on the same cycle, the renewal process becomes much easier to manage.

Exemptions from Registration

Since the franchise registration process may delay the completion of deals, restrict sales practices, require public disclosure of information and increase costs, many franchisors seek exemptions from registration. There are many different exemptions, and these vary significantly by state. Some registration states do not provide for any exemptions, while others have a host of available exemptions. Generally, the franchisor will bear the burden of proving that the franchisor or the contemplated transaction meets the requirements for a particular exemption. The most common exemption relates to experienced/high net worth franchisors, an exemption recognized by nine states. This exemption allows a franchisor to avoid registration if its (and/or its parent's) net worth and/or operating or franchising experience meets the statutory requirements.

While franchisors should carefully evaluate each exemption to determine its availability, since several states do not recognize any exemptions, the registration burden cannot be totally eliminated. Franchisors should also keep in mind that, in most cases, an exemption only impacts the applicable state's registration requirement and does not eliminate the need to update the FDD or timely provide the FDD to a prospective franchisee.

Auditors Consent

The FTC Franchise Rule and the various state franchise laws require that the franchisor's audited financial statements be included in the FDD and the franchisor's auditors must consent to the inclusion of those financial statements. There is a great deal of variability as to what the auditors may require from the franchisor before they will issue the consent. As a result, a franchisor must build in sufficient time in the renewal process in order to satisfy the auditor's requests.

Making Good Use of the Renewal Process

The annual franchise registration renewal process is often difficult, time consuming, and distracting. Franchisors are forced to divert key personnel from their primary jobs to spend at least some time on the renewal process. While this can seem like a waste of resources, the renewal process also can serve as an annual "check up" on the franchised system. Rather than just going through the motions, franchisors should use the renewal process as an opportunity to: verify the accuracy of the factual information in the FDD; consider whether changes need to be made or should be made to franchise-related agreements; review whether the franchisor still employs best practices in its franchise sales and development process; and consider whether changes are needed in light of competitive circumstances. Making good use of the renewal process can help to both minimize liability arising from incorrect disclosures in the FDD and ensure that the franchise offering remains attractive and competitive.

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