

Removing an Impediment to Franchising in New York

New York needs a more efficient franchise registration and renewal process.

BY THOMAS M. PITEGOFF

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Before a franchisor can sell franchises in New York state, the franchise offering must be registered with the New York State Attorney General's Office (the AG's Office). Registration entails the review and approval of the franchise disclosure document (the FDD) by a franchise examiner in the AG's Office. In order to continue selling franchises in New York for another year, each franchisor must update its FDD from fiscal year to fiscal year with new audited financials and a wide range of other updated information and then submit the updated FDD, with the changes highlighted, for review and approval. Material changes in the franchise offering also call for amendment filings with the AG's Office.

A franchisor cannot lawfully sell franchises in New York during the period when its application for renewal or amendment is pending unless the franchisor follows an awkward approach explained below. Most franchisors simply refrain from selling franchises while their applications are pending. "Blackout period" is the industry term for this period of time when franchise sales are suspended.

Since the start of the COVID-19 pandemic in early 2020, the franchise renewal process in New York

has become exceedingly backed up. Franchise attorneys in several states writing on the American Bar Association's Forum on Franchising listserv late that year reported wait times of six months or more with respect to filings at the New York AG's Office. And the logjam does not appear to have improved since then.

Blackout periods are especially disruptive for fast-growing franchise systems and for prospective franchisees who need to move quickly to secure retail space. Blackout periods can result in a loss of franchise sales. They can also lead to a loss of new business in New York state.

Blackout periods are especially disruptive for New York based franchisors. New York takes the position that a franchisor based in the state cannot sell franchises anywhere in the United States, or for that matter, anywhere in the world, until it is properly registered in New York. Other states that regulate franchise sales do so only with respect to sales to franchisees located in the regulating states.

There are several possible solutions that the AG's Office and New York state lawmakers might consider in order to lessen the negative effects of the blackout period. One solution would be to hire and train more franchise examiners or pull staff from other parts of the AG's Office and train them to be franchise examiners. A more radical change would be for the state to stop regulating franchise sales. Roughly



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two thirds of the 50 states do not regulate franchise sales. Other possible solutions exist and are modeled by other states. Here are three different approaches that other states appear to have implemented successfully:

- Eliminate the registration requirement while maintaining jurisdiction over franchise sales.
- Require franchise registration, renewal and amendment, but eliminate review and approval by franchise examiners.
- Make the renewal or amendment effective upon filing but allow the examiners to pause franchise sales by notifying the franchisor that it must make FDD revisions to comply with the disclosure requirements.

Oregon is the only state that has no franchise registration requirement but nevertheless maintains jurisdiction over franchise sales. Oregon requires franchisors to provide the FDD to prospective franchisees in accordance with the Federal Trade Commission's

trade regulation rule on franchising (the FTC Rule), which became effective in 1979. A company that sells franchises anywhere in the United States must deliver the FDD to each prospective franchisee at least 14 days before the prospective franchisee signs an agreement with the franchisor or makes any payment to the franchisor or an affiliate in connection with the proposed franchise sale. 16 C.F.R. §436.2. But Oregon does not require franchisors to register or make any type of filing with the state before they sell franchises. Without a registration requirement, no renewal or amendment filings are required. Nevertheless, the state's Department of Consumer and Business Services will investigate complaints that a franchisor has made material untrue disclosures or has failed to disclose a material fact in its FDD.

Indiana, Michigan and Wisconsin require franchise filings and the payment of filing fees. Like Oregon, these states maintain jurisdiction over franchise sales. But none of these states require examiner review and approval.

- **Indiana** requires franchisors to submit a notice filing, which includes a copy of the FDD. The offering becomes effective upon its receipt by the Securities Division of the Indiana Secretary of State. The review requirement that was originally a part of Indiana's 1975 franchise law was eliminated in 2001, twelve years after the FTC Rule became effective in 1979.

- **Michigan** requires a simple notice filing to the state, which can be in the form of a letter, stating the franchisor's name, its "doing business" name and its principal business address. In 1984, the state eliminated its presale review of franchise disclosures that had been required since 1974.

- With the 1972 adoption of its Franchise Investment Law, **Wisconsin** was one of the first states to adopt a franchise sales law. Franchisors were not permitted to sell franchises

in Wisconsin until their offerings were reviewed and approved by the state's franchise examiners. In 1996, Wisconsin amended its franchise law to eliminate the review of franchise filings in the state. Since then, Wisconsin has required only a simple filing of the franchisor's current FDD or revised FDD, with no review. The state maintains the most accessible **online public records** of registered FDDs.

Illinois also requires franchisors to submit a copy of their FDD as part of their application for registration, renewal or material change. The registration automatically becomes effective on the 21st day after the date of the filing unless the state has denied registration on the basis that the FDD is "materially deficient," which means that it does not comply with the requirements of the FTC Rule or is otherwise false or misleading.

All of these approaches to franchise regulation would be an improvement over the current situation in New York.

As noted above, the New York Franchise Sales Act does allow a franchisor to sell franchises in New York while its application for franchise renewal or amendment is pending provided that the franchisor follows a very specific approach.

Under New York law, when an amendment (which in New York includes a renewal) is pending, a franchisor is required to so inform the offeree in writing when the franchisor supplies the offeree with the registered FDD. The franchisor must later supply the offeree with the amended document when it has been accepted and registered by the New York State Department of Law. Any funds paid by the offeree to the franchisor are required to be held in trust in a separate bank account until 10 business days following the date on which the offeree receives the amended disclosure document. The offeree may rescind the sale and receive a refund of the funds held in the escrow account

before the offeree receives the amended document or within 10 business days following the offeree's receipt of the amended document. NYCRR, Title 13, Chapter VII, §200.3(h)(3).

Few if any franchisors want to go to the trouble of setting up an escrow account to hold funds paid by the prospective franchisee until the examiner approves the amendment and registers the offering. This requirement can probably be avoided by delaying the submission of all required payments until 10 business days after the amended FDD is registered and delivered to the franchisee. This can be accomplished with an amendment or addendum to the franchise agreement delaying the initial payments. The franchisor would also need to decide whether to require the new franchisee to sign the new version of the franchise agreement if there are any material changes from the prior version.

This unwieldy provision in New York law can be eliminated if New York were to take any of the approaches suggested above. New York is the only state that enacted its first franchise registration and disclosure law after the FTC Rule became effective in 1979. Since then, Illinois, Indiana, Michigan and Wisconsin have all simplified their registration requirements. Franchising in New York would benefit greatly from their example. It is very possible that any of these approaches would bring more business, more jobs and more entrepreneurs to New York.

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