The Start-Up Franchisor Teleconference – October 2012

Charles Internicola: Hi. Good afternoon, everyone, and welcome. This is Charles Internicola. Today is October 23, 2012, and this is just part of our continuing startup franchisor teleconferences. I see that we have a number of individuals who have signed in, and I believe for this scheduled teleseminar we have four to five published questions that were submitted over to us. We receive the questions, and the structure of this teleconference will be to go through the questions that have been submitted.

Our staff has organized the questions so they're most helpful for all the parties participating on the call. Please note that if you sent us any information with your name, we will not be revealing any personal information or any personal names. This teleconference will be recorded and is provided to other individuals that are interested in similar topics, so you are going to be welcome to participate in the call. Everyone right now is on mute. However, if you'd like to be unmuted at any point and you'd like to participate on this call, feel free at any time to press Star 7.

Also, just from a general standpoint, naturally, this teleconference is about information, sharing some ideas and exchanging information about franchising and startup franchising, so none of it's legal advice that anyone should be relying on, but it should serve as a good source of information for things that should be of concern or significance to you as a startup franchisor. So, again, if anyone would like to unmute themselves, participate in the call, feel free to hit Star 7 at any point. Otherwise, what I'm going to do is actually just go forward with the list of questions. We broke down our teleconference I believe into ten different conferences because of the registrations, and we did this to limit the questions and to provide the most efficient call for all the parties. If I do review a question and it's one that you've presented and you'd like to participate or follow up on it, please feel free to participate, and even if you haven't submitted the question, likewise, do the same.

The first question we received, and an issue that comes up often, relates to establishing territories for a franchise system, and this question wasn't – there could be two explanations to it, but the question was, "How do I establish equal territories on a low-cost basis?" Not sure what they're referring to about a low-cost basis, and certainly if this is your question, you'd like to clarify, please feel free, but at the startup franchisor stage, territories typically refer to the protected territory that you're going to be granting to your franchisees. The question of how do you establish equal territories really is going to depend on what type of business you're providing, whether it's goods you're selling, whether it's services you're providing, and then how to define and identify these territories. Traditionally, you can have a territory that's designated based on a geographic radius, or you could have a territory based on demographics, a set number of population, households, income levels, so, really, when you're setting up your territory for your franchise system, you have complete options. One option is to not include a protected territory, but I don't think that solves any problems.

I think the better solution is to evaluate what you believe to be the appropriate growth for your franchise and then set up a flexible model that'll allow you to modify territories based on different demographics and population density issues. That's an overview of the answer, and, again, if you presented the question, even if you wanna bring this up later on, feel free to interject or –

Startup Franchisor 1: Yes, hi. I submitted the question, and my question is related with the low cost meaning low-cost method of determining the territories. I've called several companies, and they want huge amounts of money for software that defines different territories. My question relates to are there any low-cost ways of determining, for example, 300,000 or 350,000 population territories?

Charles Internicola: So, when you say the pricing, what type of numbers are you referring to, just so we have a reference point?

Startup Franchisor 1: Well, I've heard anywhere from 3,000, 5,000 on up for software.

Charles Internicola: And that would be for a one-time fee for …?

[Crosstalk]

Startup Franchisor 1: For a one-time fee for the country to break down different territories.

Charles Internicola: Well, there is various services out there, and I'd have to see. There's companies that just provide you with the raw data and you enter in zip codes and information, will just tell you raw data, and then there's companies that'll actually provide you with breakdowns of specific states or territories based on demographics. So, the number you've – the number that you quote, it could be a good value depending on the service they're providing. But, there's also United States census data that you could access directly yourself, and what I can do, and certainly I could see the individuals requesting this, so if you'd like, I could send you after the call some links to some free websites, U.S. government census type websites that could provide you with some data to analyze.

Startup Franchisor 1: Great. Thank you very much.

Charles Internicola: I can also – no problem.

Startup Franchisor 1: Perfect.

Charles Internicola: And what we'll do is actually we'll also put in some other companies that our clients use –

Startup Franchisor 1: Perfect. Thank you very much, sir.

Charles Internicola: – and we'll give you that information. You're welcome. Anyone else have a question on this topic? Otherwise, out of respect for everyone's time, but, please, again, feel free to unmute yourself and participate, I'm going to move to the next question. And the next one, even for the gentleman who asked the question about setting up territories, is a good general reference point for all startup franchisors, and it's relates, really, to franchise sales.

And the question was – the question related to SBA loan financing, and the person gave this some thought. His question was, "Could I comment on problems getting the FDD approved by the SBA and how to write the FDD to avoid SBA problems?" So, first, as a general background, the primary Small Business Administration Loan Program for franchisees is a program that is issued under Section 7(a). They refer to it as an SBA Section 7(a) loan, and these programs or these loans are guaranteed by the Small Business Administration, and they're provided by individual banks. These loans, these 7(a) loans are a very significant source of financing for franchisees, and, therefore, they're important for franchisors because they're a source of capital that the franchisees will tap into.

The question is a good one, because the SBA does scrutinize franchise agreements, and there's certain provisions that the SBA does not like, and before I go into them, I just wanna let all startup franchisors or prospective franchisors know one thing. If you believe SBA financing will be a major contributor to your franchise sales and a finance option that your franchisees will follow, the SBA has a preapproval process. Now, this preapproval process is not approval of loans, but where the SBA will review your franchise agreement. They will give comments, and if you satisfy their criteria, they'll add you to a preapproved list of franchisors who at least meet their minimum criteria in terms of the franchise agreements, and it should help speed up the loan review process. But, let's get into some issues that the SBA does raise and that you should be aware of. The first red flag for the SBA on Section 7(a) loans are affiliation with franchisors, and what this means is franchisors cannot use the SBA 7(a) program to basically fund a corporate-owned store.

So, the SBA scrutinizes every franchise agreement to make sure there's no nexus or connection between the franchisee and the franchisor, and so provisions that the SBA does not like in franchise agreements are provisions where it shows excessive control by the franchisor, an example being where the franchisor has some control to divert profits from that local franchise business or where the franchisor has excessive step-in rights. A step-in right is where a franchisee will violate a franchise agreement and the franchisor is permitted to step in and take over the franchisee's operations. The SBA is okay with step-in provisions provided they're short term and provided they're triggered by a material default. Otherwise, the SBA will scrutinize your step-in provisions out of concern that the franchisor may have too much control over the franchise business that it's loaning money to.

Other provisions that the SBA will scrutinize and that you should be aware of in your franchise agreement and when your attorney is drafting it are provisions that allow the franchisor to hire personnel, provisions that allow the franchisor to collect revenues on behalf of the franchisee and provisions where the franchisor controls the price that a franchisee may or may not sell his or her franchise for. Consider that the SBA is guaranteeing a loan, and the SBA does not want a provision in the franchise agreement where the franchisor could mandate a price for the sale, because that could impact the franchisee's ability to repay the loan obligation. Other provisions that you need to be aware of in preparing your franchise agreement or modifying it are provisions regarding restriction from the transfer of a franchise. The SBA will require your franchise agreement to state that the franchisor will not unreasonably withhold or delay approval of a franchise sale or transfer.

So, that's a very stringent rule, and so in your franchise agreement, be very aware of over-aggressive transfer restrictions. This doesn't take away the franchisor's ability to review the prospective purchaser and qualify them, but the franchisor must act reasonably. The other area where franchisors run into issues with their franchise agreement and SBA financing relates to liquidated damages. Liquidated damages is a clause in your franchise agreement that sets a formula for the franchisor to determine what damages they'll receive when the – if the franchise agreement is terminated or violated. The SBA is naturally concerned about these provisions, because in the event of a franchise agreement termination, it's also possible the franchisee is defaulting on the SBA loan, and in that case the SBA's concern that if the franchisee gets hit with excessive damages, it won't have funds to repay the loan obligation.

So, when reviewing your liquidated damage provisions, and trust me, they're probably in almost every franchise agreement, you need to ensure that the liquidated damage clause is reasonable, and that's a tough definition. But, you know it when you see it and something you could discuss with your lawyer, and, more importantly, it can be quantified. The SBA will look at your liquidated damage provision and ask today, on the day the franchise agreement's signed, is this provision clear enough where we can anticipate that if there is a breach, what type of damages our franchisee/borrower will incur? So, that's important during the SBA approval process. So, again, consider the SBA does not like provisions that show an affiliation or connection between the franchisor and franchisee.

Consider that the SBA will scrutinize provisions where the franchisor gains excessive control over profits, over distributions, excessive step-in rights, the ability to hire personnel. Those are control provisions that the SBA does not typically like. Also consider the SBA requires that the franchisor be reasonable in its approval of the sale of a franchise, another provision they'll scrutinize, and lastly is the liquidated damages provision that we discussed. One thing that startup franchisors should consider is what I mentioned earlier, which is the SBA does have a preapproval process. It's not a complete approval process, but they will give scrutiny to your agreements and give you the ability to revise them.

Once you do get on the SBA's preapproval list, your franchisees will have a quicker turnaround on their SBA loan application. That's just a general overview of what we look for when we're drafting franchise agreements and we're concerned about SBA kickback on applications. I don't know if the person that asked that question – I see there's a good number of people on the call, so if you did and you'd like to unmute yourself, feel free to hit Star 7. Otherwise, we're going to proceed to the third question. And, again, if I pass by you or you have a question later on or an unrelated question – at the right moment, you'll know it – hit Star 7, and I'll address it.

It looks like on our system there's probably about 20 people on the call, so just consider that we do it in an orderly way if you'd like to participate. Third question is general, but nevertheless important, for a startup franchisor. The question is, "What is the best way to structure a franchise plan to protect and help both franchisor and franchisee to prosper?" That's an important question and is very open-ended, and so I'll just give you some of my general experiences and how we approach developing a franchise system and what we look to incorporate in both the disclosure documents and, more importantly, in terms of our – the ongoing compliance programs.

I have never seen a franchise system succeed where the franchisees also don't succeed, so the question is important. And franchise systems that thrive, they grow slowly, they build a base of satisfied franchisees, and they expand in a rational basis, so there's four points I have. There probably about 500 points about structuring a good franchise system. The first one for startup franchisors is – relates to expansion. Our experience is that franchisors that limit their initial expansion in the first 12 to 18 months after the FDD has been established are more likely to succeed.

Now, limited expansion means maybe, depending on the business, you limit yourself to a geographic area or you limit yourself to certain types of qualified franchisees. Limited expansion ensures that you can control your supply chain, ensures that you'll at least maintain whatever economies of scale that you've built into your advertising programs and your support programs, and they'll ensure that you will be able to provide the ongoing support that franchisees require. Consider that initial training and ongoing support are critical during the launch stages of a franchise system, which takes me to my second point. Best way to structure a franchise system is to ensure that your initial training and ongoing training are systematized and that they're sincere. I'm not a fan of the generic operations manuals or the standardized training programs that, many times, are just copied and pasted from other things.

Franchisors or successful business owners, they understand what it took to succeed and then franchise, so what I would say is, treat your training programs, initial training and ongoing support, as probably the most critical element to the long-term success of your franchise. Third issue for initial franchisors is avoid encroachment. Right now there's a number of startup franchise systems that I have seen, not that we've worked with, where they're expanding excessively, and I think they're running into issues of encroachment. And what I mean by encroachment is 12 months after 1 franchise unit's opened, within a very close territory, another one pops up, and encroachment may benefit your short-term royalties in the form of your percentage-based royalty, but long term they're gonna reduce the profitability of your franchisees and could lead to franchise failure, and that's a big issue that comes up very often.

The fourth point is a general one, but it's something that startup franchisors really need to focus on, although they're probably aware of it, and it's leverage. Franchising is all about leverage, leveraging the business assets that you've built, so at that initial startup stage, make sure you have a good plan to take what you've built already, the advertising programs, the marketing systems, the training systems, your supply chain, make sure they're efficient and optimized and leverage them. Let your franchisees benefit from the leverage. Let them benefit from reduced pricing from a vendor. Let them benefit from an exceptional training program, because once you prepare these programs and refine these systems, you're gonna duplicate them hopefully hundreds of times over as you add more franchisees.

So, at that initial stage, when you're at the ten franchisee stage, my big emphasis is really leveraging and refining those critical systems, and one obvious item of leverage that we run into all the time is really optimizing your website. There's a good return on investment on it. It's a good leverage point, and it's something that is valued by franchisees all the time. So, just continuing, and, again, if you'd like, you could hit Star 7 to unmute yourself, but I'm going to keep us on track unless anyone raises a question. The fourth and fifth questions – the first three dealt with franchisors, the startup – at the startup phase, and I raised those questions first because I think those questions will also benefit the individuals who have not yet franchised their business but are considering it.

And for those individuals, I've left the last two questions to the pre-startup phase, and the fourth question that we received for this teleconference was an individual who requested information about a fractional franchise system and, in particular, whether or not they should use a fractional franchise exemption to get started, and if they do that, does it pose potential problems to move toward a more traditional franchise system? I'm gonna give the short answer to that, and then I'll go into the detail. Short answer is it does present problems for later on moving into a traditional system, but let's understand what a fractional franchise exemption is, because the benefits of it may actually be outweighed when you evaluate it. First, the fractional franchise is just what it sounds.

It's not a full-fledged franchise. It's a franchise that's purchased by a franchisee who is already experienced in the business, so a fractional franchise exemption comes about under the law, under the federal law where if you qualify as a fractional franchise, you're not required to prepare an FDD or to provide the other party with disclosure documents. Now, the reason this exemption exists is because it's limited to those circumstances where your franchisee is an experienced operator in the same industry and, two, where the franchise that you're selling them will account for less than 20 percent of their sales. So, a fractional franchise exemption is an exemption from federal law. It's a value because you don't have to prepare an FDD and you don't have disclosure obligations.

However, it's a limited exemption, and it presents its own problems. Let's first discuss what the criteria is. One, to qualify for a fractional franchise exemption, your prospective franchisee must have more than two years of experience in the same type of business as the one you're franchising, so this is a market participant, someone who's in the industry. The second requirement is that at the time of signing your agreement, both you and the franchisee must have a reasonable basis to anticipate that your franchisee sales that relate to your franchise will not exceed 20 percent of the franchisee's total dollar volume sales for the year. So, basically, a fractional franchise relates to someone who's in the industry for two years, and someone who, when they add your franchise, it's not going to account for more than 20 percent of their sales in dollar volume.

Those are the criteria for the exemption. Why is this a problem? Because, one, you need to make an assessment and conduct your own due diligence as a franchisor to determine (a) whether or not your franchisee has two years' experience, (b) whether his experience or her experience qualifies as relevant industry experience where they're already in the business, (c) you have to evaluate what they're going to project to be their sales. Problem is is if you get it wrong, you violated the federal franchise law because the exemption won't apply. Now, another reason why I'm not an advocate of the fractional franchise exemption is because it's a federal exemption.

There's two layers of franchise regulation, federal and state. Certain states do not recognize the fractional franchise exemption, an example being Hawaii and the state of Washington, so right off the bat, your fractional franchise exemption will not apply if your franchise has anything to do with those two states. Another reason why I'm not a fan of the fractional franchise exemption is various states define a fractional franchise differently. California and New York have a much different definition than many other states, so you're left with an assortment of federal law and state law, and you're going to be spending money to do an assessment as to where you fall within these states. Third reason I'm not a big fan of this exemption is that you're still going to be required to file an annual registration exemption in states like New York and California.

The fractional franchise exemption has its application and has value, but I do not believe that value applies to a startup franchisor. That is an individual that is looking to eventually roll out a traditional franchise system. The other problem with a fractional franchise is that you need to conduct a due diligence process where you provide – when we work with fractional franchisors, we require our clients to provide us or sit and work with us to give us an overview of their prospective franchisee, their sales activity, their history in the market and a number of other criteria. And many times this evaluation is time consuming, and the consequences aren't good if you get it wrong. However, if you're a large entity, say a large corporate entity with many business lines, and you're just looking to roll out a very limited fractional franchise in a – within a limited state and under limited circumstances, you can consider it, but not if your ultimate goal is to roll out a traditional franchise system.

So, that's an overview of the fractional franchise exemption.

That's why I don't believe it's a good option, and the amount of time you're going to spend evaluating the fractional franchise exemption and its application could be time and money and effort well spent on actually setting up an overall system and ensuring compliance where you don't have to rely on any exemptions. So, that's an overview of the fractional franchise exemption, and, again, if anyone has questions or comments, feel free, and, otherwise, I will move on to our fifth question and the final question for this teleconference. And it's another startup franchisor type question, and it relates to licensing and franchising, which is an issue that comes up absolutely all the time. I see someone unmuted themselves. Do they have a question or would like to discuss anything?

Startup Franchisor 2: I was going to follow up on your fractional conversation.

Charles Internicola: Please, yeah.

Startup Franchisor 2: What would the differences be in the fractional versus, the name escapes me, step-in or in the initial franchising stages for the disclosure in the registration states?

Charles Internicola: *[Crosstalk]*

Startup Franchisor 2: And the name escapes me, so I apologize.

Charles Internicola: Oh, in the definition? So, you're referring to, for example, California and New York have different rules as to what a fractional franchise is?

Startup Franchisor 2: No, I was thinking more on the differences of – in the initial stages in the registration and designing the FDD for financial disclosure purposes with registration states. Wondered if that's where you were going with the fractional conversation, and then it just stayed fractional? Are you –

Charles Internicola: I am …

[Crosstalk]

Startup Franchisor 2: I am not clear, so I will have to – I'll have to jog my brain for the term that I'm reaching.

Charles Internicola: No, no, that –

Startup Franchisor 2: I apologize.

Charles Internicola: No, that's okay, but let's think this out. Are you referring to what happens after you approach registration after you've already sold a fractional franchise?

Startup Franchisor 2: No, as – not in – I was mistaken that it was even to do with fractional. I thought you were headed that direction, but I wanted to find the correlation there between fractional and the financial disclosure stipulations as far as for state registration of an FDD or a franchise –

Charles Internicola: Okay, so –

Startup Franchisor 2: – where you have less than a full year's financials to disclose.

Charles Internicola: You don't necessarily need a full year's financials to disclose for certain registration states, and, again, I'm not – and I apologize, I'm not that clear on the question, but – and maybe this'll – in the fractional franchise scenario, as a franchisor, you're going to be required to do – conduct some due diligence with the franchisee, your prospective franchisee to evaluate their current sales and then to extrapolate and estimate what you believe your franchise system will add to their sales. And in that case you need to ensure that it doesn't exceed 20 percent on these –

Startup Franchisor 2: Right, I – I do apologize, I inadvertently derailed the conversation from fractional. I'll apologize there.

Charles Internicola: That's okay.

Startup Franchisor 2: That's a different topic, so maybe at the end.

Charles Internicola: Okay, I appreciate the question, and, again, at the end, I more than welcome the question, and, again, so at any –

Startup Franchisor 2: Maybe by then I'll remember the term I'm looking for.

Charles Internicola: Okay.

Startup Franchisor 2: Thank you.

Charles Internicola: All right, and then I'm just gonna put it on mute, but then you hit Star 7 anytime you like to ask the question again, okay?

Startup Franchisor 2: Thank you, yes.

Charles Internicola: Okay, and, again, I still see there's probably now, I think, 12 people on the call, so, again, feel free to ask any question. The last issue is pros and cons of licensing as opposed to franchising. I'm going to address this one pretty quickly and pretty directly. Licensing is a small component of what's included in a franchise. When you establish a franchise system and when you sell a franchise, part – some of the rights you're giving to your franchisees relates to a license to use your trademarks and a license to use your business systems and your intellectual property.

Now, many times, due to the regulation in the franchise industry, the obligation to prepare an FDD and the obligation to disclose an FDD to prospective franchisees, we have come across a number of companies, small businesses that, without our advice, and have come to us after the fact, initially expanded by way of a license. And what they do is they say I'm granting – say – I don't even want to give a hypothetical, because I don't wanna ever reveal information about clients or not, but they would issue a license. The licensee obtains the right to establish say a store using the trademark, and the licensee sell similar products, use similar trade dress and operates basically as the same store. So, if we're XYZ brand, licensee opens up an XYZ brand store, and licensee sells the same products that all XYZ stores sell, and they follow the same business format.

In that circumstance, what was done irrespective of the fact that it's called a license is a franchise. A franchise exists where you grant the license, where the franchisor exerts control over the operations of the business and where there's a fee paid. Now, these aren't rigid requirements. Under the federal and state laws, courts and regulators don't look at the terms of an agreement in terms of whether you use the word "license" or "franchise." They get to the economic essence of the relationship, so if you're granting the right to use a trademark, if you're going to require that your franchisee or licensee, whatever you call them, conducts their business in a certain way, or if you're obligated to provide them with certain support, and if they pay you a fee, no matter what you call your relationship, it's going to boil down to a franchise, and we see this all the time.

We have clients that come to us, they've sold 30 stores as licenses and they've run into an issue and they now want us to work with them to convert them to a franchise, and we do that. The problem is is that state regulators, this needs to be disclosed to state regulators, and states like New York and California and many others, when they become aware of this, they will issue a small –

not a small – a significant administrative fine, but worse, they will require you to send a notice to all of your licensees and offer them what's called a rescission notice, where that licensee has the right to undo their license agreement, and you would potentially be obligated to repay them their investment. As much as I would like to find a simple solution and set up the perfect licensing structure that would work in lieu of a franchise system, I will tell you that after evaluating this issue significantly and litigating cases on this issue significantly that the law is so broad that there's no workaround, meaning, in my opinion, that licensing does not serve as an alternative to a traditional franchise.

I'm gonna make it even worse. In many states, you need the license of a trademark to trigger whether or not you're selling a franchise. In states like New York, you don't even need to license a trademark. You just need some control or an obligation of support and the payment of a fee, and individuals will try to disguise a fee in terms of inventory purchases or other obligations, but the regulators will look to that. Licenses are not designed to serve as a supplement for a franchise.

Licenses are really designed for discrete, limited transactions where you license or authorize another individual to utilize certain intellectual property, but it's not an alternative to franchising. It isn't, and more now than ever we're getting significant inquiries from individuals who now need to convert their licenses. The other big problem is is you're taking a big risk. If you believe your license and it turns out you're wrong, there's individual liability and, depending on what state you're in, there could be significant financial exposure. The franchisee or what you thought to be the licensee could potentially sue you for their economic losses.

So, my advice is is if an attorney or company has a foolproof package where they claim you could issue a license, I recommend that you get a guarantee and you ask them to indemnify you if you're sued and it turns out you're a franchise. And we have more information on this topic, so I'll – all the issues we actually discussed on this call, I will ask my staff to send out an e-mail with a copy of the recording of this call and materials that relate to it, including the first gentleman who had asked for information about a service to identify territories and geographic data. Those are the questions, the five questions we've allocated for this teleconference. I did allocate time if anyone has any follow-up questions, would like to discuss any other issue, but you – all you need to do is hit Star 7 to do that, and –

[Crosstalk]

Startup Franchisor 2: Yeah…

Charles Internicola: Okay.

Startup Franchisor 2: Okay, sorry. And I apologize, the term I was reaching for in my mind was phase-in regarding the financial statements –

Charles Internicola: Yes.

Startup Franchisor 2: – on the first year –

Charles Internicola: The –

Startup Franchisor 2: – and before the –

Charles Internicola: Yes.

Startup Franchisor 2: – before the end of the second year.

Charles Internicola: Right, so you're referring to the – and this is a result of recent regulation the past couple years. You're referring to a franchisor's obligation to submit audited financial statements as a part of their FDD, correct?

Startup Franchisor 2: Correct.

Charles Internicola: So, there is a limited phase-in period for startup franchisors where during that initial period they do not – they're not required to use audited financial statements, balance sheets and so forth in their FDD disclosure. Now, that's unrelated to the fractional franchise issue, but that's a significant issue for startup franchisors, because one of the things we work with our clients on day one, because I know where we're going with the legal work, and at the end I don't want to get caught up with delays because of improper planning. So, at that initial stage, when you're looking to structure your franchise, you need to be reaching out to your attorney and your accountant to determine what type of franchise or entity is going to be set up and start capitalizing that entity so your accountant becomes with the books.

And then, you could phase in the audit exemption, and, really, if you structure it the right way, an audit of a startup franchisor entity may not be that expensive, because it may be a very limited balance sheet. Does that answer that question?

Startup Franchisor 2: That it does, thank you, and I apologize for derailing your fractional conversation with that.

Charles Internicola: No, but you brought up a good issue for startup franchisors, so thank you.

Startup Franchisor 2: The only other extended question I would have on that regarding startup franchisors would be the registration or the non – no, speaking of non-registration states, as far as the registration with a non-registration state, prior to selling the first franchise, how does that work? Do you need to register with the state prior to selling your first, or it's asking for – I mean, just in research. I haven't technically done this yet, so – or would it be asking for your proposed FDD to be registered or you'd only – you only have it ready for a non-registration state when you need it –

Charles Internicola: So –

Startup Franchisor 2: – if that makes –

Charles Internicola: So, no, it's a perfect question. So, here's the thought process you need as a startup franchisor. One of the biggest issues startup franchisors – my clients call me all the time. I keep getting individuals who are asking to buy a franchise, and I – there's a delay. So, the startup phase from the first moment you decide, okay, I'm ready to go forward and I wanna work on establishing a franchise system, could go from anywhere from three to eight months, so it involves preplanning.

On average, it probably takes about six months to launch your documents. Now, to sell a franchise or to offer to sell a franchise, you need to prepare a franchise disclosure document, okay, and your question was, what do I do with registration states? Well, before you can offer or sell a franchise in a registration state, you need to first submit that FDD to the state regulator and request registration. Chances are, depending on the state, states like Indiana will probably register right away. States like New York will give you pushback, and they'll scrutinize it, and you may be required to modify your FDD.

So, if New York's the example, okay, you need to register and have New York state accept your FDD prior to you being able to offer to sell a franchise, so once you make a decision to franchise your business, before you ever sell a franchise or offer a franchise for sale, you need to go through the planning process, which involves FDD development, franchise agreement development, operations manual, all – corporate structures, license agreements, so you'll preplan. Assume that process takes six months. At the end of that six months – also, you may have issues with trademark registration – you should have a completed compliance program which features your FDD. At that point, on that day, your attorney would write down an effective date on your FDD.

For non-registration states, on that date, you could start offering and selling franchises. In franchise registration states, you cannot begin offering or selling in those states until you first submit it to them and they accept it and grant you registration, so –

Startup Franchisor 2: So, just to be clear, if I could, on a non-registration state, then, there is no – you don't file the secretary of state or any entity prior to offering for sale?

Charles Internicola: Correct.

Startup Franchisor 2: I just wanted to be sure of that, thank you.

Charles Internicola: Yeah, absolutely correct, and what you'll see, when we develop FDDs, it's developed on a multistate basis, so we assume you're going to try to sell in every state. So, there'll be addendums for New York, Indiana and so forth, because for registration states, you're required to add certain addendums. So, let's assume on day 90 there is a multistate franchise disclosure document prepared, okay, and let's assume day 90 is December 1. On that date, inside your FDD, you'll notice it says things like effective date and gives different effective dates for different states, so, for example, New Jersey is not a registration state. So, we would put down December 1 as the effective date for your franchise offering in the state of New Jersey.

Now, let's assume on December 1 we submitted your FDD to state of New York for registration. That would not be your effective date. Once New York accepts it – say it's on January 1 – well, then, that would be the effective date in New York and the date upon which you could begin to offer a sale in New York. So, if you look at an FDD, you may see different effective dates on the third or fourth page.

Startup Franchisor 2: That's very clear to me. Thank you very much.

Charles Internicola: You're welcome. If anyone else has a question – I'll just pause a moment – feel free to unmute yourself and hit Star 7. If not, I will ask my staff to follow up with a recording of this call, and we will send out some supplemental materials, and on a personal note, I thank you, and we got really an overwhelming response to these conferences. I thank you for the thought process you put into these questions and very much appreciate it, but looks like everyone's still muted, so it looks like we'll wrap up the call.

And, again, you should be receiving some follow-up information from my staff. Thank you, everyone, and have a good afternoon.

[End of Audio]