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# **SELLING FRANCHISES VIA THE INTERNET: A Legal Update**

by

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## **SELLING FRANCHISES VIA THE INTERNET: A Legal Update**

This article updates the status of some new "cyber-laws". These provisions were adopted to deal with issues stemming from the ever-increasing use of the World Wide Web by franchisors. Franchisors that advertise, offer and sell franchises over the Internet (and their counsel) should be aware of these new provisions in the various states.

The North American Securities Administrators Association ("NASAA") is an organization that studies, develops and adopts policy (not legislation) to affect uniform and consistent franchise and securities practices. NASAA currently encourages the states to exempt from state franchise registration laws offers to sell franchises over the Internet, World Wide Web, or any other similar proprietary or common carrier electronic delivery system ("Internet Offers"). In 1998, NASAA adopted an Internet Offer exemption "model" to guide the states in drafting such provisions. The NASAA model provides that an Internet Offer should be exempt from registration requirements if it meets three criteria. No registration would be required under this model, if the Internet Offer: (i) indicates, directly or indirectly, that a franchise is not being offered to the state's residents, (ii) was not otherwise directed to anyone in the state by the franchisor or anyone acting with the franchisor's knowledge, and (iii) if made into the state, it must be registered before any franchises are sold.

As of the writing of this article, over 1/2 of the "registration" states have adopted provisions that exempt such "Internet Offers" from state registration laws (Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, South Dakota and Washington). The Maryland, North Dakota and South Dakota regulations follow the NASAA model almost verbatim; the others consist of variations of the model. Rhode Island adds a requirement that a "firewall" type mechanism be added to ensure that the franchisor does not subsequently communicate directly with a prospective franchisee until registered or otherwise qualified to sell in Rhode Island. California's proposed regulation is also a mirror image of the NASAA model and its adoption is anticipated to occur shortly. The remaining registration states have not yet announced any new proposals on this issue.

A closely related issue facing franchisors is whether a franchisor's offer to sell franchises on its web site is an advertisement that must be filed and reviewed in accordance with the franchise advertising laws in many states, including California. These laws generally require the filing and pre-approval of advertisements offering a franchise subject to the registration requirements.

Most examiners conclude that registered franchisors' web sites that offer franchises for sale are advertisements that must be filed and pre-approved.

Unfortunately, the current "patchwork" policy and adoption of such provisions often result in inconsistencies when applied in conjunction with existing franchise laws. For example, when a franchisor registered in California offers to sell franchises via both a traditional print advertisement in the *Wall Street Journal* and on its web site, two different requirements are imposed even though the two ads may be exactly the same. Under current California law, an exemption from registration provides that if more than 2/3 of the circulation of the publication used to advertise a franchise is outside California, the *Wall Street Journal* ad in our example need not be filed and reviewed by a California examiner. However, many state examiners, including California, currently adhere to a policy (not yet law) that this type of web site is advertising that must be filed and reviewed even if it is exactly the same as the exempted print ad.

Such inconsistent results and the regulatory burden upon both franchisors and state regulators created by these requirements are only some of the problems. Additional problems arise because some franchisors revise their web sites on a monthly, weekly or even daily basis. Review of these web sites on an update by update basis would clearly be unmanageable, especially for franchisors registered nationwide. Conversely, state regulators maintain that they have an interest in reviewing web sites offering franchises for sale to ensure consistency between statements made on the franchisor's web site and those made in its offering circular.

These issues need more attention and the balance that will ultimately be struck is entirely unclear at this initial stage. We will keep you informed about developments in these areas but recommend that you proceed with care in the meantime. Web sites should be reviewed by counsel not only for general franchise law issues (i.e., inadvertent earnings claims) but also to ensure that the appropriate disclaimers and protective provisions are in place.