

Date of Hearing: April 4, 2016

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 2637 (Wilk) – As Amended March 28, 2016

SUBJECT: Franchise investments: offer and sale of registered franchises: registration exemption

SUMMARY: Makes changes to the California Franchise Investment Law (CFIL). Specifically, **this bill:**

- 1) Eliminates some of the conditions that must be met in order for a franchisor to claim the exemption from the franchisor having to amend its franchise registration in connection with a negotiated sale:
 - a) Deletes the requirement that the franchisee must receive all of the following in a separate written appendix to the franchise disclosure document (FDD):
 - i) That a prospective franchisee receives information regarding terms the franchisor negotiated during the previous 12 months;
 - ii) A statement indicating that copies of the negotiated terms are available upon written request; and,
 - iii) The name, telephone number, and address of the representative of the franchisor to whom requests for a copy of the negotiated terms may be obtained.
 - b) Deletes a requirement that provides the negotiated terms, on the whole, confer additional benefits on the franchisee.
- 2) Deletes a requirement that the franchisor provide a copy of the negotiated terms to the prospective franchisee within five business days following the request of the franchisee.
- 3) Adds a requirement that provides the disclosure document to state that California law does not prohibit a franchisor from negotiating, or require a franchisor to negotiate, the standard franchise agreement or other agreements contained in the disclosure document.

EXISTING LAW:

- 1) Prohibits the sale of a franchise in California unless prior to the sale the franchisor has, among other things, prepared a FDD and registered with the Commissioner of the Department of Business Oversight (DBO) (Commissioner) to sell franchises in California. [Corporations Code, Sections 31000 et seq.]
- 2) Makes it unlawful for any person to offer or sell any franchise in this state unless the offer of the franchise has been registered with the Commissioner, or qualifies under one of several specified exemptions. [Corporations Code, Section 31110]
- 3) Requires an application for registration to be accompanied by a proposed FDD, which shall contain the material information set forth in the application for registration, as specified by

rule of the commissioner, and such additional disclosures as the Commissioner may require. [Corporations Code, Section 31114]

- 4) Makes it unlawful to sell any franchise in this state that is subject to registration without first providing to the prospective franchisee, at least 14 days prior to the execution by the prospective franchisee of any binding franchise or other agreement, or at least 14 days prior to the receipt of any consideration, whichever occurs first, a copy of the franchise disclosure document, together with a copy of all proposed agreements relating to the sale of the franchise. [Corporations Code, Section 31119 (a)]
- 5) Provides an exemption when the prospective franchisee receives the offering, he or she also receives copies of all Notices of Negotiated Sale of Franchise filed with the Commissioner within the last 12 months, if any. [California Code of Regulations section 310.100.2]
- 6) Exempts certain negotiated sales of franchises. Provides the statutory exemption eliminates the requirement that a franchisor must amend its franchise registration in connection with a negotiated sale if specified conditions are met. [Corporations Code, Section 31109.1]

FISCAL EFFECT: Unknown.

COMMENTS:

Under AB 2637, franchisors would notify the prospective franchisees in California that the negotiation of franchise agreements is permitted by law and that California law does not prohibit or compel negotiations. This notice should ensure that prospective franchisees will not be misled into believing that California law disallows negotiations.

In California, franchisors have two different statutory frameworks they can work under in regards to negotiated sales: one being the California Code of Regulations Section 310.100.2 established in 1989 and the second, Corporations Code, Section 31109.1 established in 2004.

Under the California Code of Regulations, conditions for exemption include:

- 1) The initial offer must be registered;
- 2) Within 15 business days after consummating a negotiated sale, the franchisor must file a "Notice of Negotiated Sale" with DBO. The Notice of Negotiated Sale lists, among other things, a description of the changes that were made by reference to the relevant section of the franchisor's registered disclosure document;
- 3) When a prospective franchisee receives the franchisor's disclosure document, he or she must also receive copies of all Notices of Negotiated Sale filed by the franchisor in the last 12 months; and,
- 4) The franchisor must certify or declare in an appendix to its application for renewal that it has complied with all the requirement of the regulation, if this exemption is claimed.

Under the Corporations Code, the exemption eliminates the requirement that a franchisor must amend its franchise registration in connection with a negotiated sale if the following conditions are met:

- 1) The initial offer (the franchisor's disclosure document) is registered;
- 2) Within five business days after a request by the prospective franchisee, franchisor must provide to the franchisee:
 - a. A summary description of each material negotiated term that was negotiated by the franchisor for a California franchise during the previous 12 months; and,
 - b. A statement indicating that copies of the negotiated terms themselves are available upon written request, the name, phone number, and address of a franchisor representative from whom the franchisee may obtain the negotiated terms.
- 3) The negotiated terms, on the whole, must benefit the prospective franchisee; and,
- 4) The franchisor must certify or declare in an appendix to its application for renewal that it has complied with all the requirements of the statute, if this exemption is claimed.

AB 2637 eliminates conditions that must be met in order to claim the exemption which includes #2 and #3 above. AB 2637 adds a new condition which will require that the franchisor's disclosure document discloses that California law does not prohibit a franchisor from negotiating, or require a franchisor to negotiate, the standard franchise agreement contained in the disclosure document.

Background:

Franchises subject to the CFIL may only be offered or sold after compliance with various registration and disclosure obligations. In general, most franchises are sold pursuant to the terms of the franchise agreement drafted by the franchisor, which address the needs of the franchisor but may not contemplate requirements or needs of franchisees in special circumstances. In some cases, the prospective franchisees or their counsel may request changes to the franchise agreement or other terms of sale from those registered with the DBO. Depending on the circumstances, the franchisor may be willing to make some or all of the requested changes, and a negotiation process may ensue, which sometimes involves a degree of "give and take" by both parties.

The CFIL states that only a franchise agreement that is described in a disclosure document that has been registered with the DBO can be offered and sold to a resident of California or to a franchisee whose franchise will be located in California. This can lead to issues if a franchise agreement is changed as a result of negotiations between the parties. Under existing law, the franchisor would be required to amend its registration before completing the sale. If the franchisor did not want to offer the same amended franchise agreement to all future franchisees in California, the franchisor then needs to re-amend its registration to return to the original document.

Both the regulation and the amendment of the CFIL were intended to facilitate the ability of franchisors to comply with requests for modification of franchise agreements, by eliminating the need to re-register before selling a negotiated franchise agreement.

According to the sponsor, the Business Law Section, Franchise Law Committee of the California State Bar, *"both the statute and the regulation have created significant disincentives for franchisors to negotiate the terms of sales with franchisees. While virtually all franchisors are willing to negotiate with some prospective franchisees under some circumstances, the statute and the regulation actually serve to decrease the numbers of situations in which most franchisors are willing to negotiate with franchisees in California. At this time, California is the only state that currently imposes restrictions on the ability of franchisees and franchisors to negotiate or that requires the disclosure of negotiated changes."*

The sponsors go on to state, *"If a franchisor negotiates with a franchisee in California, then the results of that negotiation become publicly available, including the franchisees who are not even located in California. Many franchisors are concerned that this disclosure will cause the negotiated change to become a "new normal" with future franchisees expecting to get not only every change that was negotiated in the past but additional changes as well. To avoid this consequence, many franchisors refuse to negotiate any changes in California- even under circumstances in which they would be willing to negotiate with a similarly-situated franchisee in another state."*

Related Legislation:

AB 1782 (Maienschein) would authorize prospective franchises that have not registered with DBO to nevertheless exhibit at franchise trade shows in California as long as specified disclosures are made to the DBO and to trade show attendees. Pending in the Assembly Appropriations Committee.

Previous Legislation:

AB 525 (Holden, Atkins, Dodd & Wilk) (Chapter 776, Statutes of 2015) Revised the rights and responsibilities of franchisors and franchisees under the California Franchise Relations Act (CFRA) with respect to the termination of franchise agreements.

REGISTERED SUPPORT / OPPOSITION:

Support

The Franchise Law Committee of the Business Law Section of the State Bar of California

Opposition

None on file.

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