

Introduced by Senator Hill

February 22, 2013

An act to amend Sections 31101, 31107, 31109.1, 31114 and 31119 of the Corporations Code, relating to franchises.

LEGISLATIVE COUNSEL'S DIGEST

SB 538, as introduced, Hill. Franchises.

The Franchise Investment Law generally provides for the regulation of the offer and sale of franchises. The law requires specific written disclosures, including, but not limited to, an offering circular, and authorizes the sale of a franchise to be exempt from specified requirements if the franchisor meets certain disclosure and notice requirements.

This bill, for that exemption to apply, would modify the requirement that certain written disclosures be made by a franchisor at least 10 business days prior to the sale or material modification of a franchise and instead require those disclosures to be made at least 14 days prior to the sale or modification. The bill also would replace the term for a written document called an "offering circular" with the term "franchise disclosure document."

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 31101 of the Corporations Code is
- 2 amended to read:
- 3 31101. There shall be exempted from the provisions of Chapter
- 4 2 (commencing with Section 31110) of this part the offer and sale

1 of a franchise if the franchisor complies with each of the following
2 minimum net worth, experience, disclosure, and notice filing
3 requirements:

4 (a) Net worth. The franchisor and, when necessary, a corporation
5 owning at least 80 percent of the franchisor (parent) meet one of
6 the following net worth requirements, according to financial
7 statements for the fiscal year just ended. The franchisor and the
8 parent, when necessary, may rely upon the immediately preceding
9 fiscal year's audited financial statement for 15 months from that
10 fiscal year end date.

11 (1) The franchisor has a net worth on a consolidated basis of
12 not less than five million dollars (\$5,000,000), according to its
13 audited financial statement.

14 (2) The franchisor has a net worth of not less than one million
15 dollars (\$1,000,000) and its parent has a net worth of five million
16 dollars (\$5,000,000), according to the audited financial statements
17 of the franchisor and its parent, respectively.

18 (3) The franchisor has a net worth of one million dollars
19 (\$1,000,000), according to its unaudited financial statement, and
20 the parent has a net worth on a consolidated basis of not less than
21 five million dollars (\$5,000,000), according to its audited financial
22 statement, and the parent absolutely and unconditionally guarantees
23 to assume the duties and obligations of the franchisor under the
24 franchise agreement should the franchisor become unable to
25 perform its duties and obligations.

26 (b) Experience. The franchisor or a corporation owning at least
27 80 percent of the franchisor (parent) complies with one or more
28 of the following conditions throughout the five-year period
29 immediately preceding the offer and sale of the franchise, or
30 complies with one of the following conditions during part of the
31 period and one or more of the following conditions during the
32 balance of the period:

33 (1) The franchisor has had at least 25 franchisees conducting
34 business which is the subject of the franchise.

35 (2) The franchisor has conducted business which is the subject
36 of the franchise.

37 (3) The parent has had at least 25 franchisees conducting
38 business which is the subject of the franchise.

39 (4) The parent has conducted business which is the subject of
40 the franchise.

1 (c) Disclosure. (1) Except as provided in subparagraph (2), the
2 franchisor discloses in writing to each prospective franchisee, at
3 least ~~10 business~~ 14 days prior to the execution by the prospective
4 franchisee of any binding franchise or other agreement, or at least
5 ~~10 business~~ 14 days prior to the receipt of any consideration, the
6 following information:

7 (A) The name of the franchisor, the name under which the
8 franchisor is doing or intends to do business, and the name of any
9 parent or affiliated company that will engage in business
10 transactions with franchisees.

11 (B) The franchisor's principal business address and the name
12 and address of its agent in the State of California authorized to
13 receive service of process.

14 (C) The business form of the franchisor, whether corporate,
15 partnership, or otherwise.

16 (D) The business experience of the franchisor, including the
17 length of time the franchisor (i) has conducted a business of the
18 type to be operated by the franchisees, (ii) has granted franchises
19 for such business, and (iii) has granted franchises in other lines of
20 business.

21 (E) A copy of the typical franchise contract or agreement
22 proposed for use or in use in this state.

23 (F) A statement of the franchise fee charged, the proposed
24 application of the proceeds of such fee by the franchisor, and the
25 formula by which the amount of the fee is determined if the fee is
26 not the same in all cases.

27 (G) A statement describing any payments or fees other than
28 franchise fees that the franchisee or subfranchisor is required to
29 pay to the franchisor, including royalties and payments or fees
30 which the franchisor collects in whole or in part on behalf of a
31 third party or parties.

32 (H) A statement of the conditions under which the franchise
33 agreement may be terminated or renewal refused, or repurchased
34 at the option of the franchisor.

35 (I) A statement as to whether, by the terms of the franchise
36 agreement or by other device or practice, the franchisee or
37 subfranchisor is required to purchase from the franchisor or his or
38 her designee services, supplies, products, fixtures, or other goods
39 relating to the establishment or operation of the franchise business,
40 together with a description thereof.

1 (J) A statement as to whether, by the terms of the franchise
2 agreement or other device or practice, the franchisee is limited in
3 the goods or services offered by him or her to his or her customers.

4 (K) A statement of the terms and conditions of any financing
5 arrangements when offered directly or indirectly by the franchisor
6 or his or her agent or affiliate.

7 (L) A statement of any past or present practice or of any intent
8 of the franchisor to sell, assign, or discount to a third party any
9 note, contract, or other obligation of the franchisee or subfranchisor
10 in whole or in part.

11 (M) If any statement of estimated or projected franchisee
12 earnings is used, a statement of such estimation or projection and
13 the data upon which it is based.

14 (N) A statement as to whether franchisees or subfranchisors
15 receive an exclusive area or territory.

16 (O) A copy of the financial statement or statements required by
17 subdivision (a).

18 (P) A copy of the unconditional guaranty, if applicable, required
19 by paragraph (3) of subdivision (a).

20 (2) In the case of a material modification of an existing
21 franchise, the franchisor discloses in writing to each franchisee
22 information concerning the specific sections of the franchise
23 agreement proposed to be modified and such additional information
24 as may be required by rule or order of the commissioner. Any
25 agreement by such franchisee to such material modifications shall
26 not be binding upon the franchisee if the franchisee, within ~~10~~
27 *business 14* days after the receipt of such writing identifying the
28 material modification, notifies the franchisor in writing that the
29 agreement to such modification is rescinded. A writing identifying
30 the material modification is received when delivered to the
31 franchisee. A written notice by the franchisee rescinding an
32 agreement to a material modification is effective when delivered
33 to the franchisor or when deposited in the mail, postage prepaid,
34 and addressed to the franchisor in accordance with any notice
35 provisions in the franchise agreement, or when delivered or mailed
36 to the person designated in the franchise agreement for the receipt
37 of notices on behalf of the franchisor.

38 (d) Notice filing. The franchisor has filed with the commissioner
39 a notice of exemption and paid the fee required by subdivision (f)
40 of Section 31500 prior to an offer or sale of a franchise in this state

1 during any calendar year in which one or more franchises are sold,
2 excluding any material modification.

3 SEC. 2. Section 31107 of the Corporations Code is amended
4 to read:

5 31107. There shall be exempted from the provisions of Chapter
6 2 (commencing with Section 31110) of this part, any offer (but
7 not the sale) by a franchisor of a franchise while an application
8 for renewal or amendment is pending if the prospective franchisee
9 receives all of the following:

10 (a) ~~The offering circular~~ *franchise disclosure document* and its
11 exhibits as filed with the commissioner with the application for
12 renewal or amendment.

13 (b) A written statement from the franchisor that (1) the filing
14 has been made but is not effective, (2) the information in the
15 ~~offering circular~~ *franchise disclosure document* and exhibits has
16 not been reviewed by the commissioner, and (3) the franchisor
17 will deliver to the prospective franchisee an effective ~~offering~~
18 ~~circular~~ *franchise disclosure document* and exhibits at least ~~10~~
19 ~~business~~ 14 days prior to execution by the prospective franchisee
20 of a binding agreement or payment of any consideration to the
21 franchisor, or any person affiliated with the franchisor, whichever
22 occurs first, showing all material changes from the ~~offering circular~~
23 *franchise disclosure document* and exhibits received by the
24 prospective franchisee under subdivision (a) of this section.

25 (c) ~~The offering circular~~ *franchise disclosure document* and
26 exhibits in accordance with paragraph (3) of subdivision (b) of
27 this section.

28 SEC. 3. Section 31109.1 of the Corporations Code is amended
29 to read:

30 31109.1. (a) There shall be exempted from the provisions of
31 Chapter 2 (commencing with Section 31110) the offer and sale of
32 a franchise registered under Section 31111, 31121, or 31123 on
33 terms different from the terms of the offer registered thereunder
34 if all of the following requirements are met:

35 (1) The initial offer is the offer registered under Section 31111,
36 31121, or 31123.

37 (2) The prospective franchisee receives all of the following in
38 a separate written appendix to the ~~offering circular~~: *franchise*
39 *disclosure document*:

1 (A) A summary description of each material negotiated term
2 that was negotiated by the franchisor for a California franchise
3 during the 12-month period ending in the calendar month
4 immediately preceding the month in which the negotiated offer or
5 sale is made under this section.

6 (B) A statement indicating that copies of the negotiated terms
7 are available upon written request.

8 (C) The name, telephone number, and address of the
9 representative of the franchisor to whom requests for a copy of
10 the negotiated terms may be obtained.

11 (3) The franchisor certifies or declares in an appendix to its
12 application for renewal that it has complied with all of the
13 requirements of this section, in the event this exemption is claimed.

14 (4) The negotiated terms, on the whole, confer additional
15 benefits on the franchisee.

16 (b) The franchisor shall provide a copy of the negotiated terms
17 described in subdivision (a) to the prospective franchisee within
18 five business days following the request of the franchisee.

19 (c) The franchisor shall maintain copies of all material
20 negotiated terms for which this exemption is claimed for a period
21 of five years from the effective date of the first agreement
22 containing the relevant negotiated term. Upon the request of the
23 commissioner, the franchisor shall make the copies available to
24 the commissioner for review. For purposes of this section, the
25 commissioner may prescribe by rule or order the format and content
26 of the summary description of the negotiated terms required by
27 subparagraph (A) of paragraph (2) of subdivision (a).

28 (d) For purposes of this section, “material” means that a
29 reasonable franchisee would view the terms as important in
30 negotiating the franchise.

31 SEC. 4. Section 31114 of the Corporations Code is amended
32 to read:

33 31114. The application for registration shall be accompanied
34 by a proposed ~~offering circular~~ *franchise disclosure document*,
35 which shall contain the material information set forth in the
36 application for registration, as specified by rule of the
37 commissioner, and such additional disclosures as the commissioner
38 may require. The ~~offering circular~~ *franchise disclosure document*
39 shall recite in bold type of not less than 10-point type that

1 registration does not constitute approval, recommendation, or
2 endorsement by the commissioner.

3 SEC. 5. Section 31119 of the Corporations Code is amended
4 to read:

5 31119. (a) It is unlawful to sell any franchise in this state that
6 is subject to registration under this law without first providing to
7 the prospective franchisee, at least 14 days prior to the execution
8 by the prospective franchisee of any binding franchise or other
9 agreement, or at least 14 days prior to the receipt of any
10 consideration, whichever occurs first, a copy of the ~~offering circular~~
11 *franchise disclosure document*, together with a copy of all proposed
12 agreements relating to the sale of the franchise.

13 (b) Nothing in this division shall be construed to prevent a
14 franchisor from providing copies of the ~~offering circular~~ *franchise*
15 *disclosure* documents to prospective franchisees through electronic
16 means pursuant to any requirements or conditions that may be
17 imposed by rule or order of the commissioner.