

# The Long Reach of Franchise Laws

By David Gurnick

Laws can have effects beyond the problem they solve. California's business franchise laws are an example. Distribution of goods and services through franchising expanded widely in the 1960s and 1970s. But so did fraudulent practices, such as franchisors promising returns and assistance they could not deliver.

In 1970, Gov. Ronald Reagan signed the Franchise Investment Law (FIL) making California the first state with legislation to protect potential franchisees. The FIL seeks to prohibit sales of franchises that involve fraud or likely breach by franchisors, and to provide information to help prospective franchisees make informed decisions on buying a franchise. (Corporations Code Section 31001). Franchisors must register with the state before offering and selling franchises; present a detailed disclosure document and audited financial statements to potential franchisees; and allow a cooling-off period before a new franchisee signs any agreement or pays the franchisor any money.

In 1980, California enacted the Franchise Relations Act (FRA) to benefit franchisees in their ongoing relationship with franchisors. The FRA protects franchisees in the ongoing relationship with a franchisor. It limits grounds and sets procedures for termination and non-renewal of franchises. The FRA prohibits a franchisor from terminating a franchise before expiration of its term, or refusing to renew at the end of the term, without good cause. It also gives a deceased franchisee's heirs a right to succeed to ownership of the franchise.

These laws have done more than help franchisees. They have also had significant impacts in other practice areas. Here are a few examples:

**Family Law.** Family law practice often involves valuing assets of divorcing couples. Valuations help assure equal division of property. If a divorcing couple owns a franchise that one spouse will keep, the other spouse wants money or other property having equal value. See, for example, *Hawksley v. Gerow* 10 A.3d 715 (Maine 2011) (concerning valuation of a divorcing couple's two H&R Block tax franchises).

The value of a business franchise is based partly on its duration. Some lawyers and clients simply look at the franchise agreement's stated term. But the franchisee's statutory right to renew at the end of the term may enlarge the duration, and the value, of the franchise. Likewise, FRA protection against being terminated before expiration can also increase a franchise's value. Conversely, the FRA states some circumstances when a franchisor has good cause to terminate a franchise. (Business & Professions Code Section 20021). The franchisor's right to terminate, can decrease the franchise's value.

for ownership, or transfer the franchise to someone who qualifies. (Business & Professions Code Section 20027). Trust and estate planning attorneys whose clients own interests in a franchise, need to be aware of this estate planning benefit, and tool.

**Intellectual Property Practice.** Trademark, copyright and patent lawyers often negotiate inbound or outbound licenses in which a client grants or receives a right to use a valuable trademark, copyright or patent. Some intellectual property licenses include all the elements that make a business relationship a "franchise." This can occur when: the license

in the operation of its business, and has full power and authority to conduct its business in the manner now being conducted."

A company whose business relationships with resellers, distributors and dealers include all the elements that make them franchises, may have been required to register under the FIL. If the company did not register, it may be in violation of the FIL, and unable to give the above warranty, or if given, the warranty will be incorrect.

Sometimes in transactions, a party who cannot give an unqualified warranty will list exceptions from the warranty. The above warranty might be modified to state, "except as follows" and then note any exceptions. But FIL violations are felonies (Corporations Code Sections 31410-31411). Listing possible FIL violations as warranty exceptions could potentially admit a crime. Thus, transactional lawyers whose clients have agreements with resellers, distributors or dealers, or may buy such a company, need to be aware of the FIL to assess legal compliance, and nuance in making warranties in a purchase agreement.

**Distributor and Dealer Law.** For product distributors and dealers, the FRA provides a shield against termination, as well as compensation for losses from a wrongful early termination. These provisions apply even where the parties did not recognize that their relationship was a franchise. For example, in *To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America Inc.* 152 F.3d 658 (7th Cir. 1998) a manufacturer terminated a Mitsubishi equipment dealer nine years into the relationship. The 7th U.S. Circuit Court of Appeals agreed with the business relationship was an accidental franchise, protected against termination. The manufacturer was required to pay the wrongly terminated dealer damages

Laws can have effects beyond the problem they solve. California's business franchise laws are an example.

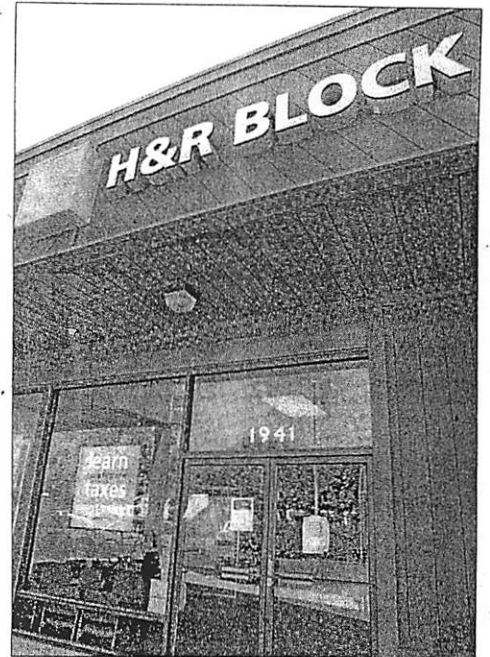
For these reasons, the FRA is of interest to family law practitioners whose clients own franchises, or are franchisors. The FRA is a tool that counsel can use to advance the interest of a client who seeks to accurately maximize, or reduce the valuation of a business franchise.

**Estate Planning and Estate Administration Practice.** In estate planning and administration, it is also necessary to value assets. See, for example, *Estate of Blouin* 490 A.2d 1212 (Maine, 1985) (decendent's Dairy Queen franchise needed to be valued). The same considerations discussed above may increase or decrease the value of a decendent's interest in a franchise. Thus, estate planning and estate administration attorneys can also benefit from having knowledge of the FRA.

The FRA has another impact in estate law. Many franchisors and franchisees believe that when a franchisee dies, the agreement ends. But the FRA assures surviving spouses, heirs and estates of deceased franchisees (also deceased majority shareholders of franchisee entities) the chance to own the franchise. The franchisor must give the spouse, heirs or estate a reasonable time to either qualify

grants a right to distribute goods or services, and includes permission to use a trademark; the licensor grants the licensee an exclusive territory, or suggests a marketing plan, or provides other significant assistance in the use of the intellectual property; and the licensee pays the licensor a royalty or other fee (Corporations Code Section 31005). When this happens, an intellectual property attorney may need to advise a licensor client of the possible need for franchise law compliance; or may need to advise a licensee client on protection available under the FIL and FRA.

**Transactional and Finance Law.** In business sales and finance transactions, sellers or borrowers must often provide buyers or lenders a warranty, and sometimes a legal opinion, that the seller is complying with all laws. A typical warranty may state: "The company has complied with and is in compliance with all material applicable federal and state laws



An H&R Block store in Mountain View.

totaling more than \$1.5 million. Recently in Hawaii, an Isuzu dealer claimed it was a franchise, thereby requiring the manufacturer to repurchase inventory following an early termination. *JICO Inc. v. Isuzu Motors America Inc.* 2009 WL 1444103 (D. Haw. 2009)).

**Energy Law.** Practitioners must be aware of the Petroleum Marketing Practices Act (PMPA) 15 U.S.C. Section 2801-2806, which regulates distribution of motor fuels through franchised gasoline stations. The PMPA restricts termination and non-renewal of gasoline station franchises, and in some situations gives franchisees a right to buy the real estate they lease for their gas station locations.

**Land Use.** An unusual, uncodi-

fied provision enacted in 1980 with the FRA, states: "In a regional shopping center located in a city with a population under 60,000 in a county of the first class, a franchise can be relocated within the regional shopping center with the consent of the franchisee and the management of the regional shopping center or the franchisor and the management of the regional shopping center." (Calif. Stats. 1980, c. 1355, p. 4896, Section 5). Though not mentioned in any reported decision, this obscure statute could possibly be used to overcome zoning or other municipal challenges to relocation of a franchise within the confines of a shopping center.



David Gurnick is with Lewitt Hackman in Encino. He represents franchisors and franchisees in regulatory compliance and litigation. He is certified as a specialist in franchising and distribution law by the State Bar Board of Legal Specialization and can be reached at dgurnick@lewittackman.com.