

THURSDAY, DECEMBER 22, 2022

PERSPECTIVE

GUEST COLUMN

Amendments to California Franchise Laws in the New Year

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California is well-known for having some of the most stringent franchisee-protection laws in the country. On Sept. 29, Gov. Gavin Newsom signed Assembly Bill 676, which amends the California Franchise Investment Law (CFIL) and the California Franchise Relations Act (CFRA) to further expand franchisee rights and address franchise investment and relations issues that came to light during the Covid-19 pandemic. The updated CFRA applies to franchise agreements entered into, renewed or amended on or after Jan. 1, 2023, and to any franchise arrangement of indefinite duration (i.e., no specified fixed term) that permits either party to terminate the arrangement without cause. It will not, however, apply to franchise agreements amended after Jan. 1, 2023 if the amendment was initiated by the franchisee to negotiate better terms.

The CFIL and CFRA amendments are largely technical updates supported and advocated by many franchisee organizations, but represent significant additional franchisee-friendly legislation on the heels of AB-5's enactment in 2020 and the infamous FAST Recovery Act that will also become effective in January 2023.

I. Removal of Exclusive Remedy Provision

Franchise offers and sales in California are regulated by the CFIL, at Cal. Corp. Code §§ 31000-31516. Generally, unless either the fran-

chisor or the offer or sale transaction is exempt, a franchisor must register the franchise and give prospective franchisees a franchise disclosure document (FDD) containing material information about the franchise. When the franchise

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relationship breaks down and the parties resort to litigation, franchisees routinely allege causes of action against their franchisors for both statutory violations as well as claims based on various common law liability theories that can include fraud, negligence, unfair competition, breach of contract and others based on the same violations. In a typical scenario, a franchisee plaintiff will assert a claim that franchisor violated a franchise registration or FDD disclosure requirement or antifraud provision of the CFIL, as well as the above common law claims based on the same act or omission of the franchisor.

The current CFIL contains a provision that has been interpreted as preempting such common law claims. Section 31306 reads as follows:

"Except as explicitly provided in this chapter, no civil liability in favor of any private party shall arise against any person by implication from or as a result of the

violation of any provision of this law or any rule or order hereunder. Nothing in this chapter shall limit any liability which may exist by virtue of any other statute or under common law if this law were not in effect."

Although the two sentences of the statute may appear to contradict each other, courts have held that the first sentence in Section 31306 states the CFIL is the exclusive remedy for misrepresenta-

tions violative of any CFIL provision. *Samica Enterprises, LLC v. Mail Boxes Etc. USA, Inc.*, 637 F. Supp. 2d 712, 721-722 (C.D. Cal. 2008). In other words, allegations of a franchisor committing a fraud or omission based on CFIL violations are preempted by the CFIL, whereas claims independent of CFIL violations are not. Courts are not uniform in this interpretation. Others have held the second sentence allows common law claims by its plain terms. *See Anderson v. Griswold Int'l, Inc.*, No. 14-cv-02560-EDL, 2014 WL 12694138 at *5 (N.D. Cal. Dec. 2014).

One important consequence of the preemption interpretation is a possibly shorter statute of limitations. For example, while a common law fraud claim in California must be brought in 3 years, the CFIL imposes an outer 2-year stat-

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ute of limitations for violations of the statute's antifraud provisions. See *Cal. Corp. Code* § 31304. The CFIL's statutes of limitation are absolute and not subject to tolling or delayed discovery principles. *People ex rel. Dep't of Corps. v. Speedee Oil Change Sys., Inc.*, 95 Cal. App. 4th 709, 726-727 (2002).

Effective January 2023, the first sentence in Section 31306 will be deleted and the second "savings clause" sentence is all that will remain. The revision abrogates case law interpreting the exclusive remedy and preemptive effect of the CFIL, and effectively disarms the argument that common law fraud, negligence or unfair competition claims arising out of the same facts are barred by the CFIL. Franchisors defending cases involving CFIL claims can now expect to defend additional common claims based on the same conduct.

II. Broader Application of California's Franchise Investment Law

The CFIL has applied to franchise transactions under three scenarios: (i) when the franchise offer is made in this state, (ii) when the franchise offer is accepted in the state, or (iii) if the franchised business is located in California and the franchisee is domiciled in California. *Cal. Corp. Code* § 31010. The domicile restriction has been eliminated under AB 676, and amended to say the CFIL will apply to a franchise purchase when the franchise business "is intended to be or will be operated in [California]." The amendment seeks to harmonize the jurisdictional reach of the CFIL with that of the CFRA. The latter applies to any franchise when either the franchisee is domiciled in California or the franchised business is or has been operated in California. *Cal. Bus. & Prof. Code* § 20015. Simply put, if the franchised location is or will be in California, the CFIL will be the governing law. Practitioners can expect to see more CFIL cases decided in other 0 franchisee has franchised operations in California.

III. Changes to Acknowledgments and Disclaimers

Many franchisors have come to rely on compliance questionnaires and signed acknowledgements to monitor problematic sales practices and identify prospective franchisees that may not understand the FDD or the franchise offer. The new CFIL Section 31512.1 will prohibit any provision of a franchise agreement, FDD, acknowledgment, questionnaire, or other writing, disclaiming or denying (i) representations by the franchisor or its personnel to a prospective franchisee, (ii) reliance by a franchisee on any representations made by the franchisor or its personnel or agents, (iii) reliance by a franchisee on the FDD and any exhibits thereto, and (iv) any prior CFIL violation. This prohibition is made in tandem with the new Statement of Policy adopted by the North American Securities Administrators Association (NASAA) that likewise bans the use of compliance questionnaires and acknowledgements in the franchise sales process effective Jan. 1, 2023.

Therefore, if a franchisee was told and relied on information not in the FDD or franchise agreement, the franchisor cannot require a franchisee to sign a document saying the franchisee did not receive that information or did not rely on it. Both the new CFIL and the NASAA Statement of Policy will require franchisors to re-evaluate their use of questionnaires and acknowledgments to conform to these prohibitions, as most if not all state regulators will adopt the new policy.

IV. New Duties Owed to Third Party Purchasers

The current CFRA restricts the franchisor's rights and imposes duties on the franchisor when a current franchisee seeks to transfer or sell assets of a franchise business. AB 676 adds a significant set of new obligations a franchisor will have to give to the **prospective buyer** of an existing franchise in California, who need not be an ex-

isting franchisee. Under the new CFRA, the franchisor must notify the prospective transferee of its existing standards for approval, and within sixty days of receiving the required documentation, its decision to approve or disapprove of a proposed transfer, with reasons for disapproval if a request is disapproved. Moreover, in any legal action involving a franchisor's disapproval of a sale, assignment or transfer, the reasonableness of the decision is a "question of fact requiring consideration of all relevant circumstances." Except in cases where reasonableness of the disapproval can be decided as a matter of law, no longer is a franchisor's mere business judgment in disapproving a proposed transaction sufficient to prevail on summary judgment over a claim that refusal was wrongful. While the CFRA already nullified provisions in franchise agreements that purported to give the franchisor discretion to summarily reject buyers, this extension of a franchisor's duties to prospective purchasers is unprecedented.

V. Changes to the Franchisor's Right to Offset

In 2015 the state legislature amended the CFRA to impose a repurchase obligation upon franchisors that retained control of the franchised business premises upon a lawful termination or nonrenewal of a franchise. In determining the former franchisee's buy-out price for "inventory, supplies, equipment, fixtures, and furnishings" of the franchised business less depreciation, a franchisor is entitled to offset any amounts to be paid to the franchisee against amounts the franchisor considered to be owed. *Cal. Bus. & Prof. Code* § 20022. Effective January 2023, however, a franchisor's offset can no longer be determined unilaterally by the franchisor; the franchisee will have a say in determining the amount he or she may owe when an agreement is being terminated.

An already extraordinary remedy for former franchisees adds addi-

tional pressure on franchisors to reach an agreement in a commonly acrimonious post-termination setting, where a non-curable default may have forced a lawful termination. Franchisors looking to repurchase a franchised location in 2023 will be best served by pointing to expenses that are unlikely to be subject to bona fide dispute, such as the amount of past-due rent owed to a landlord or an open account of a third-party supplier.

VI. Other Prohibitions Against Franchisors

In the height of the Covid-19 pandemic and mandatory store closures, many franchisors required amendments to the franchise agreement and/or had their franchisees sign general releases, in exchange for passive assistance such as deferring royalties for the period of time a business was shut down. In response to this practice, the new CFRA Section 20044 prohibits franchisors from modifying a franchise agreement or requiring a general release in exchange for any assistance related to a declared state or federal emergency.

On the franchise investment side, a new CFIL section 31312 bars franchisors from refusing to grant a franchise or provide financial assistance to a prospective franchisee based on age, ancestry, color, disability, national origin, race, religion, sex or sexual orientation. Discrimination in franchising has been the subject of ongoing and highly publicized civil rights lawsuits by minority groups against major franchise brands.

VII. Conclusion

While franchisors are certain to cry out against overregulation that makes it impossible for both franchisors and franchisees to thrive, franchisee advocates will assert that the new CFIL and CFRA are long overdue corrections in the franchise balance of power. Perhaps both sides are correct when it comes to AB 676 and similar legislation designed to equalize franchise relationships in California.