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Franchising In the Legislative and Regulatory Spotlight

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Franchising in the Legislative and Regulatory Spotlight[1]

I. Introduction

After World War II, franchising enjoyed an explosive boom with the return of soldiers from the field looking for opportunities and business format franchising taking hold as a business method ready to provide a ready supply of available opportunities. Substantial wealth and opportunity was created for many franchise market participants. At the same time, and as the franchising boom wore on into the 1970s, the excesses of otherwise healthy, unregulated franchise markets became increasingly reflected in instances of dishonest sales and overreaching relationship practices. As franchising grew, the number of seemingly vulnerable prospective franchisees who had been taken advantage of or otherwise failed in their business ventures also grew, and they began to tell their stories in mass to sympathetic federal and state legislators and regulators. To some, a "Wild West" of business format franchising had emerged that called out for regulation. It was within this environment and amid a bevy of tales of unethical business practices and failures that most of the federal and state franchise regulation and legislation that are the subject of this article initially emerged.

In the early efforts to develop franchise laws, the laws were designed generally to provide prospective franchisees with more reliable information about a franchise opportunity upon which to make an informed investment decision and to limit over-reaching practices by franchisors. At the same time, legislators and regulators appeared cognizant and confident in franchising's role in a growing economy and the American dream like opportunities that franchising done well could afford both franchisors and franchisees alike. As a result, in enacting these early franchise laws and rolling out accompanying regulations, governmental neutrals appear to have sought to carefully balance the interests of franchising, franchisors and franchisees with an aim of overall not doing more harm than good to an emerging and important aspect of the economy.

After years of relative calm, featuring a constant and mostly routine, legislative and regulatory effort to harness in a positive way the power of franchising, there has been a growing criticism that, like in the 1970s, franchisors have become too transactional and opportunistic yet again. This perception and others have led to the rise of a new wave of proposed legislation and regulation at the state and federal levels that could have a profound effect on the franchise model. Within that backdrop, questions beg whether this time is truly different. Has something fundamentally changed or are current events just the latest wave in a long line of legislative and regulatory waves? Has there been a recent rise in proposed legislation and regulation at the state and federal levels that threaten the franchise model? If so, has it been the behaviors of franchisors or representative governments and their regulators that have led to any change? Franchising as an industry is undoubtedly facing increasing legislative and regulatory efforts. In the opinion of

[1] In the interests of clarity and uniformity of presentation, the co-authors have decided to present a unified, single paper. That said, any individual statement of fact, opinion or law regarding the topics set forth below are not necessarily the views or opinions of, and should not be attributed to, any particular co-author or his/her respective partners, colleagues, fellow employees, law firms or employers, the California Department of Financial Protection & Innovation or its Commissioner, or NASAA.

some, this most recent effort involves, in part, fundamentally different types of legislation and regulation that play less deference to the economic power of franchising. In the opinion of others, there is a power imbalance in the franchise sales process and relationship that needs new guard rails to protect against opportunistic franchisor behavior.

II. Background

A. "Stupidity Breeds Rigidity" – Alan Silberman

Questionable franchise sales practices, substantial franchisee failures and losses, and arguments over control and decision-making surrounding certain issues have caused franchising to be the focus of legislative and regulatory efforts over the years. In other words, a certain level of franchisor stupidity has led to a responding level of legal and regulatory rigidity. Indeed, the legislative histories and rulemaking proceedings for franchise laws have pointed repeatedly to the need to protect vulnerable, unsophisticated franchisees from unscrupulous franchisor conduct. While some legislators and regulators have provided these protections in the form of comprehensive registration and disclosure requirements, other states have enacted provisions that protect franchisees by regulating certain post-contract formation events, such as termination, non-traditional franchise legal oversight has remained the same – a need to protect.

B. A Survey of the Legislative and Regulatory History for Franchise Laws

1. The Early Days of Franchising

The Federal Trade Commission (the FTC) estimated that there were probably fewer than one hundred franchisors in 1950.[2] As America moved further into the post-war era, several successful franchisors began to emerge, including brands like McDonald's, Kentucky Fried Chicken, Ramada Inns, Midas and many others. As franchising grew across the U.S., it attracted the attention and later the sophistication of Wall Street. Through subsequent growth and public offerings of Kentucky Fried Chicken in March 1966 and other brands thereafter, a "great franchise explosion" occurred.[3] As the 1960s came to an end, franchising like the U.S. economy in general was at the top of the economic cycle, perhaps with nowhere to go, but down.

By Friday, May 29, 1970, things had changed dramatically when *The Wall Street Journal* proclaimed: "Many Franchise Firms Fall on Hard Times After a 15-Year Boom."[4] According to the article, "once considered the darling of Wall Street and the savior of the small businessman, franchising today is spurned on Wall Street and cursed on Main Street."[5] The rapid slowdown in franchising was punctuated by compelling individual narratives of mom-and-pop franchisees losing their life savings to unsavory franchisors. As captured in the same May 29,

[2] Franchising & Business Opportunity Ventures: Disclosure Requirements & Prohibitions, 43 Fed. Reg. 59,613, 59,623 (Dec. 21, 1978) (the Original FTC Franchise Rule).
[3] The Great U.S. Franchising Boom, Newsweek, Nov. 10, 1969, at 3 and 88.
[4] James MacGregor, Many Franchise Firms Fall on Hard Times After a 15-Year Boom, *Wall St. Journal,* May 29, 1970, at 1/
[5] MacGregor, *supra* note 3, at 1.

1970, *Wall Street Journal* article, the view from Main Street of franchising had changed swiftly from euphoria to grave skepticism:

> It's clear the spectacular early success of franchising and the ease of entry into the field prompted many entrepreneurs with neither experience nor capital to become either enfranchisers or dealers. The franchise holder today is often no businessman at all but perhaps a plumber or electrician who has been told he needs no experience to profit handsomely and that the enfranchiser will teach him all he needs to know. Some business greenhorns have sunk all their savings into franchises only to see everything evaporate.

MacGregor, *supra* note 3, at 15.

2. Early Federal Attempts at Franchise Regulation

In response to the increasing level of investor disappointment with franchising, Senator Philip Hart introduced a bill into the United States Senate in August 1967 titled "The Franchise Competitive Practices Act" (the "Hart Bill"). The Hart Bill was designed to curb perceived franchisor abuses of franchisees. Senator Hart was the chairman of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee and had conducted hearings on franchising in 1965 and 1966 that led to his introduction of the Hart Bill.

After the original Hart Bill failed to move forward, Senator Hart introduced a revised Bill with many amendments in 1969. The revised 1969 Bill defined the types of franchise relationships subject to its provisions and can best be described as an early attempt at a relationship law. It prohibited terminations, cancellations, and failures to renew the relationship other than for good cause. The revised Hart Bill defined good cause as the failure of the franchisee to comply substantially with reasonable and essential requirements imposed upon it by the franchisor. Finally, the revised Hart Bill required franchisors to provide franchisees with at least 90 days' advance notice of termination.[6]

Congress did not pass the Hart Bill. Nevertheless, as Norman Axelrad stated in an article published in *The Business Lawyer* in 1971, "[i]n the several years during which this widely publicized bill and its earlier version were in committee, it served as a model and stimulus for many states to embark on an equally ambitious legislative regulation of the franchise relationship."[7] If nothing else, the Hart Bill and hearings provided a template for subsequent state legislation.

Following the demise of the Hart Bill, New Jersey Senator Harrison Williams introduced the "Franchise Full Disclosure Act of 1970 in the United States Senate on May 15, 1970. Pivoting away from the Hart Bill's attempt to regulate the ongoing franchisor-franchisee relationship, the Williams bill attempted to regulate the parties' entry into the franchise relationship by requiring "full disclosure" in the sale of business franchises in interstate commerce. The Williams bill would have

[6] Fairness in Franchising Act, S. 1967, 91st Cong. (1969).
[7] Norman Axelrad, Franchising—Changing Legal Skirmish Lines or Armageddon? Some Observation from the Foxhole, 26 Bus. Law. 695 at 713 (1971).

required that franchisors file a registration statement with the Securities and Exchange Commission (SEC) containing information about the franchisor, the extent of any celebrity involvement, exhibits that included the franchise agreement, and the terms under which the franchisor might terminate or not renew the relationship.

Congress never passed Williams' Full Disclosure Act. Although franchising's general reputation was teetering in the voice of public opinion, federal legislators in the end adopted a view that franchising was a critical and innovative part of a growing American economy and, on balance, was doing more good than harm. Perhaps, this sentiment of the time was best captured in a report commissioned by the Small Business Administration prepared by University of Wisconsin Professors Ozanne and Hunt entitled "The Economic Effects of Franchising," where the authors stated:

> We conclude that the net economic effects of franchising as a system of distribution are positive. Without franchising, thousands of small businessmen would never have had the opportunity of owning their own businesses. Similarly, franchising has enabled many entrepreneurs with little capital to take an idea and from it build a large multi-unit organization. Without franchising, these entrepreneurs would have had to give up their idea or attempt to sell it to some large corporation. Any system which opens up economic opportunities for the "little guy" should be carefully nourished and protected. Franchising represents a viable alternative to large, completely integrated corporate chains. Since the net economic effects of franchising are positive, any legislation which would cripple this very important segment of our economy should be avoided.

S. Select Comm. on Small Business, 92nd Cong., The Economic Effects of Franchising, at 63 (Comm. Print 1971).

3. California Franchise Investment Law (effective in 1971)

The first franchise legislation enacted in the United States occurred on the state level in 1971. As both a high-volume franchise growth state and perhaps as a result high volume franchise complaint state, California could have been expected to lead the way in franchise regulation. It did not disappoint.

As franchising became one of the largest area of concern for California investors[8], the state of California responded by becoming one of the first states to regulate franchising. On January 1, 1971, California enacted the California Franchise Investment Law (CFIL). The CFIL, which is a franchise disclosure law, is part of the California Corporations Code. The CFIL was based in large part on the California Corporate Securities Law and Senator Williams' Full Disclosure Act. The CFIL announced its remedial intent as follows:

> The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view in the State of California. Prior to the enactment

[8] Id. at 1103.

> of this division, the sale of franchises was regulated only to the limited extent to which the Corporate Securities Law of 1968 applied to those transactions. California franchisees have suffered substantial losses where the franchisor or his or her representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between franchisor and franchisee, and the prior business experience of the franchisor.

Cal. Corp. Code § 31001.

As reflected in the CFIL, the California legislature believed that franchising's perceived abuses could be solved by providing franchise prospects with mandated pre-sale disclosure and to prohibit fraudulent sales practices:

> It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law to prohibit the sale of franchises where the sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled, and to protect the franchisor and franchisee by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship. Id.

Likely by design, the CFIL was very similar to the Williams Full Disclosure Act. Like the Williams Full Disclosure Act, the CFIL was designed to provide pre-sale disclosure to prospective franchisees, all in an effort to give them all the "full and complete information" they needed to make an informed investment decision. Under the CFIL, franchisors were required for the first time to provide a disclosure document to each prospective franchisee within a certain time prior to execution of a binding agreement. The disclosure document had to contain certain mandated information, including information regarding the franchise business, the experience of the franchisor, the terms and conditions of termination or refusal to renew the franchise, any requirements that the franchisee purchase goods or services from the franchisor or its designee, an explanation of the basis and data underlying any statement of estimated or projected earnings, and the identification of any territorial rights or protections.

The CFIL also established a first of its kind procedure for the franchisor to file an "application for registration" with the California Commissioner of Corporations, along with the proposed offering prospectus and copies of the proposed franchise agreement, financial statements of the franchisor, and copies of advertisements offering the franchise opportunity. The CFIL also made unlawful the offer or sale of a franchise by means of any communication that contained an untrue statement of a material fact or that omitted a material fact necessary in order to make the statements made not misleading.[9]

4. Other Early State Efforts

In the decade that followed the enactment of the CFIL, a pattern of state regulation in the United States began to appear. Although California was the first state to adopt a disclosure law, the

[9] Cal. Corp. Code § 31201.

state was not the first to regulate franchising. While the California legislature was trying to pass the CFIL, Delaware enacted the Franchise Security Law on July 7, 1970. Unlike the CFIL, the new Delaware law did not mandate presale franchisor disclosures, but rather established rules to govern the franchise relationship. A franchisor violated the Delaware act if it "unjustly terminated or refused to renew" a franchise or threatened to do either. The law also required that a franchisor give franchisees at least 90 days' advanced notice of any termination or non-renewal decision.

New Jersey followed suit in 1971 with passage of its New Jersey Franchise Practices Act[91] prohibiting "arbitrary and capricious cancellation of franchises while preserving the right of franchisors to safeguard their interests through the application of clear and nondiscriminatory standards."[10]

Washington State entered the fray on February 19, 1971, with the introduction into both houses of its Franchise Investment Protection Act (FIPA).[11] The bill, as introduced, contained both disclosure provisions patterned after the California Franchise Investment Law and "fair practice" provisions based on a bill introduced into the Massachusetts legislature. Washington thus became the first state to pass a disclosure law and a relationship law at the same time. FIPA passed in the 1971 legislative session and was signed by Governor Evans, but its effective date was delayed until May 1972 to allow franchisor interests an opportunity to seek amendments during the 1972 session.

During the 1970s, several other states adopted disclosure and registration laws and a number of states adopted franchise relationship and fair practices laws.[12] As detailed below in Section ___, there are fifteen (15) states today that have laws requiring franchisor pre-sale disclosure of specified franchise opportunity information to a potential franchisee and eighteen (18) states have laws governing the franchise relationship.

5. Federal overview (1970s)

a. The Role of the FTC

On the federal level, the Federal Trade Commission, exercising its authority under the Federal Trade Commission Act (FTC Act), established franchise sales rules at the national level. On November 11, 1971, the FTC initiated formal proceedings for the promulgation of a trade regulation rule regarding disclosure requirements and prohibitions in the sales of franchise opportunities and unveiled its proposed franchise rule. After public hearings, the FTC issued its Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (the "original FTC Rule").

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[10] Gen. Assemb. 2063, 194th Leg., 2d Ann. Sess. (N.J. 1971) (sponsors' statement accompanying Assembly Bill 2063).

[11] Donald Chisum, State Regulation of Franchising: The Washington Experience, 48 Wash. L. Rev. 291, 298, 335 (1973).

[12] Delaware (1970); California (1971); New Jersey (1971); Washington (1972); Michigan (1974); Minnesota (1974); Wisconsin (1974); Hawaii (1974); Connecticut (1972); and Indiana (1976).

The original FTC Rule made it an unfair or deceptive act or practice within the meaning of Section 5 of the FTC Act for any franchisor or its broker to fail to furnish specific information required to be disclosed to franchisees. The franchisor pre-sale disclosures required under the original FTC Rule were established in large part based on the many parallel like requirements set forth in the CFIL.

The Federal Trade Commission amended its Franchise Rule on January 23, 2007 to adopt the widely used disclosure document format set forth in the Uniform Franchise Offering Circular Guidelines promulgated by the North American Securities Administrators Association, Inc. ("NASAA"), but with certain changes (the "FTC Rule"). Some changes required more disclosure, and others less. The FTC Rule disclosure document format set forth the new standard for disclosure, and was required to be used by franchisors by July 1, 2008. But because the FTC once again did not preempt state law entirely in this field, states with registration and relationship laws could still require additional disclosures.

b. The FTC Rule and its orbit

The FTC Rule applies in all fifty states and U.S. territories and requires that franchisors (and franchise brokers) provide to prospective franchisees a pre-sale franchise disclosure document in the form of a franchise offering circular. The FTC Rule applies everywhere in the United States, but because the FTC does not preempt state laws on the same subject, states are free to adopt additional laws regulating franchise operations, leading to an extra layer of regulation in many jurisdictions to provide increased investor protection. States may not reduce a franchisor's duties under federal law, but they may impose stricter requirements and require state registration. As discussed below in Section ____, about one-third of the states also impose franchise disclosure requirements, which are generally consistent with the federal requirements, with some minor variation. Some states also require that the franchise offering, and the disclosure document must be registered with the state, or an exemption notice must be filed, before offers or sales of franchises are permitted.

From a legal perspective, whether consumers recognize that a business is a franchise or whether the parties to a commercial arrangement themselves call or consider their business relationship to be a franchise is not the driver. The driver is whether the relationship meets the definitional requirements of a "franchise" under the panoply of federal and state laws that regulate franchising. If a commercial business arrangement meets the definition of a "franchise" under a particular statute or regulation, then the franchisor owes various legal duties to its franchisee and the franchisee enjoys various additional legal rights vis-à-vis its franchisor.

If a business arrangement is determined to be a franchise under the FTC Rule, a franchisor must provide a disclosure document to a prospective purchaser prior to selling a franchise to the prospect. Failure to comply with these requirements has been determined to be an "unfair and deceptive" trade practice under Section 5 of the FTC Act, and can subject the franchisor to enforcement proceedings by the FTC. The FTC is empowered by the FTC Act to impose fines and to recover monies on behalf of aggrieved franchisees as consumer redress. The FTC may also require that the franchisor offer the aggrieved franchisees the opportunity to rescind their franchise agreements.

A relationship is deemed a franchise if its meets the definitional elements of a franchise under federal and state law. The federal definition of this term is contained in the Federal Trade Commission's "Trade Regulation Rule: Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,"[13] which is generally referred to as the "FTC Rule.", which defines a franchise as any arrangement whereby the franchisor:

- Renders significant assistance to the franchisee in operating its business or significantly controls the franchisee's method of operation;
- Licenses the franchisee to distribute goods or services under, or operate using, the franchisor's trademark; and
- Requires payment of a minimal fee to the franchisor.

Because of the FTC Rule, the business of franchising is regulated today throughout the United States. The FTC Rule seeks to ensure that prospective franchisees receive full, accurate, and if they request, up-to-date information, that the prospects are entitled to rely upon and that cannot be disclaimed in the franchise agreement. Toward that end, he FTC Rule imposes disclosure requirements and prohibits certain deceptive practices. Under the FTC Rule, franchisors must prepare the FDD, provide the FDD to prospects at the required time, observe a 14-day waiting period to review the FDD, and then comply with a seven-day waiting period to review the final agreement. The FTC Rule does not require the filing of the FDD with the FTC.

c. Chevron doctrine

Federal and state courts are frequently required to review agency interpretations of questions of law, as they are required to under their respective Constitutions and Administrative Procedure Acts (APA). Procedural issues with agency interpretations of questions of law are also treated as questions of law.[14] Normally, when reviewing a question of law, the court conducts is own interpretation of the contested statute, employing methodologies of statutory interpretation. At issue in judicial review of an agency's legal interpretation is how much, if any, deference should be accorded by the court to the agency's interpretation over its own.

The federal standard of review is called the Chevron Doctrine, It has been used for decades to resolve legal challenges to regulations where litigants contend that an agency has exceeded the limits of authority bestowed by Congress.[15] The Chevron Doctrine is applied when (1) a federal statute has ambiguous text, (2) which an agency has interpreted under the federal APA (3) pursuant to the agency's statutory mandate, where (4) Congress has implicitly delegated the agency

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[13] 16 C.F.R. §436

[14] S*ee* Michael Asimow et al.*, Cal. Practice Guide: Administrative Law*, Ch. 17(B) Standard of Review for Questions of Law at ¶ 17:8 (The Rutter Group).

[15] Charlie Savage, *How a Fishery Case Fits Into a Long-Game Effort to Sap Regulation of Business*, New York Times, Jan. 17, 2024, https://www.nytimes.com/2024/01/17/us/politics/supreme-court-chevron-federal-agencies.html?searchResultPosition=2.

authority to interpret said statute. [16] If all apply, a court must afford the agency's reasonable construction full deference, even if it differs from the court's interpretation.

A challenge to the Chevron Doctrine is pending before the U.S. Supreme Court and a decision is likely to be issued by the end of June 2024. Two nearly identical cases, *Loper Bright* and *Relentless*,[17] oppose the application of the Chevron Doctrine on multiple grounds, including the contention that affording an agency any deference in judicial review violates parties' due process rights by improperly tipping the scales towards the agency.

If the Chevron Doctrine were severely narrowed or overturned, it is hard to know the full impact. During the oral arguments for *Loper Bright*, Justice Elena Kagan predicted that discarding it decision would be a strikingly disruptive move, citing that there have been 70 Supreme Court and 17,000 lower court decisions relying on *Chevron*.[18] In its coverage of the oral arguments, the New York Times quotes a Harvard University law professor's prediction that if *Chevron* disappears, it could become "a free-for-all for judges to dig into the nitty-gritty of everything agencies are doing" and "an invitation for interest-group lawyers to try to tie up the agencies in legal knots."[19] Petitioners and some justices argued that any results would be less impactful.

States do not necessarily follow the Chevron Doctrine. For example, courts in California have long rejected it and instead follow the variable deference standard of review found in *Yamaha*.[20] A narrowing or overturning of the Chevron Doctrine by the U.S. Supreme Court is not likely to directly affect California and many other states' statutory interpretation unless the U.S. Supreme Court holds that deference to agency interpretation is inherently an unconstitutional violation of due process. Even then, agency interpretation would not be invalid, but rather would be subject to the court's review and opinion of the interpretation.

6. State overview

a. The Registration and Disclosure Law States

Numerous states have enacted franchise sales laws, and deceptive or unfair trade practices laws, that provide a private right of action, often with treble damage exposure, for a franchisor's violation of applicable state disclosure and registration statutes. In a franchise registration state, a franchisor may not solicit, offer, or sell a franchise to a prospective franchisee without first registering the company's FDD with the state administrators, filing a notice, or qualifying for a state exemption, usually by filing for exemption. Some state exemptions are exemptions from registration only, and disclosure may still be required.

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[16] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.* (1984) 467 US 837, 842-845, 104 S.Ct. 2778, 2781-2783.
[17] *Loper Bright Enterprises v. Raimondo* and *Relentless, Inc. v. Department of Commerce*.
[18] Supreme Court of the United States, *Oral Argument Transcripts: 22-451 Loper Bright*, *supra* note 83 at 35.
[19] Savage, *supra* note 14, quoting Jody Freeman.
[20] *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1.

In the registration states, franchisors are required to comply in that state with both the FTC Franchise Rule and state law. The FTC Franchise Rule preempts state or local laws only if, and then only to the extent that, such laws provide less protection than the FTC Franchise Rule for prospective franchisees. Currently, fifteen states[21] have enacted franchise sales laws which generally require both (i) disclosure of information in the franchise offering circular furnished to the prospective franchisee prior to the sale and (ii) registration of the franchise or franchise offering prior to the making of any offer or sale of a franchise in the state.

The states listed below require registration of the disclosure document with a designated state agency (or that an applicable exemption from registration be effective, either because of a required filing or a self-executing exemption), before the offer or sale of a franchise is permitted in each jurisdiction, except that Oregon requires disclosure but not registration, and Michigan requires only the filing of a simple notice, not the FDD:

FRANCHISE REGISTRATION STATES

California	North Dakota
Hawaii	Oregon (no filing required)
Illinois	Rhode Island
Indiana	South Dakota
Maryland	Virginia
Michigan	Washington
Minnesota	Wisconsin
New York	

State disclosure requirements are important because several states provide a private right of action to prospective franchisees for a franchisor's violation of the state statute. In determining the states in which a franchisor may need to file registration applications, or with which state laws a franchisor may need to comply in terms of providing disclosure to a prospective franchisee, it is necessary to look to each individual state law. A state franchise sales law will usually apply when an offer, sale, or acceptance is made within the state or where the franchised business will be located or operated within the state. What constitutes an "offer" or "sale" is typically defined in the applicable state law. State franchise sales laws normally also include provisions making it unlawful, in connection with the offer, sale, or registration of a franchise, to: (a) employ any device, scheme, or artifice to defraud; (b) make any untrue statement of a material fact or omit to state a material fact; of (c) engage in any act, practice or course of business operating as a fraud or deceit upon any person.

The following jurisdictions have not enacted franchise disclosure, franchise registration, or business opportunity laws:

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[21] The states which require franchise registration are California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Michigan requires a franchisor to make a filing prior to the offer or sale of franchises in the state. Michigan and Oregon also require state-specific language to be included in an addendum to the offering circular (although the actual addenda need not be filed or registered).

STATES WITH NO FRANCHISE OR BUSINESS OPPORTUNITY REGISTRATION OR DISCLOSURE REQUIREMENTS

Alabama	Montana
Arkansas	Nevada
Colorado	New Hampshire
Delaware	New Jersey
District of Columbia	New Mexico
Idaho	Pennsylvania
Kansas	Tennessee
Massachusetts	Vermont
Mississippi	West Virginia
Missouri	Wyoming

However, these jurisdictions are still subject to the requirements of the FTC Rule. So long as a franchisor is exempt from, or complies with the FTC Rule's disclosure requirements, the franchisor can solicit, offer franchises, and sign franchise agreements with prospective franchisees in the foregoing states that have no separate franchise disclosure or registration laws, or business opportunity laws. Compliance with the FTC Rule includes having a current FDD (the FDD has to be updated at least annually, within 120 days after the end of its accounting year, including with audited financial statements for the year just ended, and updated quarterly after any material change).

There are also a number of "business opportunity law states" with laws meant to address companies that sell goods or services to put people into business (e.g., work at home business opportunities, vending machine routes and other sales schemes historically susceptible to fraudulent practices), but that also capture most franchises under the law's scope because of the promise by the offeror of marketing assistance. Business opportunity laws usually overlap with franchise laws, and many jurisdictions require that the franchisor affirmatively seek exemption before it is authorized to offer and sell franchises. Many franchisors qualify for exemption under the applicable business opportunity state laws because they comply with the FTC Rule and/or has a registered federal trademark, and has made a simple one-time filing in certain states or files a simple annual exemption application in two states (Florida and Utah). The business opportunity laws are otherwise outside the scope of this review.

b. State Franchise Relationship Laws

About half of the states have laws affecting certain aspects of the relationship between a franchisor and its franchisees. For example, approximately 17 states, Puerto Rico and the Virgin Islands restrict the right to terminate or not renew a franchise.

FRANCHISE RELATIONSHIP LAW STATES

Arkansas	Missouri
California	Nebraska
Connecticut	Rhode Island
Delaware	Virginia
Hawaii	Washington

Illinois	Wisconsin
Indiana	
Iowa	Puerto Rico
Michigan	U.S. Virgin Islands
Minnesota	
Mississippi	

In most of the relationship law state jurisdictions, good cause and/or the absence of bad faith is required in order to terminate or not renew a franchise. Notice of default and a minimum opportunity to cure period or advanced notice of intent to terminate are also generally required. Certain more serious franchisee defaults, such as acts of insolvency, abandonment, conviction of a felony or repeated defaults, require a reduced cure period or no cure period at all.

Failure to comply with applicable state relationship law restrictions could lead to a wrongful termination claim and large damages. Whenever a default, termination or nonrenewal situation arises, the franchisor needs to carefully consider whether a franchise relationship law could be pled to be in play and how it may impact the advisability of declaring any default, or proceeding with any termination or nonrenewal decision against any franchisee under such state law. These states' laws override the provisions of the agreement, so it is not enough just to comply with the agreement.

The relationship laws also cover other topics, like the right of a franchisee to transfer or freely associate.

c. NASAA

The North American Securities Administrators Association (NASAA) represents state and provincial securities regulators in the United States, Canada, and Mexico. They are the regulators closest to local communities, small businesses, and the investing public throughout North America. NASAA has a multifaceted mission of protecting investors from fraud and abuse, conducting investor education, providing guidance and assistance via the established regulatory framework, and ultimately helping power the North American economy by ensuring the integrity of the financial markets.[22]

NASAA, or its predecessor organization, has been part of the fabric of franchising since the 1970s, when some states and the FTC enacted franchise laws and regulations. Notwithstanding that NASAA is not a government agency, and franchise laws and regulations are adopted or modified by each state, NASAA has had a crucial role in the process of developing laws and regulations and interpreting those laws and regulations.

In 1975, NASAA, through its predecessor, the Midwest Securities Commissioners Association, drafted the first set of uniform pre-sale disclosure requirements for franchise offerings. These guidelines, referred to as the "UFOC Guidelines" were adopted by the states with statutes that required pre-sale disclosure for franchise investment offerings. Although the FTC had

[22] https://www.nasaa.org/about/

adopted its own set of franchise disclosure requirements in 1978, in 1979, the FTC affirmatively authorized franchisors to follow the NASAA UFOC Guidelines in lieu of the FTC's disclosure requirements.[23] NASAA revised these "old" UFOC Guidelines in 1986 to allow for disclosure of financial performance representations, then called "earnings claims," if those representations had a "reasonable basis."

In 1993, NASAA adopted revised franchise disclosures, which at the time were called the "new" UFOC Guidelines, and the FTC again affirmatively authorized franchisors to follow the NASAA "new" UFOC Guidelines in lieu of the disclosures required under the FTC Franchise Rule.[24] As a result, almost all franchisors began using the UFOC Guidelines to satisfy both federal and state franchise disclosure requirements. In 2007, the FTC adopted a final amended Franchise Rule (referred to in this paper as the FTC Franchise Rule). In July 2008, NASAA adopted the disclosure requirements of the amended FTC Franchise Rule, with minimal additional requirements, as the successor to the Uniform Franchise Offering Circular Guidelines adopted on April 23, 1994.[25]

Since 2008, NASAA has adopted other Statements of Policy on various issues, including for example, Financial Performance Representations, Disclosing Financial Performance Representations in the time of COVID-19, a Multi-Unit Commentary, State Cover Sheets and the Use of Franchise Questionnaires and Acknowledgments.[26] In each case, states have followed and implemented the NASAA Statements of Policy in their review of Franchise Disclosure Documents without significant issues or problems.

Therefore, while NASAA has no direct authority over franchising in the United States, as an association comprised of representatives of the state securities administrators who administer franchise laws, NASAA's recommendations and policy initiatives have traditionally been given great weight by the states that regulate franchises.

Due to cooperation among the Federal Trade Commission and state regulators, the disclosure requirements under the FTC Rule and state laws and regulations have been harmonized so that franchisors may use the same "multi-state" form of FDD throughout the United States, in all registration states and states not requiring registration. To address mostly minor state variations, most franchisors use the same multi-state FDD throughout the country that includes as an exhibit to the FDD individual state specific addenda to the disclosure information and state specific amendments to the franchise agreements needed to comply with individual state requirements.

III. Factors Affecting the Franchisor / Franchise Business Model and the Legal/Regulatory Environment Surrounding It.

[23] 44 Fed. Reg. 49966, 49970 (August 24, 1979).
[24] 60 Fed. Reg. 51,895 (Oct. 4, 1995).
[25] N. AM. SEC. ADM'R ASS'N, 2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES, https://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf at introduction (2008).
[26] https://www.nasaa.org/industry-resources/franchise-resources/

A. The Impact of Technology

The impact of technology upon franchising during the last thirty years has been enormous. From methods of doing business, generating and soliciting leads, providing disclosure, investigating and comparing opportunities, closing transactions, providing initial and on-going training, providing customer services, soliciting and facilitating customer orders and transactions, monitoring compliance with system brand standards and other requirements, to communicating, technology, for better and worse, has impacted everything touching and concerning franchising.

Given the rapid pace of technological development and knowledge, shifting consumer tastes and rising competition, it is not possible for a business to remain stagnant in the manner it delivers goods and services and the goods and services it delivers. If a franchisor could not require existing franchisees to adopt changes to the system, it would put those franchisees at a disadvantage compared to non-franchised competitors and new franchisees entering the system. It would also result in a non-uniform presentation to consumers, creating consumer confusion and potentially requiring that the franchisor support and manage different operating structures, something that many leading companies across various industries have learned that they cannot maintain, let alone maximize, forever. That said, the impact of technology and the pace of franchisor initiated change in some franchise systems has caused increasing relational friction and regulatory attention.

Another impact of technology has been the pace of change in the franchise sales arena. Franchisors and their brokers are increasingly adept and sophisticated at using technology to mine for prospects and leads and then use information technology and sophisticated sales processes to close franchise sales. According to some, more systems than ever are focused on the initial sale, which has caused increasing relational friction and regulatory attention.

B. Impact of Private Equity

1. Impact on Franchisors

Over the last thirty years, there perhaps has been no greater impact upon franchising than the emergence of private equity investing across the franchise spectrum. Today, private equity firms have grown to admire the steady, predictable revenue streams, scalability, finance-ability and ultimately transactability of franchisors and their multi-unit franchisees alike.

Some commentators and franchisee advocates believe that private equity ownership has reduced the overall level of stability of franchisor ownership compared to the prior, typically encountered founding family ownership structures. These founding family ownership structures afforded a certain level of continuity, stability, and, in uneven amounts, deep industry knowledge and wisdom. With relatively permanent time horizons for ownership, this type of traditional franchisor ownership reflected a long-term commitment with a vision and strategy for their brands that extended far beyond a typical private equity

company's five-to-six-year time horizon. Owners with longer time horizons tend to invest and reinvest more in their businesses compared to owners with shorter time horizons.

That said, only some founders are the best leader available to a successful franchisor, let alone throughout its entire life-cycle. Private equity investors can bring a more consistent and level degree of management to such franchisors. Moreover, long-term, buy-and-hold private equity investors may make it less likely that the franchisor's strategy or business practices will suddenly or irrationally change.

At its best, private equity investing allows an investing fund to buy a controlling or non-controlling interest in a franchise company, bring new ideas, management and capital to bear, grow the network, and then seek a future sale or other liquidity event. Done right, a franchisor partnering with private equity can bring access to more capital, seasoned professional leadership and back-office support than it otherwise could muster organically, all of which benefits hopefully the franchise company's revenues and profits and its investors' shares and interests. In return, the private equity firm gains partial or complete control over the franchise company, which can lead to changed priorities and interests compared to predecessor ownership.

On the flip side, private equity's involvement in franchising is not without its critics. Done poorly, private equity investors, like any other under-average owner or investor, can hurt a brand, its prospects and its franchisees. Quick changes made without regard to industry norms, system culture or franchisee profitability can be counter-productive and have drawn some of private equity's biggest critics. According to private equity's critics, a franchisee of a system owned by the wrong private equity group could see reductions in product development and support, cuts to national advertising and promotion programs, a freeze on reinvestment and staffing reductions. A final criticism is that private equity investors are not in it for the long haul and lack accountability to various stakeholders, including regulators.

2. Impact on Franchisees

Private equity impacts franchisees on two levels: (1) indirectly on the franchisor level as discussed above; and (2) directly on the franchisee level through investment and ownership. Thirty years ago, it was rare for private equity to be seen on the Main Street of business-format franchising, let alone on the franchisees' side of the street.

Today, the leading franchisees across all industries are ever increasingly sophisticated, well-represented, well-organized and, as fueled by their own success and efforts, as well as private equity and other professional investors, well-funded. Today's leading franchisee organizations are multi-million dollar large businesses with their own robust corporate infrastructures and legal representation. This rise of the sophisticated, corporate franchisee is not by happenstance. Franchisors across multiple industries are increasingly seeking out, contracting and growing with these large, sophisticated franchisees. Indeed, this ever-growing phenomenon is a result of a broader consolidation trend toward large multi-unit franchisees plus the entry *en masse* of private equity funds as investors in large multi-unit franchisees. These sophisticated, corporate franchisees have their own extensive management, accounting, legal and compliance capabilities

and infrastructures. Through their legal counsel and business leaders, these same large franchisee companies often tend to participate in and drive franchisee associations and now even larger councils of multiple franchisee associations.

Legislators and regulators would be wise to take notice and consider the rise of these sophisticated, well-financed, well-represented, well-organized and well-funded multi-million dollar, multi-unit franchisees within the world of franchising. This evolution could materially alter, in whole or in part, the need, scope, and desired outcomes of future franchise laws, rules and regulations. It will be interesting to see how the emergence of these large multi-unit franchisees will affect the legislative and regulatory landscape for franchising. The phenomenon appears at first blush to cut in several different directions. The growing size of franchise transactions and the initial investments surrounding them within this multi-unit environment would suggest the transactions are more important and therefore worthy of protection. On the flip side, the need to protect unsophisticated, mom and pop franchisees would appear somewhat diminished and diluted in an industry increasingly full of and dominated by large, sophisticated multi-unit franchisees. This development also diminishes and dilutes the policy argument that the franchise model creates economic opportunities for the "little guy" and should be carefully nourished and protected.

This rise of the sophisticated, corporate franchisee also has the potential to turn on their heads several traditional franchise legal stereotype-like arguments. For example, some selling franchisors today are less sophisticated and have less bargaining power than their portfolio, multi-unit franchisee counter-parties. In challenging the enforceability of their franchise contracts, franchisees have often argued that their agreements are or should be unenforceable because they were offered and provided under "take it or leave it" circumstances. That argument rings truer for a first-time franchisee than a large sophisticated, multi-unit franchisee. While mom and pop franchisees may be unable to negotiate a franchise agreement's provisions, the same argument could prove unavailing where a large sophisticated, multi-unit franchisee with bargaining power, sophisticated counsel and negotiated changes is involved.

C. Impact of Franchise Brokers/Franchise Seller Organizations

The relatively recent change in the way franchise sales are predominately marketed and sold has been another enormous impact on franchising. Traditionally, most franchisors sold their own franchises, in-house, and perhaps outsourced some portion of the process to a third-party, but not necessarily independent franchise broker or seller. Just like franchisors, franchisees and the financing under pinning them have become more complex and robust so have the franchise brokers and franchise seller organizations servicing the industry. Today, franchise brokers and franchise seller organizations have become predominant players in certain segments of the franchise sales marketplace, including in the start-up and emerging franchisor spaces. These franchise brokers and franchise seller organizations are sometimes franchise platform company or brand specific. Many promote and attempt to sell portfolios of brands. They are increasingly adept and sophisticated at using technology to mine for prospects and sales leads and then use information technology and sophisticated sales processes to close franchise sales.

One traditional criticism of third-party sellers and brokers generally is that they are near singularly focused on sales and resultant commissions, and not necessarily fit, culture or the merit

of the prospective franchisor, prospective franchisee or prospective business. As more systems than ever are focused on completing initial franchise sales, the role of franchise brokers and seller organizations have come under the scrutiny of disgruntled franchise investors and, more recently, legislatures and regulators. Traditionally, franchisors and their officers have borne exclusively the franchise sales compliance burden and any consequence for franchise sales compliance lapses. For example, most franchise registration states require franchisors to submit information about their third-party brokers in franchise seller disclosure forms. However, only two registration states (New York and Washington) require brokers to register themselves with the state, although there is no disclosure requirement. As their role, power and profits have grown that perceived regulatory gap has led to the criticism that modern-day franchise brokers and seller organizations are not responsible or accountable enough for their own franchise sales compliance efforts and lapses.

Sponsored by Senator Tom Umberg, California's proposed Senate Bill No. 919 ("SB 919") would attempt to fix this perceived broker accountability gap through the regulation of franchise brokers. If adopted, SB 919 would require third-party franchise sellers (including so-called franchise brokers) to register with the State of California. As proposed, a franchise seller's initial registration application would be $250, with a $150 annual renewal fee and $50 fee to amend a registration upon a material change. Unlike New York and Washington law, SB 919 would also add a disclosure obligation. SB 919 is being considered currently by the California Senate's Rules Committee and would go into effect July 1, 2025.

If passed, SB 919 would require third-party franchise sellers, also known as franchise brokers, to register with the State of California. The fee for a franchise seller filing an initial registration application would be $250, with a $150 annual renewal fee and a $50 fee to amend a registration upon a material change to the application's information. Under SB 919, franchise brokers would be required to file a registration application, a Uniform Third-Party Franchise Seller Disclosure Form and a Uniform Third-Party Franchise Seller Disclosure Document ("FSDD"). In addition to registering the FSDD with the state, franchise sellers would also be required to present the FSDD to a prospective franchisee prior to discussing any franchise opportunity. While not nearly as extensive as the FDD's disclosure obligations, SB 919's FSDD requirement would track some of the types of items that must also be disclosed by franchisors in their FDDs, such as litigation history and fee amounts and recipients.

SB 919 would create a private cause of action for franchisees to sue for damages and rescission if the franchise seller is determined to have violated the law with respect to a franchise sale. Additionally, the California commissioner would be able to issue stop orders prohibiting a franchise seller from offering or selling franchises in the state upon a finding that a seller had failed to comply with any applicable provisions of law or rules issued by the commissioner. The new law's rules and penalties would apply to any franchise transaction touching or concerning California, by way of prospective franchisee residency, franchisee principal place of business, or if the franchised business is located in California. If adopted, SB 919 would require franchise sellers who wish to sell franchises to be located in California or to franchise prospects located in California to be registered and to comply.

SB 919 bears close watching. Like many past California laws, SB 919 may serve as a roadmap for other jurisdictions to regulate franchise sellers on either a nationwide or state-by-state

level. Depending on its fate, SB 919 could be a precursor of more regulation to follow, either from additional registration states acting individually or through NASAA.

IV. Franchising in the Legislative and Regulatory Spotlight: Caught in the Crossfire of Increasing Partisan Politics

A. The FTC

1. Decennial FTC Rule Review

The FTC's "Franchise Rule" is a rule requiring disclosures of relevant information by a franchisor to a prospective franchisee. This is meant to "give[] prospective purchasers of franchises the material information they need in order to weigh the risks and benefits of such an investment," and provides for a disclosure document "containing 23 specific items of information about the offered franchise, its officers, and other franchisees."[27]

The FTC sought public comment on the Franchise Rule as a part of its systematic ten-year review on February 19, 2019.[28] The request for information asked whether there was still a need for the rule, and whether and how the rule should be amended. It predominantly sought information about the costs and benefits of the Franchise Rule, including comments on whether prospective franchisees benefitted from the Franchise Rule, whether the rule needed to be modified, what the compliance costs were, and whether the rule needed to be amended to account for technological or economic changes.[29] The agency then held an online public workshop on November 10, 2020 to explore issues related to the Franchise Rule, and address the public comments that the agency received.[30] Topics covered included the financial performance representations under item 19, the use of disclaimers, waivers, and questionnaires by franchisors, and the format of the disclosure document.[31] The FTC's Franchise Rule review is still pending.

2. Recent FTC Franchise Rule Enforcement Action

The FTC's only recent Franchise Rule enforcement action was in *United States v. Burgerim Grp. USA, Inc.*, a case the FTC brought against a burger restaurant franchise for false promises and the withholding of information required by the Franchise Rule.[32] In *Burgerim*, the Burgerim

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[27] FTC, *Franchise Rule*, https://www.ftc.gov/legal-library/browse/rules/franchise-rule (last visited Mar. 19, 2024); *see* 16 C.F.R. §§ 436–37.
[28] FTC, *FTC Seeks Public Comment as Part of its Review of the Franchise Rule* (Feb. 13, 2019), https://www.ftc.gov/news-events/news/press-releases/2019/02/ftc-seeks-public-comment-part-its-review-franchise-rule.
[29] *Id.*; *see Disclosure Requirements and Prohibitions Concerning Franchising*, 84 Fed. Reg. 9051, 9052 (Mar. 13, 2019).
[30] FTC, *Reviewing the Franchise Rule: An FTC Workshop* (Nov. 10, 2020), https://www.ftc.gov/news-events/events/2020/11/reviewing-franchise-rule-ftc-workshop.
[31] *Id.*; *see* FTC, *Reviewing the Franchise Rule – Workshop* 6 (Nov. 10, 2020), https://www.ftc.gov/system/files/documents/public_events/1579375/transcript-full-franchise-rule-wksp.pdf (Transcript).
[32] 2024 WL 661189, at *1, 3–4 (C.D. Cal. Jan. 19, 2024).

Defendants sold over 1,500 franchises of their fast food burger restaurant, "lur[ing] would-be entrepreneurs into paying hefty franchise fees to open their franchises," with many franchisees taking out loans to do so.[33] Defendants "consistently provided deficient [Financial Disclosure Documents]," represented that "no prior business experience was required" to operate a Burgerim franchise, "intentionally downplayed the financial risk" to franchisees, incentivized prospective franchisees to purchase multiple franchises, targeted veterans with discounts, and purported to offer (but did not honor) refunds if franchisees could not open their restaurants.[34] The Central District of California entered a default judgment against the Burgerim Defendants due to their failure to defend themselves, ordering over $48 million in monetary relief for consumer redress, $7.75 million as a civil penalty, and issuing a permanent injunction.[35]

3. Request for Information

On March 10, 2023, the FTC issued a request for information seeking public comment on "the means by which franchisors exert control over franchisees and their workers."[36] The FTC's request for information, as well as its public statements, seemed to recognize an intrinsic power imbalance between franchisors and franchisees, rather than approaching the query neutrally. The FTC indicated its interest in how and where franchisors disclose aspects of the relationship—and information on franchisor-franchisee contracts and relationships more generally—asking specifically for public comment on (1) the franchise relationship, (2) franchise agreement provisions, (3) franchisor business practices, (4) third party payments to franchisors, (5) indirect effects on franchisee labor costs, and (6) language barriers.[37] This comment period was open until June 8, 2023.[38]

The FTC posted 2,216 comments in response to this request for information.[39] These comments included many appraisals of the benefits of the franchising relationship, along with many critiques.

Commonly cited benefits included overall franchisee satisfaction with their franchise organization, the continued viability and growth of franchised businesses, the importance of franchising to entrepreneurship (especially among underrepresented communities), the millions of job opportunities for workers, and the general needs of franchisors to have consistent contractual provisions for the successful operation of franchises.

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[33] *Id.* at *1.
[34] *Id.*
[35] *Id.* at *5–6.
[36] FTC, *Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices*, 1 (Mar. 10, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/Franchise-RFI.pdf; *see also* FTC, *Submit a Comment on Franchise Request for Information*, https://www.ftc.gov/policy/studies/submit-comment-franchise-request-information (last visited Mar. 4, 2024).
[37] FTC, *Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices*, *supra* note 10, at 1–5.
[38] FTC, *FTC Extends Comment Period for Request for Information Related to Franchise Agreements and Business Practices Until June 8* (April 13, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/04/ftc-extends-comment-period-request-information-related-franchise-agreements-business-practices-until.
[39] Regulations.gov, *Solicitations for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices*, https://www.regulations.gov/docket/FTC-2023-0026/comments (last visited Apr. 22, 2024).

Commonly cited critiques included the non-negotiability of franchise agreements, the modification of relationship terms and costs by franchisors, requirements that franchisees purchase from certain third-party vendors, early termination fees, unnecessary "junk" fees, limitations on franchise license transfers, the imposition of arbitration clauses, loyalty programs that benefit franchisors and undercompensate franchisees, and other provisions that generally treat franchisees unfairly.

At various FTC open meetings held on this topic, members of the public also weighed in on the issues they saw with the franchisor-franchisee relationship. Proponents of increased FTC regulation and oversight cited the "significant financial risks" that franchisees take in opening a business, only to be contractually "bound" and "trapped" if the business does not do as well as expected.[40] Some noted that "franchisees are the primary investors but not really protected as investors should be."[41] Other commenters countered this perspective by discussing the benefits that come with the franchising model, such as the "degree of operational control in [the] business" that franchisees get - but also suggesting that the disclosure requirements could be strengthened and updated.[42] And some commenters discussed the risks that a "one size fits all" approach to the relationship between franchisor and franchisee could harm many franchisees, the majority of which express satisfaction with the system.[43]

Commenters noted that many of these purported abuses might be ameliorated through improved pre-sale disclosure and greater FTC enforcement of the Franchise Rule, rather than a reconstitution of the franchise relationship—which could undo the franchising model in the United States as we know it. Indeed, despite similar concerns raised in conjunction with the 2007 Franchise Rule review, the FTC at that time found it inappropriate to find the franchising relationship inherently unfair:

> [T]he unfairness analysis falls short. A franchise purchase is entirely voluntary. The Franchise Rule ensures that each prospective franchisee receives disclosures—expanded in key respects by the current amendments—that explain the terms and conditions under which the franchise will operate. Prospective franchisees can avoid harm by comparison shopping for a franchise system that offers more favorable terms and conditions, or by considering alternatives to franchising as a means of operating a business. Prospective franchisees are also free to discuss the nature of the franchise system with existing and former franchisees, as well as trademark-specific franchisee associations, and the amended Rule facilitates such discussion by providing prospects with contact information. Under these circumstances, the Commission cannot categorically conclude that prospective franchisees who voluntarily enter into franchise agreements, after receiving full disclosure,

[40] FTC, *Open Commission Meeting* (Sept. 14, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/ftc-open-commission-meeting-september-14-2023.pdf.
[41] FTC, *Open Commission Meeting* (Mar. 16, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/ftc-open-commission-meeting-march-16-2023.pdf.
[42] FTC, *Open Commission Meeting* (July 20, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/ftc-open-commission-meeting-july-20-2023.pdf.
[43] *Id.*

nonetheless cannot reasonably avoid harm resulting from a franchisor enforcing the terms of its franchise agreement.[44]

The FTC's staff review of comments from the 2023 request for information continues.

4. FTC Proposal to Ban Non-Compete Clauses

Separately, on January 5, 2023, the FTC issued a notice of proposed rulemaking, announcing a forthcoming rule that would essentially ban all non-competes as constituting an "unfair method of competition" and thus violating Section 5 of the FTC Act.[45] The comment period for this proposed rule closed on April 19, 2023.

In the FTC's proposal, non-competes are defined as "a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer."[46] Any agreement that has "the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer" would be prohibited.[47] The proposed rule identifies two types of agreements that would constitute impermissible "non-competes":

- A non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer; and
- A contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker.[48]

While the proposed rule would not expressly prohibit non-disclosure and intellectual property agreements with employees, those agreements could be deemed impermissible non-competes if, pursuant to the provision excerpted above, they are deemed to be written "so broadly" that they "effectively preclude[ ] the worker from working in the same field."[49] Further, the term "worker" would be defined as "a natural person who works, whether paid or unpaid, for an employer," but would not include a franchisee in a franchisee/franchisor relationship.[50]

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[44] *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities*, 72 Fed. Reg. 15444, 15447 (Mar. 30, 2007), *codified at* 16 C.F.R. § 436.
[45] FTC, *FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition* (Jan. 5, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition.
[46] *Non-Compete Clause Rule*, 88 Fed. Reg. 3482, 3535 (Jan. 19, 2023).
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] *Id.*

On April 23, 2024, the FTC voted 3-2 to adopt a final rule banning non-compete agreements for all workers, including executives, nationwide.[51] Specifically, the final rule provides that it is an unfair method of competition and a violation of Section 5 of the FTC Act for employers to enter into non-competes with workers.[52] The FTC analyzed whether the non-compete rule should extend to franchisor/franchisee non-competes, reviewing comments on both sides of the issue.[53] Some commenters noted that the relationship between franchisor and franchisee are more akin to an employer and employee, with uneven bargaining power. Others stated that franchisor/franchisee non-competes are entered into with sophisticated purchasers, and that non-competes are critical to the franchise model because they offer both franchisors and franchisees confidence that existing franchisees will likely stay with a brand and refrain from using a franchise's trade secrets to unfairly compete against the franchisor. Based on the comments presented, the FTC declined to extend the rule to cover non-competes in the franchising context.[54] It found:

> The Commission continues to believe that, as many commenters attested, franchisor/franchisee non-competes may in some cases present concerns under section 5 similar to the concerns presented by non-competes between employers and workers. The comments from franchisors, franchisees, and others provide the Commission with further information about non-competes in the context of the franchisor/franchisee relationship, but the evidentiary record before the Commission continues to relate primarily to non-competes that arise out of employment. Accordingly, the final rule does not cover franchisor/franchisee non-competes. Non-competes used in the context of franchisor/franchisee relationships remain subject to State common law and Federal and State antitrust laws, including section 5 of the FTC Act.[55]

The FTC's interest in franchisor-franchisee issues appears to be part of its broader, expanded focus on "fairness" as it relates to workers. For example, the FTC entered memoranda of understanding with the National Labor Relations Board ("NLRB") in July 2022 and the Department of Labor ("DOL") in September 2023, enabling the agencies to "collaborate by sharing information, conducting cross-training for staff at each agency, and partnering on investigative efforts within each agency's authority."[56] As part of President Biden's "whole of government" approach, the agencies will be focusing on investigating "collusive behavior; the use of business models designed to evade legal accountability, such as the misclassification of employees; illegal claims and disclosures about earnings and costs associated with work; the imposition of one-sided and restrictive contract provisions, such as non-compete and training

[51] FTC, *FTC Announces Rule Banning Noncompetes* (Apr. 23, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes.
[52] *See* FTC, Non-Compete Clause Rule 1, available at https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf (last visited Apr. 23, 2024).
[53] *Id.* at 385–89.
[54] *Id.* at 389.
[55] *Id.* at 388–89.
[56] *See* FTC, *Federal Trade Commission, National Labor Relations Board Forge New Partnership to Protect Workers from Anticompetitive, Unfair, and Deceptive Practices* (July 19, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/07/federal-trade-commission-national-labor-relations-board-forge-new-partnership-protect-workers.

repayment agreement provisions; the extent and impact of labor market concentration; and the impact of algorithmic decision-making on workers."[57]

5. Other current events – Chevron Doctrine

As discussed above, a challenge to the Chevron Doctrine is pending before the U.S. Supreme Court and a decision is likely to be issued by the end of June 2024. Two nearly identical cases, *Loper Bright* and *Relentless*,[58] oppose the application of the Chevron Doctrine on multiple grounds, including the contention that affording an agency any deference in judicial review violates parties' due process rights by improperly tipping the scales towards the agency.

If the Chevron Doctrine were severely narrowed or overturned, it is hard to know the full impact. During the oral arguments for *Loper Bright*, Justice Elena Kagan predicted that discarding it decision would be a strikingly disruptive move, citing that there have been 70 Supreme Court and 17,000 lower court decisions relying on *Chevron*.[59] In its coverage of the oral arguments, the New York Times quotes a Harvard University law professor's prediction that if *Chevron* disappears, it could become "a free-for-all for judges to dig into the nitty-gritty of everything agencies are doing" and "an invitation for interest-group lawyers to try to tie up the agencies in legal knots."[60] Petitioners and some justices argued that any results would be less impactful.

A. NLRB's Joint Employment Rule

On October 27, 2023, the NLRB published a final rule, with an effective date of March 11, 2024, establishing that "two or more employers of the same particular employees are joint employers of those employees if those employers share or codetermine those matters governing employees' essential terms and conditions of employment," with an "employer" being defined as the employer of a particular employee "if the employer has an employment relationship with those employees under common-law agency principles."[61] This rule differs from the earlier NLRB rule that took effect on April 27, 2020,[62] which set the standard to a "higher threshold of 'substantial and immediate control' over essential terms of conditions of employment."[63] The new, 2023 rule includes as "essential terms and conditions of employment" (1) wages, benefits, and other compensation, (2) hours of work and scheduling, (3) assignment of duties, (4) supervision of performance, (5) work rules and directions governing performance, and grounds for discipline, (6) tenure of employment, and (7) working conditions—and notes that "reserved control" and

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[57] *See* FTC, *FTC, Department of Labor Partner to Protect Workers from Anticompetitive, Unfair, and Deceptive Practices* (Sept. 21, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/09/ftc-department-labor-partner-protect-workers-anticompetitive-unfair-deceptive-practices.

[58] *Loper Bright Enterprises v. Raimondo* and *Relentless, Inc. v. Department of Commerce*.

[59] Supreme Court of the United States, *Oral Argument Transcripts: 22-451 Loper Bright*, *supra* note 83 at 35.

[60] Savage, *supra* note 14, quoting Jody Freeman.

[61] *Standard for Determining Joint Employer Status*, 88 Fed. Reg. 73946, 74017 (Oct. 27, 2023), *to be codified at* 29 C.F.R. § 103.40.

[62] *Joint Employer Status Under the National Labor Relations Act*, 85 Fed. Reg. 11,184 (Feb. 26, 2020), *codified at* 29 C.F.R. § 103.40.

[63] NLRB, *The Standard for Determining Joint-Employer Status – Final Rule published 10/27/2023*, https://www.nlrb.gov/about-nlrb/what-we-do/the-standard-for-determining-joint-employer-status-final-rule (last visited Apr. 22, 2024).

"indirect control" are relevant to the analysis of whether the joint-employer standard is implicated.[64]

On March 8, 2024, a federal district court located in the Eastern District of Texas vacated the NLRB's final rule in *Chamber of Com. of U.S. v. NLRB*,[65] meaning the 2020 rule currently remains in effect.[66] In evaluating the NLRB's 2023 final rule, the district court determined that the 2023 final rule was unlawful given its "sweep beyond common-law limits," and noted further that because the NLRB had not given good reasons for the rescission of the 2020 rule independent of the implementation of the 2023 rule, the rescission of the 2020 rule would be arbitrary and capricious.[67] The court also suggested, without deciding, that the 2023 rule was in itself likely arbitrary and capricious "for failing to achieve the purpose that justified the rulemaking."[68]

B. Department of Labor's Independent Contractor Rule

On January 10, 2024, the DOL published a final rule, effective March 11, 2024, revising DOL guidance on how to determine who is an employee or independent contractor under the Fair Labor Standards Act ("FLSA"), rescinding the January 7, 2021 rule.[69] Because the FLSA's minimum wage, overtime, and recordkeeping obligations only apply to covered employees, the determination of who is an employee and who is an independent contractor is significant for potential employers.[70] The test to answer this question is whether a worker, "as a matter of economic reality, [is] economically dependent on an employer for work" and thus is a covered employee, or "is, as a matter of economic reality, in business for themself" and thus is an independent contractor.[71]

This rule provides a non-exhaustive six-factor test to determine whether a worker is an independent contractor in a "totality-of-the-circumstances analysis, [wherein] no one factor or subset of factors is necessarily dispositive," weighing: (1) opportunity for profit or loss depending on managerial skill, (2) investments by the worker and potential employer, (3) permanence of the work relationship, (4) nature and degree of control, (5) extent to which work is integral to the potential employer's business, and (6) skill and initiative.[72]

A coalition of businesses have filed suit against the independent contractor rule in the U.S. District Court for the Eastern District of Texas.[73] The lawsuit challenges DOL's new test for

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[64] *Id.*
[65] 2024 WL 1045231, at *17 (E.D. Tex. Mar. 8, 2024).
[66] *Id.* at *8, 16.
[67] *Id.* at *15–16.
[68] *Id.* at *15.
[69] Dep't of Labor, *Final Rule: Employee or Independent Contractor Classification Under the Fair Labor Standards Act, RIN 1235-AA43*, https://www.dol.gov/agencies/whd/flsa/misclassification/rulemaking (last visited Apr. 22, 2024).
[70] *Employee or Independent Contractor Classification Under the Fair Labor Standards Act*, 89 Fed. Reg. 1638, 1742 (Jan. 10, 2024).
[71] *Id.*
[72] *Id.* at 1742–43.
[73] *Coal. for Workforce Innovation v. Su*, 1:21-cv-130-MAC (E.D. Tex).

classifying employees and independent contractors under the Fair Labor Standards Act. According to the challengers:

> The new rule replaces the 2021 rule's framework, which designated two 'core factors' - control over work and opportunity for profit or loss - with a more indeterminate six-factor test to assess whether a worker is an employee or an independent contractor. Under the new test, businesses and employers - especially small businesses - will face confusion and uncertainty when trying to determine whether they have properly classified their workers. DOL's new rule also threatens the independent contractor model, which allows companies to scale operations up or down, and to retain expertise as needed while providing workers with flexibility and control of their work activities.[74]

The plaintiffs' motion for summary judgment, filed on April 17,[75] is currently pending.

C. New State Legislation

1. Arkansas House Bill 1783

On March 29, 2023, House Bill 1783 ("Bill 1783") was introduced to the Arkansas General Assembly. Almost immediately thereafter, more than 100 franchised brands across diverse industries collectively wrote in opposition to Bill 1783.[76] At the core of such opposition was the apprehension of government overreach into private contractual relationships and an onerous regulatory regime that is manifestly bad for business.[77] Indeed, the March 31, 2023 letter ("Letter") in opposition cautioned that Bill 1783, as originally written, would "[d]iminish Arkansas economic development . . . [and] significantly alter the franchise business model."[78] Seemingly, what franchised brands disproved most about Bill 1783 was the potential loss of Arkansas' competitive edge from increased risks and thus costs associated with operating a franchised business. On April 4, 2023, Bill 1783 was engrossed and subsequently introduced to the Senate.[79] There, Bill 1783 was amended once more before receiving an 89:2 vote in favor of its enrollment.[80] The Bill was subsequently enrolled and transmitted to the Governor's Office and, on April 13, 2023, the Bill was passed as Act 847.[81]

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[74] *See* U.S. Chamber of Com., *Coalition for Workforce Innovation v. Su*, https://www.uschamber.com/cases/labor-and-employment/independent-contractor-lawsuit (last visited Apr. 22, 2024).
[75] Pls.' Mot. for Summ. J., ECF No. 52, *Coal. for Workforce Innovation v. Su*, 1:21-cv-130-MAC (E.D. Tex.).
[76] IFA, *IFA Statement on Amended Arkansas Franchise Relationship Bill*, INTERNATIONAL FRANCHISE ASSOCIATION (Apr. 14, 2023), https://www.franchise.org/media-center/press-releases/ifa-statement-on-amended-arkansas-franchise-relationship-bill.
[77] IFA, *Franchise Opposition to Arkansas House Bill 1783*, INTERNATIONAL FRANCHISE ASSOCIATION (Mar. 31, 2023), https://www.franchise.org/media-center/press-releases/franchise-opposition-to-arkansas-house-bill-1783.
[78] *Id.*
[79] LegiScan, *Arkansas House Bill 1783: History*, LEGISCAN, https://legiscan.com/AR/bill/HB1783/2023 (last visited Mar. 8, 2024).
[80] Arkansas State Legislature, *House Vote – Friday, April 7, 2023 10:52:00 AM*, ARKANSAS STATE LEGISLATURE, https://www.arkleg.state.ar.us/Bills/Votes?id=HB1783&rcs=1186&chamber=House&ddBienniumSession=2023%2F2023R (last visited Mar. 8, 2024).
[81] LegiScan, *Arkansas House Bill 1783: History*, LEGISCAN, https://legiscan.com/AR/bill/HB1783/2023 (last visited Mar. 8, 2024).

Bill 1783 was introduced as an amendment to the Arkansas Franchise Practices Act ("AFPA"), the subject matter of which "involves post-agreement protection for both franchisors and franchisees."[82] It sets forth the protection of franchisees from unreasonable termination, maintenance of strong and sound franchises, and provision of stable employment as the public policy for regulating franchise agreements.[83] Such regulation is directed at both the content of franchise agreements as well as post-agreement conduct of franchisors and franchisees alike. Specifically, Bill 1783 provides that with respect to any claims arising under or relating to a franchise agreement, a "provision . . . that restricts venue for a forum outside the State of Arkansas is void . . . ."[84] Bill 1783 also establishes duties of good faith and fair dealing, restricts a franchisor's rights to terminate a franchise agreement only for material cause, and makes it a violation of the AFPA for a franchisee to transfer, assign, or sell a franchise or interest therein without first giving the franchisor written notice of intent.[85] Bill 1783, in turn, requires the franchisor to provide written approval or rejection for material deficiency within 30 days after receipt of the notice; otherwise franchisor's approval is deemed granted.[86]

2. New Jersey House Bill 1958

House Bill 1958 ("Bill 1958") was introduced to the New Jersey General Assembly in January of 2022, as an amendment to the New Jersey Franchise Practices Act ("NJFPA").[87] Approximately 5 months later, the General Assembly passed Bill 1958 with committee amendments and introduced the same to the State's Senate Commerce Committee on June 1, 2023. However, unlike Bill 1783, Bill 1958 proceeded no further.[88] From the outset, Bill 1958 garnered mixed reactions from the hotel industry. While some argued that misinformation propagated by the opposition delayed its passage, others condemned Bill 1958 for its potential to destroy the hotel industry's franchise model.[89] The American Hotel & Lodging Association ("AHLA") and International Franchise Association ("IFA") are among those who take the latter position. Indeed, in its March 2023 letter to the General Assembly, IFA wrote in strong opposition to Bill 1958 and declared that it, *inter alia*, undermines the "key to franchising"—namely, a franchised brand's standards of safety, quality, and operation.[90] Currently, Bill 1958 remains stalled in the State Senate.[91]

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[82] H.B. 1783, 94th Gen. Assemb., Reg. Sess. (Ark. 2023), § 1(4).
[83] *Id.* at § 1(8)-(9).
[84] *Id.* at § 1(8)-(9)
[85] *Id.* at §§ 4(a), 5; Ark. Code §§ 4-72-205, 4-72-211, 4-72-212.
[86] *Id.* at § 4(b); Ark. Code § 4-72-205.
[87] New Jersey Legislature, *Bill A1958 Aca (1R) Session 2022-2023,* NEW JERSEY LEGISLATURE, https://www.njleg.state.nj.us/bill-search/2022/A1958 (last visited Mar. 8, 2024).
[88] Ed Brock, *New Jersey Franchise Law Stalled in State Senate,* ASIAN HOSPITALITY (Jan. 12, 2024), https://www.asianhospitality.com/new-jersey-franchise-law-stalled-in-state-senate/#:~:text=Proposed%20legislation%20that%20would%20make,to%20the%20hotel%20franchise%20model.
[89] *Id.*
[90] IFA, *IFA Comments NJ AB 1958 ltr*, INTERNATIONAL FRANCHISE ASSOCIATION, para. 3 (Mar. 20, 2023), https://www.franchise.org/sites/default/files/2023-03/IFA%20comments%20NJ%20AB%201958%20ltr.pdf.
[91] Ed Brock, *New Jersey Franchise Law Stalled in State Senate,* ASIAN HOSPITALITY (Jan. 12, 2024), https://www.asianhospitality.com/new-jersey-franchise-law-stalled-in-state-senate/#:~:text=Proposed%20legislation%20that%20would%20make,to%20the%20hotel%20franchise%20model.

Bill 1958 solely addresses hospitality franchises maintaining a place of business within the State of New Jersey.[92] The language of Bill 1958 purports to introduce a series of protections for franchisees by limiting a franchisor's control over certain franchisee choices. To that end, Bill 1958 contains a list of franchisor activities that will be considered a violation of the NJFPA. Bill 1958 makes it a violation for a franchisor to require or attempt to require a franchisee to relocate or make any capital investment over $25,000 more than once every five years as well as purchase goods, services, supplies, or inventories exclusively from the franchisor or sources designated by the franchisor where the same of comparable quality are available elsewhere.[93] Bill 1958 also prohibits a franchisor from receiving consideration from a vendor or affiliate unless the consideration is first disclosed and subsequently turned over to the franchisee, unilaterally changing material terms of the franchise agreement by modifying the operations manual, imposing fees not disclosed in the FDD, and selling points in a loyalty program to guests to use at a franchisee's business without compensating that franchisee for lost revenue.[94] Notably, Section 2(c) of Bill 1958 ensures a franchisor will not establish a competing franchise within a franchisee's exclusive or protected territory without the franchisee's written consent.[95]

3. California

Over approximately the past decade, there has been no state more active in the regulation of franchises and the quick service restaurant (QSR) industry class of franchise businesses than the State of California.

In 2015, Assembly Bill 525 (AB 525) was introduced and passed, which the California Governor signed into law on October 11, 2015 and which became effective on January 1, 2016.[96] AB 525 made significant changes to provisions of the California Franchise Relations Act (CFRA) involving termination, non-renewal, and transfer of an existing franchise business.[97] AB 525 also provided an important expansion of the remedies available to a franchisee for a franchisor's violation of the CFRA.[98]

In 2018, Assembly Bill 5 (AB 5)[99] was adopted into law codifying and expanding the scope of the California Supreme Court's decision in *Dynamex Operations West, Inc. v. Superior Court*, which instituted the ABC Test for distinguishing between employees and independent contractors in California wage orders.[100] AB 5 expanded the ABC Test to the entire California Labor Code

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[92] H.B. 1958, Gen. Assemb., Reg. Sess. (N.J. 2023), §1(b).
[93] *Id.* at § 2(b).
[94] *Id.* at §§ 2(a), (d), (e), (g).
[95] *Id.* at § 2(c).
[96]. Assemb. B. 525, 2016–16 Reg. Sess. (Cal. 2016), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201520160AB525 (go to "History") (codified in scattered sections of CAL. BUS. & PROF. CODE § 20000–20044).
[97]. *Id.*
[98]. *Id.*
[99]. Assemb. B. 5, 2019–20 Reg. Sess. (Cal. 2019), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5.
[100]. Dynamex Ops. W., Inc. v. Sup. Ct., 416 P.3d 1 (Cal. 2018).

and Unemployment Insurance Code.[101] It made it more difficult to classify workers, and potentially franchisees, as independent contractors rather than employees.[102] AB 5 codified the ABC Test established in *Dynamex Operations West, Inc. v. Superior Court*[103] as follows:

> [A] person providing labor or services for remuneration shall be considered an employee rather than an independent contractor unless the hiring entity demonstrates that all of the following conditions are satisfied:
>
> (A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
> (B) The person performs work that is outside the usual course of the hiring entity's business.
> (C) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.[104]

A few years later in 2022, California passed the California Fast Food Accountability and Standards Recovery Act (FAST Act), also referred to as Assembly Bill 257 (AB 257).[105] AB 257 was first introduced in the California Assembly on January 15, 2021.[106] AB 257 narrowly failed to pass the California Assembly on June 3, 2021, falling three votes short of a 41-vote majority.[107] AB 257 passed the California Assembly on January 31, 2022,[108] the last day possible for a bill introduced in calendar year 2021.[109]

As originally proposed, a section of AB 257 numbered 1472 provided for (i) QSR franchisor responsibility for ensuring franchisee compliance with California workplace laws, (ii) QSR franchisor joint and several liability for franchisee violations of such laws, and (iii) franchisee indemnification provisions related to such matters being deemed per se unlawful. An August 22, 2022 amendment by the California Senate deleted proposed Section 1472 from the text of AB 257

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[101]. Assemb. B. 5 § 2, 2019–20 Reg. Sess. (Cal. 2019), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5.

[102]. For a discussion of the *Dynamex* case and AB 5 *see* Theresa D. Koller, Norman M. Leon & Doug Luther, *Independent Contractor or Employee: The Current State of the Ever-Changing Law and Its Impact on Franchising,* AM. BAR. ASS'N 43RD ANN. FORUM ON FRANCHISING W-11, at 30–41 (2020).

[103]. Dynamex Ops. W., Inc. v. Sup. Ct., 416 P.3d 1 (Cal. 2018).

[104]. CAL. LAB. CODE §2775(b)(1).

[105]. Assemb. B. 257, 2021–22 Reg. Sess. (Cal. 2022), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB257.

[106]. Assemb. B. 257, 2021–22 Reg. Sess. (Cal. 2022), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB257.

[107]. AB-257 Food facilities and employment, CAL. LEGIS. INFO., https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202120220AB257 (go to "History").

[108]. AB-257 Food facilities and employment, CAL. LEGIS. INFO., https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202120220AB257 (go to "History").

[109]. 2022 Tentative Legislative Calendar, CAL. STATE ASSEMB. (Rev. Oct. 21, 2021), https://www.assembly.ca.gov/sites/assembly.ca.gov/files/2022_assembly_calendar_final.pdf.

along with approximately 90 additional changes.[110] On August 29, 2022, the California Senate passed AB 257 as amended, and Governor Gavin Newsom signed it into law on Labor Day, September 5, 2022.[111] AB 257's original effective date was January 1, 2023.[112]

After the enactment of the FAST Act, on September 7, 2022, the IFA, the National Restaurant Association, and the U.S. Chamber of Commerce spearheaded a coalition backed by restaurant owners and business groups called Save Local Restaurants (Coalition) to place a referendum on the November 2024 ballot to allow California voters the opportunity to overturn the FAST Act. The Coalition gathered and submitted over one million voter signatures by the December 5, 2022 deadline in support of the referendum, well in excess of the number needed.

Had the FAST Act survived the referendum and gone into effect after the November 2024 election, it would have established a new, unelected council of ten members (Council), with eight members appointed by the Governor, one member appointed by the Speaker of the Assembly, and one member appointed by the Senate Rules Committee.[113] The Council would have had broad regulatory powers to enact new workplace standards and regulations that would have had the force of law for covered fast food employers in California, unless the legislature enacted legislation quickly enough after notice of their adoption by the Council to prevent the standards and regulations from taking effect.[114] The Council would have had express authority to set the minimum wage for covered fast food employees up to up to $22 per hour in 2023, which would have been nearly seven dollars more than the state minimum wage for 2023,[115] and then to increase the minimum wage annually at the lesser of 3.5% or the rate of inflation.[116] The existence of the Council would have sunsetted on January 1, 2029 if not extended.[117] Thereafter, on every January 1, the minimum wage for covered fast food employees would increase at the lesser of 3.5% or the rate of inflation.[118] The FAST Act, if it had become effective, would also have prohibited franchisors and franchisees as operators of covered fast food systems from discharging or discriminating or retaliating against an employee for exercising rights established under the FAST Act.[119] It would also have granted employees a cause of action to sue their employer for violating these prohibitions.[120] Had the FAST Act survived the referendum and gone into effect, there would have been a material risk that the Council could attempt to enact and implement the same noxious

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[110]. Assemb. B. 257, 2021–22 Reg. Sess. (Cal. 2022) (as amended by Senate Aug. 25, 2022), https://leginfo.legislature.ca.gov/faces/billVersionsCompareClient.xhtml?bill_id=202120220AB257&cversion=20210AB25793AMD (go to "Compare Versions" and select "08/25/22 Amended Senate").

[111]. AB-257 Food facilities and employment, CAL. LEGIS. INFO., https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202120220AB257 (go to "History").

[112]. CAL. CONST. art. IV, § 8(c)(1) ("Except as provided in paragraphs (2) and (3) of this subdivision, a statute enacted at a regular session shall go into effect on January 1 next following a 90-day period from the date of enactment of the statute . . .").

[113]. CAL. LAB. CODE § 1471(a).

[114]. CAL. LAB. CODE § 1471(d)(1)(B).

[115] CAL. LAB. CODE § 1471(d)(2)(A). The authority to raise the minimum wage up to twenty-two dollars is specific to the year 2023. However, even if the referendum to overturn it fails, the FAST Act will not come into effect until after the November 2024 election.

[116]. CAL. LAB. CODE § 1471(d)(2)(B). The statute measures inflation as the one-year rate of change of the average Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers.

[117]. CAL. LAB. CODE § 1471(m).

[118]. CAL. LAB. CODE § 1473.

[119] CAL. LAB. CODE § 1472(a).

[120]. CAL. LAB. CODE § 1472(b).

provisions the Senate removed during the final legislative process. In addition, with the referendum pending, there was then the twin risk that the legislature would attempt to enact those same provisions legislatively through the slimmed-down AB 1228.

Even as AB 257 was deferred pending the outcome of the voter referendum, the Fast Food Franchisor Responsibility Act, also referred to as Assembly Bill 1228 (AB 1228), was introduced as a bill on February 16, 2023.[121] AB 1228 was a freestanding bill that contained, with some modifications, some of the very same provisions stripped out of the early versions of AB 257. Those same provisions would have made franchisors, among other things, jointly and severally liable for franchisee violations of California workplace laws. In particular, AB 1228 provided for a new standalone Section 2810.9 to be added to the Labor Code, which would serve to fill in and replace what the deleted Section 1472 of the originally proposed AB 257 would have provided concerning franchisor joint and several liability, but with some differences, using the same definition of covered QSR franchisors and franchisees contained in AB 257 as enacted.

With the 2024 voter referendum on AB 257 and the extraordinary costs associated with conducting it looming, representatives from labor and the Quick Service Restaurant industry made a compromise on September 11, 2023, which is reflected in a further modified AB 1228 and subsequently the California Labor Code at section 1475. After the compromise was announced, Governor Newsom signed Assembly Bill (AB) 1228 into law, which repealed the FAST Act and replaced it with the other provisions referenced above.

While the deal achieved certain priorities for workers, it also included some much-needed relief for quick service restaurant franchisors and their franchisees. Under the compromise, the minimum wage for fast food workers in California was raised initially to $20 per hour effective April 1, 2024, the provisions under AB 1228 that would have made franchisors jointly liable for their franchisees' labor violations was eliminated, and the referendum was cancelled. Another key aspect of the compromise was the role and defined powers of the Fast Food Council. The Fast Food Council is set to determine annual wages beginning in 2025 and through 2029, subject to a yearly increase cap tied to the Consumer Price Index. While the law allows the Fast Food Council to recommend regulations related to health and safety working conditions, security, taking protected leave, and protection from harassment and discrimination, the Council no longer has the authority to regulate paid sick leave, vacation, or predictable scheduling for franchisees.

In addition to AB 5 and AB 257, the 2021-22 California legislative session also produced Assembly Bill 676 (AB 676), which was introduced on February 12, 2021.[122] AB 676 failed to pass the Assembly in 2021, but following amendment succeeded in passing the Assembly close to the deadline for doing so on January 27, 2022.[123] Following further amendment, AB 676 passed the Senate, Governor Newsom signed it into law on September 29, 2022, and it became effective January 1, 2023.[124]

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[121]. Assemb. B. 1228, 2023–24 Reg. Sess. (Cal. 2023), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240AB1228.

[122]. Assemb. B. 626, 2021–22 Reg. Sess. (Cal. 2022), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220AB676.

[123]. *Id.*

[124]. *Id.*

AB 676 amended both the CFRA and the California Franchise Investment Law (CFIL).[125] The amendments to the CFRA, applicable only to franchise agreements entered into, amended, or renewed on or after January 1, 2023 or to franchises of an indefinite duration that may be terminated by the franchisee or franchisor without cause,[126] included an anti-waiver provision[127] and a restriction on the franchisor offsetting amounts owed to a franchisee against amounts owed by the franchisee upon termination or nonrenewal unless the franchisee has agreed to the amount or the franchisor has received a final adjudication of any amounts owed.[128] The amendments to the CFIL included: (i) an expansion of the jurisdictional scope of the CFIL to provide that a franchisor now offers or sells a franchise in California where the franchise will be operated in California, rather than where *both* the franchisee is domiciled in California *and* the franchise will be operated in the state (in addition to when the offer to sell was made in California or the offer to buy was accepted in California),[129] (ii) requirements on both the prospective transferee franchisee and the franchisor to provide information relating to an application for a transfer of an existing franchise (amended in the legislative process to make clear that the requirements do not apply to the sale of a new franchise), and requiring the franchisor to provide a statement of approval or disapproval of the application within 60 days of receiving information and documentation setting forth the reasons for disapproval, if applicable, and apparently providing a prospective franchisee standing to bring an action challenging the reasonableness of the franchisor's decision;[130] (iii) prohibitions on the franchisor failing or refusing to grant a franchise or to provide financial assistance to a franchisee or prospective franchisee that has been granted or provided to other similarly situated franchisees or prospective franchisees based solely on any protected characteristics of the franchisee or prospective franchisee, or any protected characteristics of the neighborhood or geographic area where the franchisee is located or where the proposed franchise would be located, as such characteristics are defined under the California Unruh Civil Rights Act;[131] (iv) an express disclaimer of protection from civil liability by implication;[132] and (v) a declaration that disclaimers of representations, violations of the CFIL, or reliance on franchise disclosure document including through franchise disclosure questionnaires and acknowledgment statements are all void and unenforceable.[133]

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[125]. Assemb. B. 257, 2021–22 Reg. Sess. (Cal 2022), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220AB257 (codified in scattered sections of CAL. BUS. & PROF. CODE §§ 20000–20044 and CAL. CORP. CODE § 31000–31512.1).

[126]. CAL. BUS. & PROF. CODE § 20041(c).

[127]. CAL. BUS. & PROF. CODE § 20015(b).

[128]. CAL. BUS. & PROF. CODE § 20022(h).

[129]. CAL. CORP. CODE § 31013(a).

[130]. CAL. CORP. CODE § 31126.

[131]. CAL. CORP. CODE § 31212 (incorporating CAL. CIV. CODE § 51(b), (e)).

[132]. CAL. CORP. CODE § 31306.

[133]. CAL. BUS. & PROF. CODE § 31512.1. The goal of § 31512.1 is now also achieved under the more detailed North American Securities Administrators Association, Inc. Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments applicable to all franchise registration states, including California. *See* N. Am. Sec. Adm'rs. Ass'n, NASAA Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements (Sept. 18, 2022) (unpublished policy statement), https://www.nasaa.org/wp-content/uploads/2022/09/NASAA-Franchise-Questionnaires-and-Acknowledgments-Statement-of-Policy-9-18-2022.pdf.

As discussed in Section II.C.3 above, California's proposed SB 919 seeks to regulate franchise brokers. If adopted, SB 919 would require third-party franchise sellers (including so-called franchise brokers) to register with the State of California. Unlike New York and Washington law, SB 919 would also add a disclosure obligation. SB 919 is being considered currently by the California Senate's Rules Committee and would go into effect July 1, 2025.

If passed, SB 919 would require third-party franchise sellers, also known as franchise brokers, to register with the State of California. Under SB 919, franchise brokers would be required to file a registration application, a Uniform Third-Party Franchise Seller Disclosure Form and a Uniform Third-Party Franchise Seller Disclosure Document ("FSDD"). In addition to registering the FSDD with the state, franchise sellers would also be required to present the FSDD to a prospective franchisee prior to discussing any franchise opportunity. While not nearly as extensive as the FDD's disclosure obligations, SB 919's FSDD requirement would track some of the types of items that must also be disclosed by franchisors in their FDDs, such as litigation history and fee amounts and recipients.

SB 919 would create a private cause of action for franchisees to sue for damages and rescission if the franchise seller is determined to have violated the law with respect to a franchise sale. Additionally, the California commissioner would be able to issue stop orders prohibiting a franchise seller from offering or selling franchises in the state upon a finding that a seller had failed to comply with any applicable provisions of law or rules issued by the commissioner. The new law's rules and penalties would apply to any franchise transaction touching or concerning California, by way of prospective franchisee residency, franchisee principal place of business, or if the franchised business is located in California. If adopted, SB 919 would require franchise sellers who wish to sell franchises to be located in California or to franchise prospects located in California to be registered and to comply.

SB 919 bears close watching. Like many past California laws, SB 919 may serve as a roadmap for other jurisdictions to regulate franchise sellers on either a nationwide or state-by-state level. Depending on its fate, SB 919 could be a precursor of more regulation to follow, either from additional registration states acting individually or through NASAA.

V. The Status Quo: Consistent with Past Trends or Is Something New and Different Occurring?

Franchising as an industry is undoubtedly facing increasing legislative and regulatory efforts. The recent surge in legislative efforts aimed at tightening regulations on franchising, both at the federal and state level, again implicates the evolving dynamics between franchisors and franchisees and has sparked debate about whether it signifies a new paradigm or merely reinforces existing trends that have been witnessed over the past several decades.

Franchising has long been a popular business model, offering franchisees the opportunity to operate under an established brand and an existing system. However, franchising has also faced criticism for the perceived power imbalances between franchisors and franchisees, leading to calls for greater regulation to protect the interests of the latter.

To some, recent legislative activity is a direct response to growing concerns about fairness, transparency, and accountability within the franchising relationship. Franchisees argue that these legislative efforts are intended to rebalance the power dynamics, ensuring that franchisees are not unfairly disadvantaged by overly restrictive contracts or abusive practices imposed by franchisors. For example, some legislation may focus on providing franchisees with more comprehensive disclosure requirements regarding fees, territorial rights, and termination clauses, empowering them with better information to make informed decisions.

Moreover, these legislative efforts may reflect broader societal shifts towards greater scrutiny of corporate practices and a desire for increased protections for small business owners. As such, they may indeed represent a new paradigm in which there is a heightened emphasis on fairness, equity, and accountability.

In the opinion of others, this most recent effort involves, in part, fundamentally different types of legislation and regulation. Indeed, according to its critics, this wave of legislation and regulation appears to play less deference to the economic power and opportunity of franchising.

No matter your perspective, it is essential to recognize that many of the issues addressed by recent legislation are not entirely novel, but rather are continuations of longstanding challenges within the franchising landscape. For decades, franchisees have voiced concerns about the need for more equitable contracts, fair treatment, and meaningful avenues for dispute resolution. In this light, the current legislative wave could be viewed as a reaffirmation of these ongoing trends rather than a radical departure from past dynamics.

Furthermore, while regulatory intervention can certainly play a crucial role in addressing systemic issues within franchising, it is not a panacea. Effective regulation must strike a delicate balance, protecting the interests of franchisees without stifling innovation or hindering the growth of franchising. Moreover, the effectiveness of any regulatory framework depends not only on its design but also on enforcement mechanisms and industry compliance.

The recent wave of legislation aimed at regulating franchising raises important questions about the evolving nature of the relationship between franchisors and franchisees. While it may signal a shift towards greater fairness and accountability, it also reflects ongoing concerns that have persisted within the industry for years. Ultimately, the true impact of these legislative efforts will depend on their implementation, enforcement, and the extent to which they succeed in promoting a more balanced and equitable franchising landscape.

VI. Possible Opportunities to Improve the Franchise Sales Process and Relationship

Franchising relies on, and necessarily requires for its success, the strength of the relationship between franchisors and franchisees. In recent years, various measures have been proposed and implemented to enhance transparency, protect whistleblowers, and empower the collective voice of franchisees through associations. According to their proponents, these initiatives hold significant promise in fostering healthier dynamics within the franchising relationship.

Franchisee associations, for example, serve as collective bodies that represent the interests of franchisees within a franchise system. By providing a unified voice on system-wide issues, these associations often afford franchisees the ability to negotiate more effectively with franchisors and advocate for fairer terms and conditions, and often, positive and needed changes to the franchise system. Additionally, they offer a platform for sharing best practices, addressing common challenges, and promoting collaboration among franchisees. By strengthening the cohesion and bargaining power of franchisees, these associations often contribute to a more equitable and balanced relationship with franchisors.

Whistleblower protection laws play a crucial role in safeguarding individuals who report misconduct or unethical behavior within franchising organizations. By offering legal protections to whistleblowers, such as immunity from retaliation or anonymity, these laws encourage franchisees and employees to speak out against wrongdoing without fear of reprisal. This can help uncover instances of fraud, deception, or unfair practices, thereby promoting greater transparency and accountability. Ultimately, whistleblower protection laws create a more ethical and trustworthy franchising environment, which benefits both franchisors and franchisees.

Finally, increased transparency initiatives aim to provide franchisees with clearer and more comprehensive information about the franchise opportunity being considered, the seller of the opportunity and the fees to be earned by any sale, and the way advertising and marketing fees are being utilized. By ensuring that franchisees have access to accurate and relevant information upfront, these transparency measures enable them to make more informed decisions about investing in a franchise. Moreover, transparency fosters trust and credibility between franchisors and franchisees, laying the foundation for a more transparent and collaborative relationship.

Collectively, franchisee associations, whistleblower protection laws, and increased transparency initiatives offer valuable opportunities to enhance the franchise sales process and strengthen the relationship between franchisors and franchisees. By promoting fairness, accountability, and open communication, these measures contribute to a more equitable and mutually beneficial franchising landscape. As such, franchisors and franchisees should continue to support and prioritize initiatives that promote transparency, protect whistleblowers, and empower franchisee associations, ultimately fostering a healthier and more sustainable franchising industry.

VII. Conclusion

Franchising as an industry is undoubtedly facing increasing legislative and regulatory efforts. In the opinion of some, this most recent effort involves, in part, fundamentally different types of legislation and regulation that play less deference to the economic power of franchising. In the opinion of others, there is a power imbalance in the franchise sales process and relationship that needs new guard rails to protect against opportunistic franchisor behavior. Nevertheless, and irrespective of its qualities, there should be agreement on the fact that there has been a wave of recent activity. The existence of this recent wave of legislation aimed at regulating franchising raises important questions about the future of franchising and the evolving nature of the relationship between franchisors and franchisees.