



BUSINESS LAW SECTION
FRANCHISE LAW COMMITTEE
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***PERMITTING FRANCHISORS WITHOUT A CURRENTLY REGISTERED
DISCLOSURE DOCUMENT TO EXHIBIT AT A TRADE SHOW***

LEGISLATIVE PROPOSAL (BLS-2016-01)

TO: Office of Governmental Affairs
FROM: Tal Grinblat, *Co-Chair*
Business Law Section (the “Section”) Franchise Law Committee (the “Committee”)
DATE: July 23, 2015
RE: Proposal to amend the Franchise Investment Law (Corporations Code Title 4, Div. 5) to permit franchisors without a currently registered disclosure document to exhibit at a trade show under specified conditions

SECTION ACTION AND CONTACTS

Date of Approval by Section Executive Committee (the “Executive Committee”):
Approval Vote: August 7, 2015

For: 10 Against: 0

Executive Committee Contact:	Committee Contact:
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HISTORY, DIGEST AND PURPOSE

The law governing the offer and sale of franchises in California is set forth in the California Franchise Investment Law (the “CFIL” – Corp. Code § 31000 *et seq.*) and related regulations (Cal. Admin. Code, Title 10, Chapter 3, Subchapter 2.6, Reg. 310.000 *et seq.*). Such offers and sales are also regulated by the Federal Trade Commission under similar, but distinct, regulations. The CFIL and related California regulations impose various registration and

disclosure obligations on “franchisors” and “subfranchisors” in connection with their offer and sale of franchises to prospective franchisees.

Relevant Existing Code Sections

The CFIL provides, subject to exceptions and exemptions listed therein, that a franchisor may not sell a franchise in California unless prior to the sale the franchisor has registered to sell franchises in California, has prepared a disclosure document containing certain information described in the CFIL, and has provided the franchisee with a copy of the disclosure document at least 14 calendar days before entry into any contract with, or receipt of any payment from, the franchisee. The procedures and requirements for registration are established by regulations promulgated by the Department of Business Oversight (“DBO”).

Proposal

Currently, the DBO views non-registered franchisors exhibiting at trade shows as an “offer” to sell a franchise under the CFIL, which is prohibited unless the franchisor has first registered or has satisfied an exemption from registration. The Committee proposes that the CFIL be amended to permit a franchisor who does not have a currently effective franchise registration and/or a disclosure document to display at a franchise trade show for the limited purpose of determining whether there is sufficient interest in its franchise to warrant the time and expense of preparing a franchise disclosure document and obtaining a registration. Such participation would be conditioned on the franchisor giving the DBO prior notice of its intent to participate at the trade show, and posting a conspicuous notice that it does not have a currently registered disclosure document and that it is not offering franchises for sale in California at this time. The DBO would be directed to adopt regulations concerning the form, content and timing of the notice and the form and content of the notice to be posted at the trade show to advise attendees that the franchisor may not actually sell a franchise until after it obtains a registration.

Reasons for the Proposal

Pursuant to section 31110 *et seq.* of the Corporations Code, as enforced by the DBO, franchisors cannot exhibit their franchise system at trade shows without first going through the full process of preparing a franchise disclosure document, obtaining an audit, securing a registration and incurring the attendant expense and delay in doing so. Specifically, the DBO interprets a franchisor’s exhibit at a trade show as an illegal offer of a franchise (whether or not a sale occurs) if the franchisor has not first registered their offering with the DBO as required by Section 31110. However, the registration process and expense may be pointless to a franchisor if it discovers that there is no interest in the franchise system or that substantial changes need to be made to the franchise system, which would thereby also require a further amendment to the registration, additional costs, and further delay. The proposed legislative amendment will facilitate a franchisor’s interest in assessing the potential successful entry into the California market, including, without limitation, any modifications to the offering or business model that may be needed, prior to incurring the substantial costs of preparing a franchise disclosure document and registering. And, by facilitating franchisor’s ability to “test the market” in

California, the proposed legislative amendment will increase potential franchisee knowledge of the franchise opportunities that are or may be potentially available in California.

Benefit to Franchisors

Franchisors have suggested for some time that there should be an exemption from the DBO policy of treating an unregistered franchisor's mere attendance at a trade show as an illegal offer, whether or not any actual sale takes place. Franchisors maintain that participating in a trade show would allow them to test the market for their franchise system whether they are a start-up or an existing domestic or foreign franchisor thinking of expanding into the California market. Franchisors could gain valuable insight from comments and suggestions made at trade shows by prospects, other franchisors, and even attending consultants. There is no single event or forum other than trade shows where they can be exposed to this valuable information.

This information could help the franchisor decide whether to start up a franchise or expand into the California market, and would also allow the franchisor to make changes or adjustments to its program to produce a franchise that is more likely to be successful for both the franchisor and franchisees. .

In addition to these benefits for franchisors, the State of California (the "State") and the vendors and suppliers who sell to franchisors could also benefit from such a business-friendly approach, since educated franchisors, who better understand the unique California market, are more likely to be successful and thereby generate a continuing source of revenue and taxes within the State for a longer period of time.

The ability to make adjustments to the franchise system prior to full entry into California reduces risks for all concerned and could translate into a better system and a more acceptable disclosure document, thereby making the registration process smoother.

It is not unusual for a prospective franchisor to find itself running up against sign-up deadlines for reserving space at various trade shows as it waits for its franchise registration to be processed, thereby creating unneeded pressure on both the franchisor's staff and the DBO's examiners. Since franchisors have little control over, or visibility into, the length of the registration process, an exemption would save some franchisors from missing trade shows that are often critical to their evaluation of growth potential or anticipated expansion to the California market.

Today's cost of developing and launching a franchise system is very high. Permitting franchisors to exhibit their program without registering (while prohibiting sales until registration is complete and all required disclosures made) would permit franchisors to test the California market and, if no interest is shown by prospects, to decide to conserve resources and not pursue the franchise program in California.

Benefit to Prospective Franchisees

Many of the benefits discussed below are the same as the benefits for the franchisors, just from a different viewpoint. Specifically, the exemption will enhance prospective franchisee

knowledge of the potential types of franchises that may, at some point, be available within California for the particular market. The exemption will also drive competition between franchise systems, including those already registered in California, to improve products and innovate their systems to the benefit of current franchisees and consumers. In addition, the exemption will drive competition between franchisors to attract new franchisees, thereby potentially enhancing the terms extended to potential franchisees. As a result, the franchisee is better suited to make a more informed and educated choice prior to selecting any particular franchise.

Similar Exemptions in Other States

The New York attorney general provides for a similar exemption for trade shows which has been in place for approximately three years.

APPLICATION

If enacted in 2016, the proposed legislation would become effective on January 1, 2017.

PENDING LITIGATION

We are not aware of any litigation currently pending that would be affected by this proposal.

LIKELY SUPPORT AND OPPOSITION

Franchisors and franchisees (and their respective counsel) will likely support this proposed statutory amendment because it would provide an avenue for franchisors to attend and display their concept at trade shows without risk to franchisees. Franchisees would not be harmed because unregistered franchisors will be clearly identified to prospective franchisees and not allowed to sell franchises in California prior to registration. In addition, no agreement could be signed or money taken from them without a registration. The exemption would simply allow prospective franchisees to review and assess a potential new franchise concept. Under the proposed statutory amendment, the DBO would have advance notice of the contact information for the franchisor and its principals when seeking the exemption, which will allow the DBO to enforce any violations. Additionally, if approached, the International Franchise Association (the industry-wide association of franchisors and franchisees) would also likely support the proposed amendment.

Based on reactions by members of the Franchise Law Committee of the Business Law Section, which includes counsel for both franchisors and franchisees, we anticipate no opposition to the proposed amendment.

FISCAL IMPACT

There may be minor, absorbable costs to the DBO associated with the proposed new notification. There may also be a positive fiscal impact generated by increased registrations, and ongoing franchise activity.

GERMANENESS

The subject matter of the proposed amendment of the California Franchise Investment Law requires the special knowledge, training, experience and technical expertise of the Business Law Section, since it relates to the statutory and regulatory scheme governing franchise sellers' registration and disclosure obligations under the California Franchise Investment Law, including experience in representing franchisors, prospective franchisors, franchisees and prospective franchisees, the filing and processing of applications for registration and familiarity with the related provisions of the Federal Trade Commission Franchise Rule, the franchise registration laws (and exemptions) of California and other states and the provisions of the Uniform Franchise and Business Opportunities Act and the Model Franchise Investment Act. Experience in and knowledge of the preceding laws and regulations naturally fall within the purview of the Business Law Section.

DISCLAIMER

This position is only that of the Franchise Law Committee of the Business Law Section of the State Bar of California. This position has not been adopted by the State Bar's Board of Trustees or overall membership, and is not to be construed as representing the position of the State Bar of California.

Membership in the Franchise Law Committee and in the Business Law Section is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources

TEXT OF PROPOSAL

SECTION 1. The following provision would be added to the Franchise Investment Law, Title 4, Division 5, Part 1 of the Corporations Code:

XXXX "Franchise Trade Show" means an event in this state, which is advertised and to which the general public is invited, at which franchisors who satisfy the reasonable criteria of the Franchise Trade Show's organizer may secure a space from which they can inform the members of the general public in attendance about their existing and prospective products, services and/or systems, and may offer franchises for sale pursuant to the provisions of this Division.

SEC. 2. Section 31013 of the Corporations Code is amended to read:

§ 31013. Offer or sale of, or offer to sell franchise made in this state

(a) An offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state.

(b) An offer to sell is made in this state when the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to sell is accepted in this state when acceptance is communicated to the offeror in this state; and acceptance is communicated to the offeror in this state when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed.

(c) An offer to sell is not made in this state merely because (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which has had more than two-thirds of its circulation outside this state during the past 12 months, or (2) a radio or television program originating outside this state is received in this state.

(d) An offer to sell is not made in this state merely because a franchisor who is not then offering franchises for sale in California and has not registered an offering pursuant to this Division secures space at a Franchise Trade Show from which it offers information about its products, services and/or system to the general public, provided that:

i. The franchisor notifies the Commissioner, in a form approved by the Commissioner at least seven days prior to the commencement of the franchise trade show, of its intent to attend and display its concept at the franchise trade show; and

ii. Conspicuously posts within its franchise trade show booth in public view a notice in a form established by Rule of the Commissioner, which states, at a minimum, that the franchisor is not offering franchises for sale in California, that it is not yet legally able to offer franchises for sale in California, and that if anyone associated with the franchisor offers a franchise for sale or solicits an offer to purchase a franchise in California, that action should be reported to the Commissioner, along with the Commissioner's contact information.