

HOUSE BILL REPORT

ESSB 5256

*As Reported By House Committee on:
Commerce & Labor*

Title: An act relating to franchise investment protection.

Brief Description: Providing franchise investment protection.

Sponsor(s): Senate Committee on Law & Justice (originally sponsored by Senators Nelson, A. Smith and Newhouse).

Brief History:

Reported by House Committee on:
Commerce & Labor, March 26, 1991, DPA.

**HOUSE COMMITTEE ON
COMMERCE & LABOR**

Majority Report: *Do pass as amended.* Signed by 9 members: Representatives Heavey, Chair; Cole, Vice Chair; Fuhrman, Ranking Minority Member; Franklin; R. King; O'Brien; Prentice; Vance; and Wilson.

Minority Report: *Without recommendation.* Signed by 1 member: Representative Jones.

Staff: Jim Kelley, (786-7166).

Background: Franchising is a contractual method for marketing and distributing the goods or services of a company (the franchisor) through a dedicated or restricted network of distributors (franchisees). Under the terms of a franchise contract, a franchisor grants the right and license to a franchisee to market a product or service using the trademark and/or business system developed by the franchisor.

The Washington Franchise Investment Protection Act of 1972 regulates franchises in Washington through disclosure requirements, the delineation of rights and prohibited acts, and mandatory registration of offerings, brokers, and agents.

The act defines a franchise to be a contract exchanging a franchise fee for the right to use a trade name in the marketing of goods or services.

A franchisor must register an offer to sell a franchise by submitting a list of enumerated disclosures to the director of the Department of Licensing. However, an isolated sale is not subject to the registration requirements of the act.

An exception to the registration requirements of the act is made for a franchisor who delivers a disclosure statement, containing various enumerated disclosures, to a prospective franchisee at least 48 hours prior to closing of the sale.

Motor vehicle leasing franchises are exempt from the registration requirement.

A supplemental report must be filed by the franchisor if adverse changes occur in the franchisor's condition.

Summary of Amended Bill: The Franchise Investment Protection Act is amended. The use of a trade name or a logo in exchange for a franchise fee, by itself, no longer constitutes a franchise. The definition of franchise is narrowed by requiring that the use of the trademark be substantially associated with the business and that the business be operated in accordance with a marketing plan established by the franchisor.

A marketing plan is defined as a system of conducting business and may include price specifications, sales equipment and techniques, advertising materials, training and operational requirements or financial guidelines.

A franchisor must register a sale and an offer to sell a franchise. "Offer to sell" and "sale" include: any offer or sale directed toward a resident of, or a purchaser located in, this state; an offer or sale originating in this state and violating the business opportunity laws of the jurisdiction to which it is directed; and an offer or sale in which the subject franchise will be located in this state. An offer to sell does not include advertisements in a publication that has more than two-thirds of its circulation outside this state, or a broadcast originating outside this state.

An isolated sale is not subject to the registration requirements of the act. The definition of an isolated sale is the sale of a single franchise by a franchisee. An isolated sale may not be effected through a franchisor, but may be subject to the approval of a franchisor who grants or denies approval in a reasonable manner.

The exception to the registration requirements of the act for a franchisor who delivers a disclosure statement to prospective purchasers is amended as follows:

- 1) The statement must be delivered at least 10 days, rather than 48 hours, in advance of closing. The enumerated disclosures are eliminated. Instead, the disclosure statement must comply with guidelines to be adopted by the director of the Department of Licensing. The director's guidelines must be based on the guidelines for the preparation of the Uniform Franchise Offering Circular adopted by the North American Securities Administrators Association, Inc.
- 2) This exemption only applies to:
 - a) A large franchisor who files an annual statement with the director claiming an exemption and paying a filing fee of \$100 per year;
 - b) A franchisor who has no outstanding franchises located outside the state of Washington and has granted no more than three franchises within the state of Washington, and the buyer is represented by counsel or a certified public accountant; or
 - c) A franchisor who does not charge a franchise fee in excess of \$500.

The exemption of motor vehicle leasing franchises from the registration requirement is eliminated. An exemption from the registration requirement is added for a franchise sold to an accredited investor. An exemption is also added for a franchise sold to a current franchisee of the same business, who has operated a franchise for at least two years and whose first franchise purchase was regulated by the registration requirement.

The list of disclosures that must be contained in an application for registration of an offer to sell is eliminated. Instead, a public disclosure statement complying with the director's guidelines must be included with the application. The application must contain: a copy of agreements proposed to franchisees; consent to service of process; any application for registration of a franchise broker; the filing fee; and any other information the director deems appropriate.

The director is authorized to require a franchisor to file financial statements audited by an independent certified public accountant. The director may deny or suspend either registration or an exemption from registration when it is in the best interest of the public and when the applicant: filed an application that is incomplete, false, or misleading; willfully violated a provision of the act; received certain recent convictions; is enjoined from any

aspect of the franchise industry; is engaged in unethical practices; or is insolvent.

An amended report must be filed by the franchisor if adverse changes occur in the condition of the franchisor or in the registered disclosure statement.

The act states that "this chapter represents a fundamental policy of the state of Washington."

A statute of limitations of one year for an action arising out of a failure to register and three years for any other cause of action arising under the act is established by the act.

Amended Bill Compared to Engrossed Substitute Bill: The amended bill increases the fee for large franchisors claiming an exemption from \$50 to \$100 per year.

Fiscal Note: Requested March 27, 1991 (for amended bill).

Effective Date of Amended Bill: Ninety days after adjournment of session in which bill is passed.

Testimony For: This bill is the result of much effort and compromise by many people. The bill will make franchise law more clear, predictable, and consistent with other states. The bill also minimizes the disincentives that keep franchisors out of Washington and retains the important consumer protection aspects of current law. It is based on uniform and model state acts.

Testimony Against: The statute of limitations is too short.

Witnesses: C. Kent Carlson, Washington State Bar Franchise Act Revision Committee (in favor); Jerald E. Farley, International Franchise Association (in favor); and Mike Stevenson, Department of Licensing, Securities Division (opposed).