Winter 2016
Vol.19, No.1

ABA Forum on Franchising

The Franchise Lawyer

American Bar Association • Forum on Franchising

Message from the Forum Chair

By Karen Satterlee, Hilton Hotels

It was wonderful seeing so many of you at the 38th annual Forum on Franchising meeting in New Orleans. Our registration numbers set an all-time record, with 870 attendees from the United States and several other countries. We are excited about the continued growth of the Forum and look forward to beating this record at the 39th Forum on Franchising, which will be held in Miami November 2–4, 2016.

The New Orleans Forum had many highlights, including the plenary session featuring Richard Griffin, General Counsel for the National Labor Relations Board, and David Weil, Administrator of the Wage and Hour Division of the U.S. Department of Labor. This session highlighted the well-publicized tension that has surfaced between various aspects of employment law and franchise law and practice, and it showcased the thoughtful, substantive, and collegial dialogue that distinguishes the Forum and its annual meeting. Kudos go to Andrew Loewinger, Eric Karp, Jonathan Solish, and Deborah Coldwell for their outstanding work on this program. As always, our intensives, workshops, and plenaries on cutting-edge topics added value by offering tips and best practices from our distinguished faculty of Forum members. Our events on Thursday night at the New Orleans Museum of Art and Friday night at the Presbytre were both lively and rich with good company, local music, and the best of New Orleans cuisine.

In addition to the educational sessions and networking events, there was Forum business to attend to. During the annual meeting, the Forum presented the following awards:

- The Rising Scholar Award to Mei Zhang, a 2015 graduate of Southern Methodist University, for her article *International Franchising: Food Safety and Vicarious Liability in China*, published in the Summer 2015 edition of the *Franchise Law Journal* (*FLJ*);
- The Future Leader Award to Trishanda L. Treadwell, a partner with Parker, Hudson, Rainer & Dobbs LLP and Associate Editor of the FLJ;
- The Chair's Award for Substantial Written Work or Presentation to Keri A. McWilliams of Nixon Peabody LLP for her article *PCI Compliance: What Franchisors Need to Know*, published in the Fall 2014 edition of *The Franchise Lawyer*; and
- The Lewis G. Rudnick Award to W. Michael Garner of Garner & Ginsburg, P.A. Michael is a former member of the Forum's Governing Committee, has served an editor in chief of the FLJ, and is the editor of the Forum's *Franchise Desk Book*.

In addition to these awards, the Forum

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Rights of Franchisees, Prospects of Litigation Rise Under New California Law

By Matthew J. Kreutzer, Howard & Howard

California has recently amended its franchise law to regulate franchise agreements entered into or renewed after January 1, 2016, as well as franchises of an indefinite duration that may be terminated without cause.

The new law substantially amends the existing California Franchise Relations Act (CFRA), Cal. Bus. & Prof. Code §20000 *et seq.*, and caps off a five-year effort by the legislature to implement additional protections for California franchisees against perceived franchisor abuses. The new law comes on the heels of a near miss in 2014, when the legislature passed the more rigorous Senate Bill 610, also intended to modify the CFRA. California Governor Jerry Brown vetoed SB 610, stating that he needed more proof that franchisors engage in "unacceptable or predatory practices" before he would sign off on a law that would "significantly impact California's vast franchise industry." Brown then stated that he would be open to amending the CFRA if legislators would take a more collaborative approach, including both sides of the industry.

The new law embodies that collaborative approach. The original version of the bill garnered early support from the Coalition of Franchisee Associations (CFA) and the Service Employees International Union (SEIU) but faced heavy opposition from the International Franchise Association (IFA). Mindful of Brown's admonition and the political reality that a new law would likely be enacted, the IFA and CFA worked out a compromise, announced in June, that resulted in several amendments to the bill, which the SEIU also supported.

Franchise Terminations

The revised CFRA imposes additional limits on a franchisor's ability to terminate its franchisees. Specifically, Section 20020 has been amended as follows: Under the new law, "good cause" for termination prior to expiration of the term is limited to a franchisee's failure to substantially comply with the lawful requirements of the parties' franchise agreement. This is less open-ended than the former version of the law, which stated that "good cause" included (but notably was not limited to) the failure of a franchisee to comply with any lawful requirement of the franchise agreement after being given notice and an opportunity to cure the failure. Litigation will determine the scope of "substantial" compliance.

The new law requires franchisors to give franchisees at least 60 days to cure a material default, measured from the date the franchisee is notified of its noncompliance. Previously, the CFRA did not set any minimum number of days for a franchisee to cure a material default, but stated that the cure period need not be more than 30 days. Oddly, the amended law also prohibits a franchisee's cure period from exceeding 75 days, unless the parties otherwise agree to extend the time.

The new 60-day cure period will not apply to every type of default. Franchisors may continue to terminate franchisees upon ten or fewer days' notice for certain time-sensitive material defaults, identified in Section 20021, including: failure to timely pay amounts due to the franchisor or its affiliate; abandonment of the business; conduct that reflects materially and unfavorably on the franchise system; failure to comply with laws or regulations; and repeated defaults.

Obligations After Termination, Non-Renewal

The most significant changes to the CFRA concern a franchisee's rights, and a franchisor's obligations, when the franchisor terminates or fails to renew. The CFRA's new provisions (in new Section 20022 and replaced Section 20035) require the franchisor to provide value to a departing franchisee under many circumstances, even if the termination or non-renewal complies with the statute.

For example, a franchisor now must purchase from the franchisee "all inventory, supplies, equipment, fixtures, and furnishings purchased or paid for" by the franchisee if those purchases were

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made in accordance with the requirements of the franchise agreement. To be covered by this provision, the franchisee, when it ceases operation, must still possess the asset and be able to give the franchisor clear title to it.

This repurchase requirement will not apply, however, where:

- The assets to be purchased were not "reasonably required to conduct the operation of the franchise business;"
- The franchisee cannot give the franchisor clear title to and possession of the assets;
- The franchisee declined an offer from the franchisor to renew the agreement;
- The franchisor does not prevent the franchisee from retaining control of the franchise business location after termination or nonrenewal;
- The franchisor's termination or nonrenewal is based on a publicly-announced, nondiscriminatory decision to withdraw all franchise activity from the geographic market area where the franchisee is located; or
- The parties mutually agree in writing to terminate or not renew the franchise.

Critically, the franchisor may offset the purchase price of the assets against any money the franchisee owes to the company.

Sanctions for Failure to Comply

Under the new Section 20035, if a franchisor terminates or fails to renew a franchisee in violation of the CFRA, the aggrieved franchisee may recover from the franchisor "the fair market value of the franchised business and franchise assets," as well as any other damages caused by the franchisor's violation of the CFRA. Significantly, the newly-enacted statute also authorizes a court to grant preliminary and permanent injunctive relief for a franchisor's violation (or threatened violation) of the statute.

Franchisee's Right to Sell

Finally, the new law has created a new framework enabling franchisees to sell or transfer their businesses. Specifically, under the new law (enacted in new Section 20028), a franchisor may not prevent a franchisee from selling: the franchise; all or substantially all of the assets of the franchise business; or an interest in the franchise business or franchisee business entity (whether controlling or noncontrolling) to another person. Exceptions are made where the buyer does not meet the franchisor's then-existing standards for new or renewal franchisees or where the parties fail to comply with the transfer provisions specified in the franchise agreement.

The CFRA's new Section 20029 requires a franchisee to notify its franchisor, in writing, of its intention to sell all or substantially all of the franchise. The notice must contain: the proposed buyer's name and address; a copy of all agreements related to the sale; and the proposed buyer's application to become a successor franchisee, which must include the forms, financial disclosures, and other information the franchisor generally uses in reviewing new prospective franchisees. If the franchisor's then-existing standards for approving new franchisees are not generally available, the franchisor must provide those standards to the selling franchisee within 15 days of receiving the franchisee's written notice.

Under new Section 20029, the franchisor must inform the selling franchisee of its approval or disapproval of the sale in writing within 60 days of receiving all required documentation from the franchisee. If the franchisor does not approve the sale, it must inform the franchisee in writing of the reasons for its disapproval. If the franchisor does not disapprove the sale within 60 days, then the sale will be deemed approved. The statute expressly authorizes a trier of fact to determine whether a franchisor's disapproval of a sale was reasonable, considering all existing circumstances.

Importantly, a franchisor's contractual right of first refusal will not be affected by any of the new provisions — except that for the right to be valid, the franchisor must offer the seller payment that is equal to or greater than the value offered by the third-party prospective buyer.

New Law Changes Landscape

This new law significantly changes the landscape for franchisee-franchisor relations in California. Franchisors and prospective franchisees will need to be mindful of how the law will affect their relationships going forward. The new law seems certain to generate litigation, and the franchise community as a whole will be closely watching for court decisions interpreting its provisions—including, in particular, the meaning of "substantial" compliance as it relates to termination. Franchisors should be especially cautious in terminating or refusing to renew franchisees, and mindful of the repurchase requirements they face under those circumstances. Finally, franchisors should consider reevaluating the disclosures made in California state-specific addenda to their Franchise Disclosure Documents to determine whether changes are necessary in view of the law. ■