
**SENATE COMMITTEE ON
BANKING AND FINANCIAL INSTITUTIONS**
Senator Monique Limón, Chair
2023 - 2024 Regular

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Author: Umberg
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Consultant: Michael Burdick

Subject: Franchise Investment Law: third-party franchise sellers

SUMMARY

This bill requires a third-party franchise seller to register with DFPI prior to engaging in the offer or sale of a franchise in this state and to provide a specified disclosure before engaging with a prospective franchisee about a franchise opportunity.

EXISTING FEDERAL LAW

- 1) Provides the Franchise Rule, enforced by the Federal Trade Commission, which requires a franchisor offering or selling a franchise to provide the prospective franchisee with 23 specified items of information about the franchise, its officers, and other franchisees. Examples of information include the franchisor’s business background, financial performance representations, the fees charged by the franchisor, specifications for renewing the franchise agreement, and contact information for current and former franchisees. (16 CFR Parts 436 and 437)
- 2) Defines “franchise seller” as a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor. (16 CFR 436.1(j))

EXISTING STATE LAW

- 1) Provides the Franchise Investment Law (FIL) that generally requires franchisors to register with the commissioner of the Department of Financial Protection and Innovation (DFPI) before offering and selling franchises in this state. (Division 5 of Title 4 of the Corporations Code, commencing with Section 31000 et seq.)
- 2) Provides the following regulations, among others, that apply to the sale of a franchise:
 - a) Provides that it is unlawful for a person to offer or sell a franchise unless the offer has been registered under the FIL, unless exempted. (Corporations Code Section 31110)
 - b) Requires that an application for registration to be accompanied by a proposed franchise disclosure document containing specified information and containing a disclaimer that the registration does not constitute approval, recommendation, or endorsement by DFPI. (Corporations Code Section 31114)

- c) Authorizes DFPI to stop a registration for a variety of reasons, including but not limited to: a failure to comply with the FIL, the offer would constitute misrepresentation or fraud, or if a person involved in the offer or sale poses an unreasonable risk to prospective franchisees and has been convicted of a felony, held liable in a civil action involving fraud or embezzlement, or subject to an enforcement action from a federal regulator. (Corporations Code Section 31115)
- d) Requires that a person provide to a prospective franchisee, at least 14 days prior to the sale of a franchise, a copy of the franchise disclosure document, together with a copy of all proposed agreements related to the sale. (Corporations Code Section 31119)
- 3) Prohibits various fraudulent acts and practices related to the sale of a franchise, such as making untrue or misleading statements. (Corporations Code Section 31200 – 31204)
- 4) Prohibits a person to effect or attempt to effect a sale of a franchise, except in specified exempt transactions, unless such person is:
 - a) Identified in an application filed with DFPI pursuant to the FIL,
 - b) Licensed by the Bureau of Real Estate as a real estate broker or real estate salesperson, or
 - c) Licensed by DFPI as a broker-dealer or agent pursuant to the Corporate Securities Law of 1968. (Corporations Code Section 31210)
- 5) Imposes civil liability, as specified, on any person who offers or sells a franchise in violation of the FIL. (Corporations Code Section 31300 et seq.)
- 6) Authorizes DFPI to bring a court action, or request the Attorney General to bring an action in the name of the people of the State of California, to enjoin the acts or practices or to enforce compliance with the law whenever it appears that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of FIL or any rule or order thereunder. (Corporations Code Section 31400)
- 7) Requires DFPI to charge fees for filing specified applications, an amendment, or an initial notice of exemption, ranging from \$50 to \$675 per filing. (Corporations Code Section 31500)

THIS BILL

- 1) Defines “third-party franchise seller” as a person who directly or indirectly engages in the business of the offer or sale of a franchise, including, but not limited to, a franchise broker, a broker network, a broker organization, and a franchise sales organization, which are undefined terms in the bill. Provides that a “third-party franchise seller” does not include: a franchisor or its officers, directors, or employees; a subfranchisor or its officers, directors, or employees; an area representative or its officers, directors, or employees; an employee of a wholly owned affiliate of a franchisor or subfranchisor; a franchisee of the franchise offering being presented to a prospective franchisee, unless the franchisee operates a franchised broker business.
- 2) Requires a third-party franchise seller to register with DFPI prior to effecting or attempting to effect a sale of a franchise.

- 3) Requires an application for registration to include:
 - a) A completed, signed, and verified Uniform Third-Party Franchise Seller Disclosure Form.
 - b) A completed Uniform Third-Party Franchise Seller Disclosure Document, as described in #10 below.
 - c) The required registration fee, as described in #12 below.
 - d) Any additional documents or exhibits prescribed by the commissioner.
- 4) Specifies processes related to registrations and renewals of registration.
- 5) Requires a registered third-party franchise seller to promptly notify DFPI of any material change in their Form, which includes a change in litigation history, a change in services provided, or a change in compensation.
- 6) Authorizes DFPI to issue a stop order suspending or denying the effectiveness of a registration if the third-party franchise seller has failed to comply with the FIL, as specified.
- 7) Requires a third-party franchise seller to comply with existing provisions of the FIL related to:
 - a) A prohibition from characterizing a registration with DFPI under the FIL as a finding by DFPI that any document filed under the FIL is true, complete, or not misleading, or that DFPI has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, franchise or transaction.
 - b) A prohibition from publishing any advertisement offering a franchise, as specified, unless a true copy of the advertisement has been filed with DFPI at least three business days prior to the first publication.
 - c) A prohibition from publishing any advertisement concerning a franchise after DFPI finds that the advertisement contains any false or misleading statement.
- 8) Provides that it is unlawful for a third-party franchise seller to offer or sell a franchise in this state, as specified, unless the third-party franchise seller is registered.
- 9) Provides that it is unlawful for a third-party franchise seller to engage with a prospective franchisee before providing a copy of the completed Uniform Third-Party Franchise Seller Disclosure Document, described in #10 below.
- 10) Provides that the Uniform Third-Party Franchise Seller Disclosure Document shall contain all of the following information:
 - a) A cover page that contains standardized language regarding third-party franchise sellers, including the types of sellers, their role in the franchise sales process, the services they provide, types of compensation, and examples of questions a prospective franchise might ask a third-party franchise seller.

- b) Specified information about the third-party franchise seller, including name, owners, place of business, and contact information.
 - c) The third-party franchise seller's professional experience during the last five years.
 - d) Administrative, civil, or criminal actions alleging that the third-party franchise seller, or an owner, officer, or director of the third-party franchise seller, violated any franchise, antitrust, or securities law, or committed fraud, unfair or deceptive practices, or similar violations, whether pending or resolved, within the last five years.
 - e) The industries of the brands the third-party franchise seller represents and how many brands within each industry the third-party franchise seller represents.
 - f) A description of the services performed by the third-party franchise seller.
 - g) How the third-party franchise seller is compensated, including, but not limited to, how the amount of any consideration the third-party franchise seller receives is calculated.
 - h) Whether a broker network, broker organization, or franchise sales organization (which are not defined terms) may receive any additional consideration.
 - i) The name and contact information for all franchisees to whom the third-party franchise seller sold a franchise anywhere in the United States or its territories during the last calendar year, including, but not limited to, the total number of units sold to each franchisee.
- 11) Provides that provisions described in #2-#10 are operative on July 1, 2025.
- 12) Provides the following fees for filing applications:
- a) \$250 for an application for registration as a third-party franchise seller.
 - b) \$150 for an application for renewal of a registration as a third-party franchise seller.
 - c) \$50 for an application for amendment of a registration as a third-party franchise seller.
- 13) Removes exemptions for a real estate broker, real estate salesperson, and broker-dealer or agent, requiring these persons to be identified in registration documents before effecting or attempting to effect a sale of a franchise.
- 14) Provides that a third-party franchise seller who offers or sells a franchise in violation of the FIL is liable to the franchisee, who may sue for damages, and if the violation is willful, the franchisee may also sue for rescission, as specified. Provides that the franchisor may also sue for damages or may assert claims of indemnity against the third-party franchise seller caused by the violation.

COMMENTS

1) PURPOSE

This bill is sponsored by the International Franchisors Association, the Coalition of Franchisee Associations, and the American Association of Franchisees and Dealers.

According to the author:

Senate Bill 919 increases transparency in the franchise sales process for prospective franchisees in the State by providing information not only about what the prospective franchisee is buying (a franchise opportunity) but also who is selling it to them. SB 919 ensures that a prospective franchisee understands the role of the third party franchise seller and the incentives they may receive for referring the prospective franchisee to one franchise opportunity over another.

2) BACKGROUND

Franchising is a business model where a franchisee is granted the right to engage in the business of offering goods or services under a marketing plan that is mostly prescribed by a franchisor. The franchisee's business is inextricably linked to the brand of the franchisor, often through a trademark, logo, or other commercial symbol representing the franchisor. In exchange for operating its businesses under the marketing plan of the franchisor, the franchisee pays a fee, either directly or indirectly. Examples of large franchises include McDonald's and many other popular fast food chains, Ace Hardware, and Marriott International. According to industry research, there are more than 800,000 franchise establishments nationwide across 9,000 franchise brands, employing more than 8.5 million workers.¹

The California Franchise Investment Law (FIL) covers activities related to the offering and sale of a franchise in this state. The FIL generally requires franchisors to register with the Department of Financial Protection and Innovation (DFPI) before offering and selling franchises in California, unless otherwise exempt. The FIL requires that registration disclosure documents and final franchise agreements be provided to prospective franchisees at least fourteen days before the sale of a franchise. The purpose of the pre-sale disclosure is to provide, fully and truthfully, material information about the franchisor and its franchise offering to the prospective franchisee, prior to the prospective franchisee making a purchase decision. **Similar to securities laws, the FIL prohibits a person from engaging in fraudulent or deceptive practices related to the offering of a franchise. The FIL provides as enforcement mechanisms civil remedies, criminal punishment, and authorizes DFPI or the Attorney General to bring an action to enjoin activities or to enforce compliance with the law.**

The actual contract between a franchisor and franchisee is governed by the California Franchise Relations Act (CFRA). This bill does not implicate the CFRA. This bill focuses on the offer or sale of a franchise under the FIL, particularly, the involvement of third-parties in the offering and sale of a franchise.

¹ <https://www.franchise.org/sites/default/files/2024-02/2024%20Franchising%20Economic%20Report.pdf>

3) THE OFFERING AND SALE OF A FRANCHISE

Entrepreneurship is often a risky endeavor, and franchising can offer a quicker and easier way for a person to start their own business, compared to thinking of and implementing their own concept. But franchising is not a guaranteed path to owning a profitable business. In addition to paying the initial franchise fee that can range from \$20,000 to more than \$50,000, franchisees may need to invest capital in building the particular franchise location, acquiring inventory and supplies, and establishing initial working capital for the business. If the franchisee is unable to develop and operate a profitable business, they may lose not only their initial investment but may also be personally liable for business loans that commonly require a franchisee to provide a personal guarantee.

Some prospective franchisees begin investigating franchise opportunities with little knowledge or experience related to running a business generally or investing in and operating a franchise specifically. Navigating the hundreds of franchise opportunities available to them may be daunting. Nowadays, a prospective franchisee likely begins their research online, where rather than engaging directly with a franchisor, they are more likely to first engage with third-party franchise sellers.² The spectrum of activities and persons engaged in third-party franchise selling is discussed in the subsequent comment.

If a prospective franchisee engages with a third-party franchise seller and shows adequate interest in a particular franchise opportunity, they eventually transition to engaging directly with the franchisor. The responsibilities of the franchisor pertaining to the offer and sale of a franchise are subject to the federal Franchise Rule, described in the Existing Federal Law section above, and the FIL. Those laws require the franchisor to provide a specified franchise disclosure document, at least 14 days prior to a franchisee signing the franchise agreement, with information relevant to the prospective franchisee in evaluating the investment opportunity. The law also prohibits the franchisor from engaging in any fraudulent acts and practices related to the sale of a franchise, such as making untrue or misleading statements. Importantly, though a third-party may engage in the sales process, the franchisor is ultimately responsible for complying with the disclosure requirement and applicable franchise laws; the franchisor cannot simply outsource this responsibility to third parties.

4) TYPES OF THIRD-PARTY FRANCHISE SELLERS

The range of third-party involvement in the franchise sales process ranges from the relatively light touch of lead generators to the more significant involvement of franchise brokers and franchise sales organizations. A brief description of various third-party participants is summarized below, but the terminology used within the industry to describe these actors and their activities is far from uniform.³ A common characteristic of all these entity types is that the third parties typically enter into contractual relationships with franchisors who are their

² Larger and more established franchises are more likely to use their own in-house teams to solicit and facilitate the sale of franchises. Many franchises, however, outsource various aspects of their franchise sale operations to third parties.

³ These descriptions rely primarily, but not exclusively, on a paper presented at the American Bar Association (ABA) 45th Annual Form on Franchising, titled, "The Latest on Working with Franchise Sales Organizations, Agents and Brokers," accessed through the following link on 4/14/24: <https://drive.google.com/file/d/1TZpsIHNM9fhd3qwFJS7W9usbZhhtEytB/view>.

clients; despite nomenclature like “franchisee coach,” prospective franchisees are not the clients.⁴

- *Lead Generator.* Lead generation networks are individuals or entities that identify potential franchisees and provide the names and/or contact information for such potential franchisees to franchisors for a fee. The lead generation network and franchisor usually operate under a contract that details how the lead generation network is compensated for leads. Most lead generation networks, at a minimum, operate online lead generation websites or franchise portals, which are widely used by prospective franchisees searching the internet to research and find franchise opportunities. These websites and portals usually provide information on various franchise brands, including a general franchise description, certain startup costs, and ongoing fees.
- *Franchise Broker.* A franchise sales broker is an independent sales agent not employed by the franchisor who solicits prospective franchisees to purchase a franchise and receives a fee or commission from the franchisor on the sale of the franchise. Most franchise sales brokers are solely paid by the franchisor in the form of a fee or commission and generally do not charge the prospective franchisee for connecting them with the franchisor. Franchise sales brokers can go by various other names, including coaches, consultants, agents, and representatives. The franchise sales broker’s role in the franchise sales process can range from very limited to highly involved. However, the essential element of the franchise sales broker’s role is introducing franchisors to prospective franchisees, with the franchisor reserving final approval rights.
- *Franchise Broker Network.* A franchise broker network (also known as a “broker organization”) is a network of individual franchise brokers and suppliers that all work together to refer potential franchisees to franchisors. Franchise broker networks differ from franchise broker organization in the way they receive compensation – franchise broker networks typically are compensated based on sales whereas franchise broker organizations typically are membership-based, with franchisors paying a membership fee to be represented by the organization. A franchise broker network or franchise broker organization may represent many (sometimes hundreds of) franchise opportunities, which may be competitors within the same industry.
- *Franchise Sales Organizations.* A franchise sales organization often functions as an extension of (or replacement for) a franchisor’s sales and development team, leading all aspects of the franchise sales process, including marketing and development. These sellers represent various brands and are employed by the franchisor to carry out franchisee recruitment services for the franchisor. Franchise Sales Organizations may and do work with Franchise Broker Networks that refer business to the Franchise Sales Organization or franchisor for whom the Franchise Sales Organization performs services.

5) BENEFITS AND RISKS OF THIRD-PARTY FRANCHISE SELLERS

The increasing use of third parties in the offering and sale of franchises suggests that these third parties deliver value to the process, as no franchisor or franchisee is required to engage with a third-party seller. But the value added by a third party is partially offset by the risks

⁴ <https://www.thefranchiseking.com/what-everybody-ought-to-know-about-franchise-consultants>

incurred by franchisors and franchisees. The approach implicit in this bill is to preserve the benefits that third parties can provide, while mitigating at least some of the risk.

Franchisors benefit from using third-party sellers in several ways.⁵ A prominent benefit is the cost savings from outsourcing sales functions. Many third-party franchise sellers are compensated when a deal closes, meaning the franchisor does not directly incur an expense until there is associated revenue to cover the expense. This is particularly attractive for smaller or earlier-stage franchises that are less able to bear the risk and capital investment to build an in-house sales team. By leveraging outside parties, a franchisor can spend its marketing and sales budget more efficiently. Outsourcing can provide access to professional salespeople with broad geographic reach and connections to more prospective franchisees than the franchisor would be able to develop in-house.

Franchisees can also benefit from engaging with third-party sellers. Similar to franchisors, third-party sellers can reduce a prospective franchisee's costs, though these costs are often denominated in time and energy, rather than dollars. Third-party sellers have knowledge of franchising and specific franchise opportunities that a prospective franchisee may access on-demand, rather than developing through their own extensive market research. There are also many prospective franchisees who value someone they believe to be a market expert, which can alleviate the stress and uncertainty of navigating an unfamiliar and complicated marketplace.

Third parties often introduce risks to the franchise sales process, especially if the third party provides services beyond simple lead generation. Franchisors that outsource significant aspects of the sales process lose oversight and control of what prospective franchisees hear about a franchise opportunity. Third parties often have less knowledge of and history with a given franchise brand than a franchisor's employees. If a third party makes errors or omissions or otherwise misbehaves during the sales process, the ultimate liability for those mistakes often rests with the franchisor.

A risk shared by franchisors and franchisees using third-party sellers is misaligned incentives. As discussed previously, many third-party sellers are compensated only when a franchisee signs a franchise agreement with a franchisor, creating a transactional, short-term incentive for the third party to do whatever it takes to close a deal. But it is the franchisor and franchisee who enter a long-term agreement with each other. A bad fit will often leave a franchisee with a poorly performing investment that can wipe out not only their investment in the franchise, but may saddle them with personal liability for loans taken out to finance property, equipment, and other start-up costs. For the franchisor, a dissatisfied franchisee may not only hamper their growth plans as prospective franchisees learn of problems, but may also lead to litigation claiming that the franchisee was misled during the sales process. Meanwhile, the third-party seller often has moved on, leaving the franchisor and franchisee to clean up the mess that the third party may have, at least partially, created.

6) HOW THIS BILL ADDRESSES RISKS POSED BY THIRD-PARTY SELLERS

To address the risks described in the previous comment, this bill relies primarily on transparency, by the way of a prescriptive disclosure requirement that third-party franchise sellers would provide to prospective franchisees. The disclosure document contains information that could alert a prudent prospective franchisee to red flags that would cause the

⁵ The following discussion of benefits and risks relies heavily on the previously cited ABA paper.

prospective franchisee to consider whether working with the third-party franchise seller is in the prospective franchisee's best interests. Information about the third-party franchise seller that could trigger red flags includes their litigation history, information about their compensation schemes, and their professional experience during the last five years. These pieces of information could provide evidence of the third-party franchise seller's honesty, potential conflicts of interest, and their knowledge, experience, and suitability in providing advice to the prospective franchisee.

In addition to information about the specific third-party franchise seller, the disclosure also provides general information about third-party franchise sellers, such as the role they play in the sales process, the particular services that they may provide, and examples of questions that a prospective franchisee might ask a third-party franchise seller. This general information could be used to give the prospective franchisee tools in conducting due diligence of third-party franchise sellers before engaging in more extensive discussions with such parties.

In addition to the required disclosure, this bill requires third-party franchise sellers to register with DFPI. The process for registration is intentionally ministerial in nature; DFPI is neither required nor authorized to review the information provided in a registration filing. DFPI is authorized to issue a stop order suspending or denying the effectiveness of a registration if DFPI finds that the third-party franchise seller has failed to comply with a requirement of this bill, but it is unclear how DFPI would come to learn of such violation. The bill does not require or authorize DFPI to conduct any examinations of registered third-party franchise sellers, meaning enforcement by DFPI will likely be initiated by complaints received from franchisors, franchisees, or prospective franchisees who allege harm caused by a third-party franchise seller.

In addition to the registration requirement, the bill provides a cause of action to a franchisee or franchisor who is harmed by a third-party franchise seller that violates a provision of this bill. Given the relatively weak authority provided to DFPI, it is likely that the provisions of this bill primarily will be enforced through private enforcement through the courts.

7) CONSIDERATIONS MOVING FORWARD

This bill is intended to mitigate the consequences of a mostly unregulated market of persons who play an important role in the sale of franchises. While well-intended, the bill is a work-in-progress and may evolve considerably. Third-party franchise sellers – the people who would be covered by this regulation – have yet to engage directly in the legislative process. Lacking their involvement, Committee staff has attempted to identify aspects of the bill that may be unclear or potentially controversial, but it is likely that issues not enumerated below may surface if affected parties eventually provide feedback. Considerations for the author and sponsor are summarized below, and the author is encouraged to keep Committee staff and the Chair involved in discussions as this bill evolves.

a) Definitional refinement

The author and sponsors may consider whether the proposed definition of “third-party franchise seller” is sufficiently broad to capture their intended audience. The definition reads, in part, “person who directly or indirectly engages in the business of the offer or sale” of a franchise. Some persons may not deem themselves to be in the business of offering or selling a franchise; instead, they may describe their activities as gathering

information from prospective franchisees and providing referrals when a prospective franchisee may be a good fit with a franchisor. Additionally, what is the intended reach of “indirectly” in the definition? Certainly, there is a line beyond which no reasonable person could assume the bill intends to reach, **but the bill gives no indication of how narrowly or broadly to interpret “indirectly.”**

The definition also introduces undefined terms that are expressly deemed “third-party franchise sellers,” including franchise broker, broker network, broker organization, and franchise sales organization. If these terms are not defined or described, how is a court or DFPI expected to interpret these terms? The inclusion of such undefined terms in a lynchpin definition for the bill – third-party franchise seller – begs for litigation and misinterpretation by courts and DFPI.

Consideration: If the intent is to capture third-parties who are compensated as a result of the sale of a franchise, there may be a more direct way to capture that activity. A “third-party franchise seller” could mean a person who receives compensation related to the sale of a franchise, while exempting persons who not considered to be third parties, like the franchisor, subfranchisor, or an affiliate. This approach may avoid the thorny problem of needing to describe the range of activities undertaken by, or labels self-applied to, persons who are engaging in this third-party sales-related activity. The author and sponsor may also consider whether any person paid on commission should be required to register, given the inherent conflict of interest that incentive-based compensation can introduce between that person and a prospective franchisee.

b) Effecting a sale

This bill provides that it is unlawful for a person to “effect or attempt to effect a sale of a franchise” unless that person is named in a specified disclosure in the franchise disclosure document or that person is registered as a third-party franchise seller. Similar to the discussion immediately preceding related to the definition of “third-party franchise seller,” it is unclear if the author and sponsors’ intent will be fully realized, depending on their views in whether certain activities of third-party franchise sellers should be deemed as “effecting or attempting to effect” a franchise sale. Committee staff is not aware of relevant case law that informs the interpretation of effecting a franchise sale, but *Nationwide Investment Corp. v. California Funeral Service, Inc.* may be informative. The court held in *Nationwide* that a person who participates in negotiations that involve the purchase or sale of securities is effecting or attempting to effect a transaction in such securities and is thus considered a “broker-dealer” under California securities law. Many third-party franchise sellers may argue that their activities do not constitute effecting a franchise sale, as they do not participate in *negotiating* the terms of the franchise sale. They may argue that their activities are limited to gathering information from prospective franchisees and sharing general information about franchise opportunities.

Consideration: If the author and sponsor intend for this section to apply narrowly to third-party franchise sellers that engage in negotiations related to a franchise sale, then the current language in the bill may suffice. If, however, the author and sponsor intend for this provision to apply more broadly to activities undertaken by a majority of third-party franchise sellers, the author may consider amendments that clarify the intended scope of “effecting or attempting to effect” a franchise sale or amendments that expressly

expand the scope of activities related to marketing a franchise opportunity to ensure that the author's intent is fully reflected in the bill.

c) Conduct requirements for third-party franchise sellers

The International Franchisors Association (IFA), one of the co-sponsors of this bill, argues that this bill is necessary “due to the significant role third-party franchise sellers play in franchise sales, often acting as the primary point of contact for prospective franchisees.” IFA also identifies the risk that a third-party franchise seller will steer the prospective franchisee to one franchise opportunity over another based on the different incentives that influence the third party. These concerns are backed by comments from industry participants that bad actors sell to unqualified candidates, misrepresent franchise offerings, and make unauthorized financial performance representations.⁶

To address these concerns, this bill proposes requirements of third-party franchise sellers related to disclosure and registration. The conduct requirements of a registered third-party franchise seller are fairly sparse. The bill prohibits a third-party franchise seller from certain misrepresentations in DFPI filings, including the mandatory disclosure document, and from false advertising. It is not clear whether any other material requirements or prohibitions apply to the conduct of a third-party franchise seller.

Consideration: To better address problematic behavior of some third-party franchise sellers, the author may consider adding, or clarifying the application of, conduct standards that should apply to third-party franchise sellers. An important first step is to clarify whether Corporations Code Section 31201, which prohibits a person offering or selling by means of making an untrue statement of a material fact or omitting to state a material fact that makes their statement misleading, is intended to apply to a third-party franchise seller. Though likely more complex and controversial, the author may also consider whether certain third-party franchise sellers owe an obligation to assess the suitability of a prospective franchisee before presenting any particular franchise opportunities to the prospective franchisee.

d) Pros and cons of more specificity

In conversations with Committee staff, a sponsor raised the prospect of codifying the specific language required in the Uniform Third-Party Franchise Seller Disclosure Document directly into this bill. Specifying the disclosure language in statute carries the benefit of avoiding the potentially lengthy and costly administrative processes that would need to be undertaken by DFPI to specify the details of the document. This approach would also allow the Legislature to weigh-in directly at a level of detail that would be deferred to DFPI under the current version of the bill. On the other hand, a more lengthy administrative process led by DFPI may result in a better outcome. For one, DFPI has subject matter experts on the issue of franchising who have knowledge and experience in this field that exceeds that of legislative staff. Secondly, third-party franchise sellers have yet to engage in the legislative process, and these entities may have valuable feedback to inform the contents of the disclosure.

⁶ <https://www.jdsupra.com/legalnews/california-paves-way-for-franchise-1835318/#:~:text=Franchise%20brokers%20are%20then%20paid,maintain%20a%20separate%20registration%20process.>

Consideration: If the author plans to specify the language of the disclosure in the bill, the author may consider amending the bill with such language as soon as possible. Making public the specific language of the disclosure may help to bring stakeholders to the table and give the Legislature more information about areas of potential disagreement. Additionally, the author may consider strongly encouraging the sponsors to invite third-party franchise sellers to join negotiations with the Legislature as the bill moves through the process, to the extent that sponsors have not done so already.

e) Where specificity may be controversial

This bill requires a third-party franchise seller to disclose how they are compensated, including, “how the amount of any consideration the third-party franchise seller receives is calculated.” The bill does not elaborate on how specific this disclosure must be. For example, would a third-party seller need to disclose that they receive \$35,000 from Franchisor A, plus 1.5% of the franchisee’s monthly sales in royalties for ten years; \$25,000 from Franchisor B, plus a 0.5% equity stake in the franchise; and \$50,000 from Franchisor C? Or would a more general description, such as “we receive a flat fee commission that ranges from \$20,000 to \$50,000 from various franchisors, with some franchisors providing ongoing royalty payments or equity shares in the franchise,” suffice?

The more specific this disclosure is required to be, the more controversial it may be for third-party franchise sellers and, potentially, some franchisors. Contractual arrangements between a franchisor and third-party franchise seller may be considered a trade secret, and compelling disclosure may raise concerns about fair competition. This information could be used by a franchisor in attempting to negotiate more favorable terms with third-party franchise sellers if the franchisor knows what other franchisors are paying the third-party franchise sellers. Likewise, a third-party franchise seller could use the information disclosed by a competing third-party franchise seller to negotiate more favorable terms with a given franchisor.

Consideration: The author may consider elaborating on how specific the required disclosure related to compensation is intended to be. In lieu of highly specific disclosures of compensation, the author may consider a more general disclosure about compensation that is enhanced by a clear and conspicuous statement related to the following points:

- That a prospective franchisee should be aware that a third-party franchise seller is not working on their behalf, but is in a contractual arrangement with franchisors.
- That the third-party franchise seller may be influenced to present, recommend, or otherwise suggest a particular franchise opportunity based on how much the third-party franchise seller will be compensated, rather than the suitability of that franchise opportunity for the prospective franchisee.
- That a prospective franchisee cannot expect that a third-party franchise seller will provide information or make recommendations that are aligned with the best interests of the prospective franchisee.

f) Rescission of a franchise agreement

This bill provides a cause of action to a franchisee who is harmed by a third-party franchise seller who offers or sells a franchise in violation of the requirements of this bill. One of the available remedies available to a prevailing franchisee is rescission of the franchise agreement. As the franchise agreement is between a franchisor and franchisee, it is unclear how the acts of a third-party franchise seller could or should result in the rescission of such an agreement. If a franchisor is harmed by the rescission, is the franchisor left to bring a separate action against the third-party franchise seller for damages or claims of indemnity, as provided in the bill? Or could the court order a judgment against the third-party franchise seller to compensate the franchisor in the same proceeding that resulted in the rescission?

Consideration: This bill is double-referred to the Committee on Judiciary, and the author may consult with staff in that committee about the proper way to handle rescissions of franchise agreements in this bill.

8) ARGUMENTS IN SUPPORT

Notably, the major trade association representing franchisors, the International Franchisor Association (IFA), and major trade associations representing franchisees, the American Association of Franchisees and Dealers (AAFD) and the Coalition of Franchisee Associations, are co-sponsoring this bill. While franchisors and franchisees often have competing interests in establishing policies around franchise investments and relations, the two sides see mutual benefit in stronger oversight of third-party franchise sellers. IFA and a coalition of franchise brands write in support:

There is a need for greater transparency in the franchise sales process concerning the role of the various franchise sellers with whom a prospective franchisee may interact with when considering a franchise opportunity. It is common for a prospective franchisee to engage with a broker, employees of a franchise sales organization, and a franchisor's development personnel in connection with a single franchise opportunity, each of whom are influenced by different incentives to steer the prospective franchisee to one franchise opportunity over another. Franchisees currently have limited visibility into this network of franchise sellers and the incentives driving their advice. SB 919 seeks to provide greater visibility by requiring third-party franchise sellers to provide minimal but important disclosures to prospective franchisees that are material to understanding the role of the third-party franchise seller, including ownership structure, a general description of the services performed on behalf of franchisor clients and the method by which they are compensated for those services, industries represented and the number of brands within the represented industry, litigation history, and the franchisees to whom the third party franchise seller sold franchises during the preceding year.

AAFD writes:

Senate Bill 919 will specifically require franchise sellers to register with the state, provide significant disclosures to its clients, and assign liability if they don't provide accurate information on the franchise they are selling. Currently, franchise sellers, often called franchise brokers, have no requirements. For example, to become a franchise broker, all you have to do is call yourself one.

The importance of registration and disclosure is because buying a franchise puts the franchisee at significant risk. Most franchises, and often the loans required to obtain the franchise, require personal guarantees by the franchisee. Unlike most other large investments where only the investment is at risk, buying a franchise can put ALL your assets at risk. Because of these risks it is critical that franchise sellers have disclosure requirements and liability if they provide improper information about the franchise they are selling.

9) ARGUMENTS IN OPPOSITION

None received.

10) DOUBLE-REFERRAL

This bill is double referred to the Committee on Judiciary.

11) PRIOR AND RELATED LEGISLATION

AB 676 (Holden, Chapter 728, Statutes of 2022) made modest changes to various provisions of the Franchise Investment Law and Franchise Relations Act, including a provision that deems void and unenforceable any provision of a franchise agreement that disclaims or denies representations made by the franchisor or its personnel or agents to a prospective franchisee, reliance by the prospective franchisee on any representations made by the franchisor or its personnel or agents, reliance by the prospective franchisee on any representation in the franchise disclosure document including any accompanying exhibits, or violation of any provision of the FIL.

LIST OF REGISTERED SUPPORT/OPPOSITION

Support

American Association of Franchisees & Dealers (co-sponsor)
 Coalition of Franchisee Associations (co-sponsor)
 International Franchise Association (co-sponsor)
 Alta Mere Auto Care
 Beauty Bungalows
 Bishops Cut and Color
 Brain Balance
 Bright STAR
 Camp[Bow Wow
 Capriotti's
 Certapro Painters
 Church's Texas Chicken
 City Wide Facility Solutions
 College H.u.n.k.s Hauling Junk
 Dr. Nick Transmissions
 Drybar
 Eatgatherlove
 Elements Massage
 Elmer's Restaurants, Inc,
 Fastsigns

Firstservice Brands/california Closets
Fitness Together
Floor Covering International
Frenchie's Modern Nails
Gojoe Patrol, INC.
Great Clips
Gymguyz
Home Helpers Home Care
Ikids U Franchise, LLC
Instant Imprints
Inxpress
Milex Complete Auto Care
Mr. Transmission
Msa Worldwide
Multistate Transmission
Wise Coatings Franchises

Opposition

None received

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