

Duff on Hospitality Law

Washington State Franchise Law Catching Up

Margaret Breen on 8.15.11 | Posted in Update

The Securities Division of the Washington State Department of Financial Institutions has just released a draft bill it is sending to the Legislature next January. The bill would make state franchise law more consistent with the modernized Federal Trade Commission (FTC) Rule governing the offer and sale of franchises.

Since 1970, the FTC Rule on Franchising has required franchisors to prepare and deliver to prospective franchisees an Offering Circular containing information about the management and financial condition of the franchisor, its history of operating franchises, and terms of the underlying contracts, before accepting either a binding contract or any money. The Rule was substantially revised and effective in 2007-2008. Document delivery requirements, which were timed in the sometimes-ambiguous “business days,” are now simplified so that a franchisor must deliver the Franchise Disclosure Document (formerly, the “Offering Circular”) 14 calendar days before the prospective franchisee is committed either by contract or payment. See [16 CFR § 436.2](#). The Rule also says that, if the franchisor changes any material term of the franchise agreement, the prospective franchisee must have at least 7 calendar days to review the changes before signing or making payment.

The FTC does not review Franchise Disclosure Documents for compliance with the Rule, and it does not give an individual franchisee the right to sue a franchisor for violations. It leaves only the Department of Justice to pursue civil or criminal penalties for violation.

The Washington Securities Division has generally followed the federal Rule, but has taken it steps further to protect Washington franchisees. The [Washington Franchise Investment Protection Act, RCW 19.100](#) and regulations under it have used the federal definitions, but have added a registration requirement. Before a franchisor may make any offer of a franchise (i) to a Washington resident, (ii) for a franchised business to be located wholly or partly in Washington, or (iii) offer and receive acceptance of the contract in Washington, it must first file the draft Franchise Disclosure Document with the Securities Division of the Department of Financial Institutions for merit review. The Division may request changes to make sure that the FDD complies with federal law and contains fairness provisions specific to Washington that protect franchisees (for example, a Washington franchisee must have the right to bring an action against the franchisor in Washington, and has the right to a minimum prior notice of termination of the agreement). The Securities Division will also examine the franchisor’s audited financial

statements for financial stability, and may ask for an impound, surety bond, or deferral of initial fees if needed to ensure that a franchisor can actually do all it has promised to get a franchised business up and running before taking initial franchise fees.

The proposed revisions make Washington law more consistent with the new federal Rule. Definitions are made the same; a “prospective franchisee” has the same meaning as in the federal regulation, and the disclosure is now a “disclosure document” rather than an “offering circular.” The law has always said that the Director of the Department of Financial Institutions shall be guided in making rules for disclosure by the guidelines adopted by the North American Securities Administrators Association; it now specifically adds the Federal Trade Commission as a source of guidance. This suggests that the Washington state lawmakers and administrators may intend to have Washington courts consider legal developments in other states in interpreting and applying our law, and brings Washington closer to a more uniform interpretation of the laws.

The process of registration has always been paper-intensive, and three states that impose registration requirements now accept or require documentation to be submitted on CDs; California has used these to make an extremely useful public database available. Language in the bill expanding the definitions of “filing” a “Record” to include retrievable electronic formation suggests that Washington is on its way to implementing a similar system.

Finally, the Act revises the timing for requesting a hearing from fifteen to twenty calendar days to be consistent with the requirements set forth in [Washington's Administrative Procedure Act, RCW 34.05.413](#). If you would like more information about these proposed changes, or have questions about franchising generally, [please contact us](#).

Tags: franchise, FTC, Legal, Washington Administrative Code