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California State Assembly to Vote on New Franchise Legislation

August 4, 2014

The California Assembly is scheduled to vote today on the California Senate Bill 610 (Small Business Investment & Protection Act). The International Franchise Association (IFA) has issued an alert and call to action by its members. While the bill addresses many relationship issues, three are of particular importance:

1. The bill would change the standard for termination of a franchise agreement in California. Currently a franchisor may terminate a franchise agreement only for good cause (good cause being defined as including the failure of the franchisee to comply with any lawful requirement of a franchisee agreement after being given notice and an opportunity to cure). The Bill would only allow a franchisor to terminate a franchise agreement if there is a "substantial and material breach on the part of the franchisee of a lawful requirement of the franchise agreement." In essence, the standard would change from one based on objective criteria to one based on subjective criteria. This new standard is not found in any other state regulation or in case law.
2. The bill prohibits a requirement that a franchisee waive the implied covenant of good faith and fair dealing as a condition of the franchise agreement. As this is not a practice that exists, it is questionable as to why California finds a need to legislate it. Moreover, there is dispute as to whether the prohibition is limited to franchise agreements.
3. The bill would allow franchisee transfers to "qualified persons" and offers no definition or conditions regarding who is a qualified person. Specifically, the Bill prohibits a provision in the franchise agreement that prevents a franchisee from selling or transferring a franchise or part of the interest of a franchise to another person, "provided the person is qualified." A franchisee shall not, however, have the right to sell, transfer, or assign the franchise, or a right thereunder, without the consent of the franchisor except that the consent shall not be unreasonably withheld. The Bill states that whether the withholding of consent is unreasonable is a question of fact. Further, a proposed sale, assignment, or transfer shall be deemed approved, unless disapproved by the franchisor in the manner provided by the statute.

IFA has requested the following actions be taken: (1) encourage franchisees to work to defeat the bill; (2) submit letters from franchisors operating in California or considering operating in California that suggest that the franchisor will re-examine operations in California if the bill is passed; and (3) send representatives to

California on August 4 to help lobby against the bill. More information regarding IFA's requested actions can be found here.