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# California Amends its Franchise Relationship Law. What You Need to Know.

On October 11, 2015, California's Governor signed into law a bill amending the California Franchise Relationship Act ("CFRA"). Here is what you need to know about the amendments.

**1) The amendment applies only to agreements executed or renewed on or after January 1, 2016**, unless the franchise is of indefinite duration and can be terminated by either party without cause.

**2) The amendment is designed to provide franchisees greater protection against termination.**

The amendment impacts the franchisor's ability to terminate in two important ways. First, with certain exceptions discussed below, it increases the required cure period from 30 days to at least 60 days (but no more than 75 days unless the parties separately agree to a longer cure period). It also introduces a new 60-day notice of termination requirement. While the cure and notice of termination periods could presumably run simultaneously, that would appear to be the case only if the franchisor issues a combined notice of default and termination. Since the cure period and notice of termination period are separate obligations, if the franchisor only issues a notice of default, the franchisor may find itself having to issue a separate notice of termination at the end of the cure period, and termination would not be effective for another 60 days. To avoid unintended timing consequences, franchisors will want to carefully decide how these notices are structured.

Second, in defining what constitutes "good cause" for termination, the amendment imposes a new "substantial noncompliance" standard—similar to the franchise laws of several other States—designed to eliminate terminations for trivial violations of the franchise agreement. Courts will determine the differences between the previous standard, which allowed for termination if a franchisee failed to ***comply*** with ***any*** lawful requirement of the franchise agreement, and the amended standard, which only allows for termination if a franchisee fails to ***substantially comply*** with ***the*** lawful requirements imposed by the franchise agreement. We understand from our discussions with the principal author of the amendment that the intent behind the change was to distinguish between material breaches that under common law would warrant termination of the agreement, on the one hand, and lesser breaches that would simply give rise to a money damages claim, on the other hand. Although this insight may be useful conceptually, it remains unclear how courts will interpret and treat this change.

**3) The same exceptions to the requirement to provide opportunity to cure continue to apply with one notable clarification.**

Despite the new notice and cure requirements, franchisors may, provided their agreements allow them to do so, still terminate immediately with no opportunity to cure under circumstances such as bankruptcy, abandonment, mutual agreement, material misrepresentation, illegal activity, repeated non-compliance with the franchise agreement, and imminent danger to the public. However, the amendment now references violations of "health, safety, building, and labor laws or regulations" among the law violations that require a 10-day cure period. As a result, violation of health or safety codes, for example, will not be a basis for immediate termination unless the violation creates an imminent danger to the public.

**4) The amendment creates a new repurchase obligation.**

Under the amended CFRA, even where a franchise agreement is properly terminated or not renewed, the franchisor is obligated to purchase from the franchisee, at original price less depreciation, all ***inventory, supplies, equipment, fixtures, and furnishings*** that the franchisee purchased from the franchisor or an approved supplier.

There are a number of exceptions to this repurchase provision, however. The franchisor is not required to repurchase personalized items or items not reasonably required to run the business in compliance with the franchise agreement's terms, or any items for which the franchisee cannot deliver clear title and possession. The repurchase obligation also does not apply if: (a) the franchisee declined to renew; (b) the franchisor does not prevent the franchisee from retaining control of the principal place of the franchise business (which is an important exception given California's general prohibition against post-term non-competes); (c) the franchisor and franchisee agreed in writing to terminate or not renew; or (d) termination or nonrenewal was the result of the franchisor's market withdrawal. Because the CFRA allows the franchisor to offset against the purchase price any amounts owed by the franchisee to the franchisor, liquidated damage provisions may become increasingly important.

**5) The amendment restricts a franchisor's right to disapprove transfers.**

Typically, franchise agreements require the franchisor's prior approval of any proposed transfers of the business, the franchise agreement, or an interest in the franchisee. The amended CFRA makes it unlawful for a franchisor to prevent a sale to a purchaser who meets the franchisor's then-existing standards for franchisees. This change is of particular importance to those franchisors who factor the economic terms of the proposed transfer into their approval process. The CFRA now also creates a framework under which a selling franchisee must provide its franchisor with written notice of the proposed transfer, copies of all agreements related to the proposed sale, and all forms and financial disclosures that the franchisor typically requires of a new prospective franchisee. If the franchisor's standards are not readily available, it must provide them to franchisee within 15 days of after receipt of franchisee's notice of intent to transfer. The franchisor must, "as soon as practicable" after receiving the franchisee's notice, let the franchisee know of any additional information it requires, then issue its disapproval (with reasons) or approval within 60 days (or any shorter period provided in the franchise agreement), or it will be deemed to have approved the transfer.

**6) The amendment increases remedies available to franchisees.**

The remedies available to franchisees for violations of the CFRA were also expanded. In addition to any other damages, franchisees now may be awarded the fair market value of the franchised business and franchise assets in the event of a wrongful termination or nonrenewal.

While the changes in the new law are much more balanced than what was in the previous bill vetoed by Governor Brown, they do create a more restrictive landscape for many. Careful treading in California is in order.

For questions or more information regarding this Alert, please contact us.

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| **Contacts** | **Contact Information** |
|---|---|
| Amy Cheng | 312-243-1716 or amy.cheng@chengcohen.com |
| Fredric A. Cohen | 312-243-1717 or fredric.cohen@chengcohen.com |
| Michael R. Daigle | 312-957-8366 or michael.daigle@chengcohen.com |