



**House
Legislative
Analysis
Section**

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THIS CORRECTED COPY REPLACES THE COPY DATED 2-28-89

CLARIFY LIABILITY OF FRANCHISORS

House Bill 4030 as introduced
First Analysis (3-29-89)

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Sponsor: Rep. John Bennett

Committee: Corporations and Finance *Mich. State Law Library*

THE APPARENT PROBLEM:

Franchising in Michigan has seen significant growth since laws governing franchisors (corporate owners of franchise chains) were eased under Public Act 91 of 1984. The act amended the Franchise Investment Law to remove cumbersome filing procedures which many franchisors felt were ridiculously extensive and time-consuming. Many felt the rigorous filing requirements under the original act were doing more harm than good to the state — by scaring potential franchisors from entering business here. The act was amended to provide both a simple filing procedure for franchisors, as well as protection to franchisees (persons who buy individual franchises). Currently, a franchisor must provide to potential buyers complete disclosure information on the company ten days before a sale, and must submit an annual notice of intent to do business in the state to the attorney general, accompanied by a \$250 annual fee. The notice must include the name, address, and description of the franchise offerings of the franchisor. The act provides criminal penalties for franchisors convicted of serious violations of the act, and also has civil penalties (\$100 per day for each day past the deadline, up to \$10,000 maximum) for failure to meet the filing deadline. Failure to file, however, can also make a franchisor liable to a franchisee for rescission costs — that is, a franchisor could be required to buy back any franchises sold while in violation of the filing provision. Although few franchisors have had to buy back franchises simply because they failed to file on time, some believe the rescission penalty puts franchisors at great risk of financial loss for what may only be an unwitting clerical oversight. They feel the rescission obligation in such instances represents an overly harsh penalty, and therefore propose amending the act to specify franchisor liability only for costs related to the civil penalty for failing to file in a timely manner.

THE CONTENT OF THE BILL:

The bill would amend the Franchise Investment Law to specify that a person who offered or sold a franchise in violation of that portion of the act which requires the seller to notify the attorney general prior to the sale would be liable to the franchise purchaser only for damages caused due to non-compliance with this portion of the act.

MCL 445.1531

FISCAL IMPLICATIONS:

The bill would not affect state expenditures, according to the House Fiscal Agency. (2-23-89)

ARGUMENTS:

For:

The bill would ensure that a franchisor is not unfairly punished for failing to timely notify the attorney general of its intent to do business in the state. Penalizing violators

\$100 per day, up to a maximum of \$10,000, for each day beyond the filing deadline seems an adequate penalty for what is usually nothing more than a franchisor's clerical oversight. Requiring violators to also pay rescission costs, which in some instances could easily reach a half million dollars or more, seems extremely harsh. In fact, this provision could jeopardize the entire franchise industry in the state. If, for instance, the economy were to slip into a recession, which could put individual franchise owners into financial hardship, franchisees could place the burden of their hardship back onto the franchisor simply because the corporate owner failed to meet the state's filing requirement; a resulting "domino effect" could cripple the company on a state and national level. The current provision essentially provides franchisees an easy way out of a financial hardship which probably had nothing to do with the franchisor's failure to file on time. By removing the provision, the bill could encourage more companies to enter the state's franchise industry.

For:

Although most agree that "ignorance of the law is no excuse," apparently, many franchisors who wish to offer franchises in the state may not even be aware of their responsibility to file at all, not to mention on an annual basis. Because the filing deadline varies depending on the original date of a franchisor's entrance into the state, the attorney general leaves the burden to file on time up to each individual franchisor. In any case, removing franchisors' rescission liability for failure to notify does not in any way weaken the act's other stiff penalties in instances where intent to mislead a buyer actually occurs.

Response: Franchising is big business and involves large sums of money. Every other state, as well as the federal government, has laws regulating franchising to some degree. Having responsibility to notify the proper authorities of intent to franchise (or operate any business venture, for that matter) in a region should be assumed from the outset of a venture. Someone who claims ignorance of this requirement is either very stupid (and, therefore, should not even be doing business at this level) or intentionally trying to conceal something. The history of fraud within the franchise industry indicates the latter to be the case more often than not. The rescission penalty, although harsh, sends a message to all potential franchisors seeking to enter the state to make them think twice before offering even a legitimate franchise contract.

Against:

When Public Act 91 eliminated the lengthy filing procedures of the Franchise Investment Act, it tried to balance what was essentially pro-big business legislation with the need to protect the "small" business person (in this case, the

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"franchisee"). Recission penalties for failure to notify on a regular basis of intent to do business represent the balance of the equation. Although the act provides other remedies for criminal intent to violate the law, removing the recission penalty for failure to notify would serve the interests of big business in the long run, and would result in more attempts to fraudulently mislead. The recission penalty should be left in, if for no other reason than to deter the unscrupulous from setting up operations within the state.

Against:

The bill should require the attorney general to notify franchisors within a specified amount of time before their notification and license renewal deadline. (A substitute version of the bill, in fact, would require a 30-day advance notice by the attorney general.) This would seem to be an adequate remedy to the problem of franchisors inadvertently forgetting to annually notify in a timely manner.

Response: Such a measure would increase the administrative burden of the attorney general, and would have to be accompanied by increased license fees — which could defeat the original purpose of the bill.

POSITIONS:

The International Franchise Association supports the bill. (2-22-89)

Representatives of the following franchisors support the bill: (2-22-89)

NuVision, Inc.

Molly Maid, Inc.

Little Professor Book Centers, Inc. and

Little Caesar's Enterprises

The Department of the Attorney General has no position on the bill. (2-23-89)