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BILL ANALYSIS

Senate Fiscal Agency

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House Bill 4030 (as reported without amendment)

Sponsor: Representative John Bennett

House Committee: Corporations and Finance

Senate Committee: Commerce and Technology

Date Completed: 3-15-89

RATIONALE

Franchising in Michigan apparently has increased considerably since laws governing franchisors were changed by Public Act 91 of 1984. The Act amended the Franchise Investment Law to remove filing procedures that many franchisors considered extensive, cumbersome, and time-consuming. Many felt that the rigorous filing requirements under the original law were doing more harm than good to the State--by scaring potential franchisors from entering business here. The Act was amended to provide a simple filing procedure for franchisors and protection to franchisees (persons who buy individual franchises). Currently, a franchisor must provide to potential buyers complete disclosure information on the company 10 days before a sale, and must submit to the Attorney General an annual notice of intent to do business in the State, accompanied by a \$250 annual fee. The notice must include the name, address, an description of the franchise offerings of the franchisor. The Act provides criminal penalties for franchisors convicted of serious violations of the Act, and specifies civil penalties (\$100 per day for each day past the deadline, up to a \$10,000 maximum) for failure to meet the filing deadline. Failure to file, however, also can make a franchisor liable to a franchisee for rescission costs--that is, a franchisor can 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 that rescission obligations in such instances represent 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.

CONTENT

The bill would amend the Franchise Investment Law to specify that a person who offered or sold a franchise in violation of the Act's requirement that the seller annually file a notice with the Attorney General stating the seller's name and business name and address, would be liable to the franchise purchaser only for damages caused due to noncompliance with the notification provision.

MCL 445.1531

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

ARGUMENTS**Supporting Argument**

The bill would ensure that a franchisor was not unfairly punished for failing to notify the Attorney General in a timely manner of his or her intent to do business in the State.

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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 also to pay rescission costs, which in some instances can easily reach \$500,000 or more, is 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 franchisors into financial hardship, they could place the burden of their hardship on 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 that 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.

Supporting Argument

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 would not in any way weaken the Act's other stiff penalties in instances in which intent to mislead a franchise 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 in a region (or operate any business venture, for that matter) should be assumed from the outset of a venture. Someone who claims ignorance of this requirement either is not paying attention to standard business practices or the laws that govern business operation or is 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, serves as a warning to all potential franchisors seeking to enter the State that they must conduct their businesses honestly and legally.

Opposing Argument

When Public Act 91 of 1984 eliminated the lengthy filing procedures of the Franchise Investment Act, it tried to balance what was essentially big business legislation with the need to protect the "small" business person (in this case, the franchisee). Rescission penalties for failure to file annual notification 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 rescission penalty for failure to notify would serve the interests of big business in the long run, and would result in more attempts fraudulently to mislead franchisees. The rescission penalty should be left in, if for no other purpose than to deter the unscrupulous franchisor from setting up operations within the State.

Opposing Argument

The bill should require the Attorney General to notify franchisors within a specified amount of time before their notification and license renewal deadline. This would seem to be an adequate remedy to the problem of franchisors' forgetting to file 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.

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