

105TH CONGRESS  
2D SESSION

# H. R. 4841

To establish minimum standards of fair conduct in franchise sales and franchise business relationships, and for other purposes.

---

## IN THE HOUSE OF REPRESENTATIVES

OCTOBER 14, 1998

Mr. COBLE (for himself, Mr. CONYERS, Mr. NORWOOD, Mr. TAYLOR of North Carolina, Mr. NADLER, Mr. COBURN, Mr. ACKERMAN, Mr. DICKEY, Mr. KING, Mr. JENKINS, and Mr. HILLEARY) introduced the following bill; which was referred to the Committee on the Judiciary

---

## A BILL

To establish minimum standards of fair conduct in franchise sales and franchise business relationships, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

4 (a) SHORT TITLE.—This Act may be cited as the  
5 “Small Business Franchise Act of 1998”.

6 (b) TABLE OF CONTENTS.—The table of contents of  
7 this Act is the following:

- Sec. 1. Short title; table of contents.
  - Sec. 2. Findings and purpose.
  - Sec. 3. Franchise sales practices.
-

Sec. 4. Unfair franchise practices.  
 Sec. 5. Standards of conduct.  
 Sec. 6. Procedural fairness.  
 Sec. 7. Actions by State attorneys general.  
 Sec. 8. Transfer of a franchise.  
 Sec. 9. Transfer of franchise by franchisor.  
 Sec. 10. Independent sourcing of goods and services.  
 Sec. 11. Encroachment.  
 Sec. 12. Private right of action.  
 Sec. 13. Scope and applicability.  
 Sec. 14. Definitions.

1 **SEC. 2. FINDINGS AND PURPOSE.**

2 (a) FINDINGS.—The Congress makes the following  
 3 findings:

4 (1) Franchise businesses represent a large and  
 5 growing segment of the nation’s retail and service  
 6 businesses and are rapidly replacing more traditional  
 7 forms of small business ownership in the American  
 8 economy.

9 (2) Franchise businesses involve a joint enter-  
 10 prise between the franchisor and franchisees in  
 11 which each party has a vested interest in the fran-  
 12 chised business.

13 (3) Most prospective franchisees lack bargain-  
 14 ing power and generally invest substantial amounts  
 15 to obtain a franchise business when they are unfa-  
 16 miliar with operating a business, with the business  
 17 being franchised and with industry practices in fran-  
 18 chising.

19 (4) Many franchises reflect a profound imbal-  
 20 ance of contractual power in favor of the franchisor,

1       and fail to give due regard to the legitimate business  
2       interests of the franchisee, as a result of the  
3       franchisor reserving pervasive contractual rights over  
4       the franchise relationship.

5           (5) Franchisees may suffer substantial financial  
6       losses when the franchisor does not provide truthful  
7       or complete information regarding the franchise op-  
8       portunity, or where the franchisor does not act in  
9       good faith in the performance of the franchise agree-  
10      ment.

11          (6) Traditional common law doctrines have not  
12      evolved sufficiently to protect franchisees adequately  
13      from fraudulent or unfair practices in the sale and  
14      operation of franchise businesses, and significant  
15      contractual and procedural restrictions have denied  
16      franchisees adequate legal recourse to protect their  
17      interests in such businesses.

18          (7) A franchisee's freedom to contract is greatly  
19      limited by the disparity of bargaining power, lack of  
20      consistent legal standards, and other factors de-  
21      scribed above. This Act is necessary to restore free-  
22      dom to contract, and to remove restrictive barriers  
23      impeding entry into industries and markets domi-  
24      nated by franchise systems.

1       (b) PURPOSE.—It is the purpose of this Act to pro-  
2 mote fair and equitable franchise agreements, to establish  
3 uniform standards of conduct in franchise relationships  
4 and to create uniform private Federal remedies for viola-  
5 tions of Federal law.

6 **SEC. 3. FRANCHISE SALES PRACTICES.**

7       (a) IN GENERAL.—In connection with the advertis-  
8 ing, offering, sale or promotion of any franchise, it shall  
9 be unlawful for any person—

10           (1) to employ a device, scheme, or artifice to  
11 defraud;

12           (2) to engage in an act, practice, course of busi-  
13 ness or pattern of conduct which operates or is in-  
14 tended to operate as a fraud upon any prospective  
15 franchisee;

16           (3) to obtain property, or assist others to obtain  
17 property, by making an untrue statement of a mate-  
18 rial fact or any failure to state a material fact;

19           (4) to discriminate among prospective  
20 franchisees on the basis of race, color, sexual ori-  
21 entation, sex, religion, disability, national origin, or  
22 age—

23               (A) in the solicitation, offering or sale of  
24 any franchise opportunity; or

1 (B) in the selection of any site or location  
2 for a franchise business.

3 (b) MISREPRESENTATIONS IN REQUIRED DISCLO-  
4 SURE.—

5 (1) In connection with any disclosure document,  
6 notice, or report required by any law, it shall be un-  
7 lawful for any franchisor, subfranchisor, or franchise  
8 broker, either directly or indirectly through another  
9 person—

10 (A) to—

11 (i) make an untrue statement of ma-  
12 terial fact;

13 (ii) fail to state a material fact; or

14 (iii) fail to state any fact which would  
15 render any required statement or disclo-  
16 sure either untrue or misleading;

17 (B) to fail to furnish any prospective  
18 franchisee with—

19 (i) all information required to be dis-  
20 closed by law and at the time and in the  
21 manner required; and

22 (ii) a written statement specifying,  
23 prominently and in not less than 14-point  
24 type, whether the franchise agreement in-

1                   volved contains a right to renew such  
2                   agreement; or

3                   (C) to make any claim or representation to  
4                   a prospective franchisee whether orally or in  
5                   writing, which is inconsistent with or con-  
6                   tradicts such disclosure document.

7                   (2) For purposes of this subsection, the term  
8                   “disclosure document” means either the disclosure  
9                   statement required by the Federal Trade Commis-  
10                  sion in Trade Regulation Rule 436 (16 C.F.R.  
11                  § 436) as amended from time to time, or any offer-  
12                  ing format allowed or required by State law.

13 **SEC. 4. UNFAIR FRANCHISE PRACTICES.**

14                  (a) **DECEPTIVE AND DISCRIMINATORY PRACTICES.**—  
15                  In connection with the performance, enforcement, renewal,  
16                  or termination of any franchise agreement, it shall be un-  
17                  lawful for a franchisor or subfranchisor, either directly or  
18                  indirectly through another person—

19                         (1) to engage in an act, practice, course of busi-  
20                         ness, or pattern of conduct which operates as a  
21                         fraud upon any person;

22                         (2) to discriminate among franchisees on the  
23                         basis of race, color, sexual orientation, sex, religion,  
24                         disability, national origin, or age;

1           (3) to hinder, prohibit, or penalize (or threaten  
2           to hinder, prohibit, or penalize), directly or indi-  
3           rectly, the free association of franchisees for any  
4           lawful purpose, including the formation of or partici-  
5           pation in any trade association made up of  
6           franchisees or of associations of franchises; or

7           (4) to discriminate against a franchisee by im-  
8           posing requirements not imposed on other similarly  
9           situated franchisees or otherwise retaliate, directly  
10          or indirectly, against any franchisee for membership  
11          or participation in a franchisee association.

12          (b) TERMINATION WITHOUT GOOD CAUSE.—

13               (1) It shall be unlawful for a franchisor, either  
14               directly or indirectly through an affiliate or another  
15               person, to terminate a franchise agreement prior to  
16               its expiration without good cause for such termi-  
17               nation.

18               (2) For purposes of this subsection, good cause  
19               shall exist only where—

20                       (A)(i) the franchisee fails to comply with a  
21                       material provision of the franchise agreement  
22                       after receiving notice that specifies the precise  
23                       basis for the default, each material term of the  
24                       franchise agreement with which the franchise is

1 not in compliance, and a 30-day period to cure  
2 the default; and

3 (ii) if the nature of the default is such that  
4 it cannot be cured through reasonably diligent  
5 conduct, the franchisee fails to initiate within  
6 30 days, and diligently pursue substantial con-  
7 tinuing action to cure the default;

8 (B) the franchisee, without the require-  
9 ment of notice and opportunity to cure—

10 (i) voluntarily abandons the business  
11 licensed by the franchise agreement, except  
12 that loss or termination of a leasehold for  
13 the business prior to the term of a fran-  
14 chise agreement by reason of eminent do-  
15 main, foreclosure sale, natural disaster or  
16 other termination not the fault of the  
17 franchisee shall not be considered abandon-  
18 ment by the franchisee;

19 (ii) is convicted of a felony, for which  
20 imprisonment of 1 year or more can be im-  
21 posed, which substantially impairs the  
22 good will associated with the franchisor's  
23 trade mark, service mark, trade name, log-  
24 otype, advertising, or other commercial  
25 symbol;



1 (iii) is repeatedly in default of the  
2 same material provision of the franchise  
3 agreement, where the enforcement of such  
4 provision is substantially similar to en-  
5 forcement of that provision with other  
6 franchisees; or

7 (iv) operates the business licensed by  
8 the franchise agreement in a manner that  
9 creates an imminent danger to public  
10 health or safety; or

11 (C) the franchisor withdraws from the  
12 marketing area of the business licensed by the  
13 franchise agreement and pays the franchisee  
14 reasonable compensation for damages incurred  
15 from the shortened term of the agreement and  
16 agrees in writing not to enforce any contractual  
17 prohibition against the franchisee continuing to  
18 engage in the business at the franchised loca-  
19 tion.

20 (c) POST-TERM RESTRICTIONS ON COMPETITION.—

21 (1) A franchisor shall not prohibit, or enforce  
22 a prohibition against, any franchisee from engaging  
23 in any business at any location after expiration of a  
24 franchise agreement.

1           (2) Nothing in this subsection shall be inter-  
2        preted to prohibit enforcement of any provision of a  
3        franchise contract obligating a franchisee after expi-  
4        ration or termination of a franchise—

5           (A) to cease or refrain from using a trade-  
6        mark, trade secret, or other intellectual prop-  
7        erty owned by the franchisor or its affiliate, ex-  
8        cept that the existence of language in the fran-  
9        chise agreement purporting to determine owner-  
10       ship of a trademark, trade secret, or other in-  
11       tellectual property shall not be binding upon  
12       any court or forum for purposes of this para-  
13       graph, but may be considered by such court or  
14       forum as evidence of such ownership;

15          (B) to alter the appearance of the business  
16        premises so that it is not substantially similar  
17        to the standard design, decor criteria, or motif  
18        in use by other franchisees using the same  
19        name or trademarks within the proximate trade  
20        or market area of the business; or

21          (C) to modify the manner or mode of busi-  
22        ness operations so as to avoid any substantial  
23        confusion with the manner or mode of oper-  
24        ations which are unique to the franchisor and  
25        commonly in practice by other franchisees using

1 the same name or trademarks within the proxi-  
2 mate trade or market area of the business.

3 **SEC. 5. STANDARDS OF CONDUCT.**

4 (a) DUTY OF GOOD FAITH.—

5 (1) A franchise contract imposes on each party  
6 thereto a duty to act in good faith in its perform-  
7 ance and enforcement.

8 (2) As used in this subsection, a duty of good  
9 faith shall—

10 (A) obligate a party to a franchise to do  
11 nothing that will have the effect of destroying  
12 or injuring the right of the other party to ob-  
13 tain and receive the expected fruits of the con-  
14 tract and to do everything required under the  
15 contract to accomplish such purpose; and

16 (B) require honesty of fact and observance  
17 of reasonable standards of fair dealing in the  
18 trade.

19 (3) No provision of any franchise agreement,  
20 express or implied, shall be interpreted or enforced  
21 in such a way as to obfuscate a party's duty to act  
22 reasonably and in good faith with the other, or oth-  
23 erwise allow a disparate result in the franchise rela-  
24 tionship.

25 (b) DUTY OF DUE CARE.—

1           (1) A franchise agreement imposes on the  
2           franchisor a duty of due care. Unless a franchisor  
3           represents that it has greater skill or knowledge in  
4           its undertaking with its franchisees, or conspicuously  
5           disclaims that it has skill or knowledge, the  
6           franchisor is required to exercise the skill and knowl-  
7           edge normally possessed by franchisors in good  
8           standing in the same or similar types of business.

9           (2) For purposes of this subsection—

10           (A) the term “skill or knowledge” means  
11           something more than the mere minimum level  
12           of skill or knowledge required of any person en-  
13           gaging in a service or business and involves a  
14           special level of expertise—

15           (i) which is the result of acquired  
16           learning and aptitude developed by special  
17           training and experience in the business to  
18           be licensed under the franchise agreement,  
19           or the result of extensive use and experi-  
20           ence with the goods or services or the oper-  
21           ating system of such business;

22           (ii) which is the result of experience in  
23           organizing a franchise system and in pro-  
24           viding training, assistance and services to  
25           franchisees; and

1 (iii) which a prospective franchisee  
2 would expect in reasonable reliance on the  
3 written and oral commitments and rep-  
4 resentations of the franchisor; and

5 (B) a franchisor shall be permitted to show  
6 that it contracted for, hired or purchased the  
7 expertise necessary to comply with the require-  
8 ments of this subsection and that such expertise  
9 was incorporated in the franchise or commu-  
10 nicated or provided to the franchisee.

11 (3) The requirement of this subsection may not  
12 be waived by agreement or by conduct, but the  
13 franchisor may limit in writing the nature and scope  
14 of its skill and knowledge, and of its undertaking  
15 with a prospective franchisee, provided that no in-  
16 consistent representation, whether written or oral, is  
17 made to the prospective franchisee irrespective of  
18 any merger or integration clause in the franchise  
19 agreement.

20 (c) LIMITED FIDUCIARY DUTY.—

21 (1) Without regard to whether a fiduciary duty  
22 is imposed generally on the franchisor by virtue of  
23 a franchise agreement, the franchisor owes a fidu-  
24 ciary duty to its franchisees and is obligated to exer-

1 cise the highest standard of care for franchisee in-  
2 terests where the franchisor—

3 (A) undertakes to perform bookkeeping,  
4 collection, payroll, or accounting services on be-  
5 half of the franchisee; or

6 (B) administers, controls or supervises (ei-  
7 ther directly or through any subsidiary or affili-  
8 ate) any advertising, marketing, or promotional  
9 fund or program to which franchisees are re-  
10 quired to, or routinely, contribute.

11 (2) A franchisor that administers or supervises  
12 the administration of any fund or program described  
13 in paragraph (1)(B) shall—

14 (A) keep all moneys contributed to such  
15 fund or program in a separate account;

16 (B) provide an independent certified audit  
17 of such fund within 60 days following the close  
18 of the franchisor's fiscal year, which shall in-  
19 clude full disclosure of all fees, expenses, or  
20 other payments from the account to the  
21 franchisor or to any subsidiary, affiliate, or  
22 other entity controlled in whole or in part by  
23 the franchisor; and

24 (C) disclose the source and amount of, and  
25 deliver to such fund or program, any discount,

1           rebate, compensation, or payment of any kind  
2           from any person or entity with whom such fund  
3           or program transacts.

4           (3) While not limiting the ability of any court  
5           to identify other circumstances for which a fiduciary  
6           duty may also exist, this subsection does not create  
7           or extend a fiduciary duty by implication to other  
8           aspects of a franchise.

9   **SEC. 6. PROCEDURAL FAIRNESS.**

10          (a) It shall be unlawful for any franchisor, either di-  
11          rectly or indirectly through another person, to—

12               (1) require any term or condition in a franchise  
13               agreement, or in any agreement ancillary or collat-  
14               eral to a franchise, which directly or indirectly vio-  
15               lates any provision of this Act; or

16               (2) require a franchisee to assent to any dis-  
17               claimer, waiver, release, stipulation or other provi-  
18               sion which would purport—

19                       (A) to relieve any person from a duty im-  
20                       posed by this Act, except as part of a settle-  
21                       ment of a bona fide dispute; or

22                       (B) to protect any person against any li-  
23                       ability to which he would otherwise be subject  
24                       under this Act by reason of willful misfeasance,  
25                       bad faith, or gross negligence in the perform-

1           ance of duties, or by reason of reckless dis-  
2           regard of obligations and duties under the fran-  
3           chise agreement; or

4           (3) require a franchisee to assent to any waiver,  
5           release, stipulation, or other provision, either as part  
6           of any agreement or document relating to the oper-  
7           ation of a franchise business, in any agreement or  
8           document relating to the termination, cancellation,  
9           forfeiture, repurchase, or resale of a franchise busi-  
10          ness or as a condition for permitting a franchisee to  
11          leave the franchise system, which would purport to  
12          prevent the franchisee from making any oral or writ-  
13          ten statement relating to the franchise business, to  
14          the operation of the franchise system or to the  
15          franchisee's experience with the franchise business.

16          (b) Any condition, stipulation, provision, or term of  
17          any franchise agreement, or any agreement ancillary or  
18          collateral to a franchise, which would purport to waive or  
19          restrict any right granted under this Act shall be void and  
20          unenforceable.

21          (c) No stipulation or provision of a franchise agree-  
22          ment, or of an agreement ancillary or collateral to a fran-  
23          chise, shall—

24                  (1) deprive a franchisee of the application and  
25          benefits of this Act, of any other Federal law, or of



1 the law of the State in which the franchisee's prin-  
 2 cipal place of business is located;

3 (2) deprive a franchisee of the right to com-  
 4 mence an action (or, if the franchise provides for ar-  
 5 bitration, initiate an arbitration) against the  
 6 franchisor for violation of this Act, or for breach of  
 7 the franchise agreement, or of any agreement or  
 8 stipulation ancillary or collateral to the franchise, in  
 9 a court (or arbitration forum) in the State of the  
 10 franchisee's principal place of business; or

11 (3) prevent a franchisee from participating as a  
 12 member of a class permitted by Rule 23 of the Fed-  
 13 eral Rules of Civil Procedure or applicable State law.

14 (d) Compliance with this Act or with an applicable  
 15 State franchise law is not waived, excused, or avoided, and  
 16 evidence of violation of this Act or of such State law shall  
 17 not be excluded, by virtue of an integration clause, any  
 18 provision of a franchise agreement, or an agreement ancil-  
 19 lary or collateral to a franchise, the parol evidence rule,  
 20 or any other rule of evidence purporting to exclude consid-  
 21 eration of matters outside the franchise agreement.

22 **SEC. 7. ACTIONS BY STATE ATTORNEYS GENERAL.**

23 (a) CIVIL ACTION.—Whenever an attorney general of  
 24 any State has reason to believe that the interests of the  
 25 residents of that State have been or are being threatened

1 or adversely affected because any person has engaged or  
2 is engaging in a pattern or practice which violates any pro-  
3 vision of this Act, the State, as *parens patriae*, may bring  
4 a civil action on behalf of its residents in an appropriate  
5 district court of the United States to enjoin such viola-  
6 tions, to obtain damages, restitution or other compensa-  
7 tion on behalf of residents of such State or to obtain such  
8 further and other relief as the court may deem appro-  
9 priate.

10 (b) PRESERVATION OF POWER.—For purposes of  
11 bringing any civil action under subsection (a), nothing in  
12 this Act shall prevent an attorney general from exercising  
13 the powers conferred on the attorney general by the laws  
14 of such State to conduct investigations or to administer  
15 oaths or affirmations or to compel the attendance of wit-  
16 nesses or the production of documentary and other evi-  
17 dence.

18 (c) VENUE.—Any civil action brought under sub-  
19 section (a) in a district court of the United States may  
20 be brought in the district in which the defendant is found,  
21 is an inhabitant, or transacts business or wherever venue  
22 is proper under section 1391 of title 28, United States  
23 Code. Process in such action may be served in any district  
24 in which the defendant is an inhabitant or in which the  
25 defendant may be found.

1 (d) NO PREEMPTION.—Nothing contained in this  
2 section shall prohibit an authorized State official from pro-  
3 ceeding in State court on the basis of an alleged violation  
4 of any civil or criminal statute of such State.

5 **SEC. 8. TRANSFER OF A FRANCHISE.**

6 (a) IN GENERAL.—A franchisee may assign an inter-  
7 est in a franchised business or in a franchise to a trans-  
8 feree provided the transferee satisfies the reasonable quali-  
9 fications then generally applied by the franchisor in deter-  
10 mining whether or not a current franchisee is eligible for  
11 renewal. If the franchisor does not renew a significant  
12 number of its franchisees, then the transferee may be re-  
13 quired to satisfy the reasonable conditions generally ap-  
14 plied to new franchisees. For the purpose of this section,  
15 a reasonable current qualification for a new franchisee is  
16 a qualification based upon a legitimate business reason.  
17 If the proposed transferee does not meet the reasonable  
18 current qualifications of the franchisor, the franchisor  
19 may refuse to permit the transfer, provided that the re-  
20 fusals of the franchisor to consent to the transfer is not  
21 arbitrary or capricious and the franchisor states the  
22 grounds for its refusal in writing to the franchisee.

23 (b) NOTICE OF PROPOSED TRANSFER.—A franchisee  
24 shall give a franchisor not less than 30 days written notice  
25 of a proposed transfer of a transferable interest, and on

1 request shall provide in writing the ownership interests of  
2 all persons holding or claiming an equitable or beneficial  
3 interest in the franchise subsequent to the transfer or the  
4 franchisee, as appropriate.

5 (c) CONSENT TO PROPOSED TRANSFER.—A transfer  
6 by a franchisee is deemed to have been approved 30 days  
7 after the franchisee submits the request for permission to  
8 transfer the franchise involved unless, within that time the  
9 franchisor refuses to consent to the transfer as evidenced  
10 in writing in accordance with subsection (a). A statement  
11 of the grounds for refusal to consent to the transfer is  
12 privileged against a claim of defamation.

13 (d) CONDITIONS OF TRANSFER.—

14 (1) PERMISSIBLE CONDITIONS.—A franchisor  
15 may require as a condition of a transfer that—

16 (A) the transferee successfully complete a  
17 reasonable training program;

18 (B) a reasonable transfer fee be paid to re-  
19 imburse the franchisor for the franchisor's rea-  
20 sonable and actual expenses directly attrib-  
21 utable to the transfer;

22 (C) the franchisee pay or make reasonable  
23 provision to pay any amount due the franchisor  
24 or the franchisor's affiliate; or

1 (D) the financial terms of the transfer at  
2 the time of the transfer, comply with the  
3 franchisor's current financial requirements for  
4 franchisees.

5 (2) IMPERMISSIBLE CONDITIONS.—A franchisor  
6 may not condition its consent to a transfer described  
7 in paragraph (1) on—

8 (A) a franchisee's forgoing existing rights  
9 other than those contained in the franchise  
10 agreement;

11 (B) a franchisee's entering into a release  
12 of claims broader in scope than a counterpart  
13 release of claims offered by the franchisor to  
14 the franchisee; or

15 (C) requiring the franchisee or transferee  
16 to make, or agree to make, capital improve-  
17 ments, reinvestments, or purchases in an  
18 amount greater than the franchisor could have  
19 reasonably required under the terms of the  
20 franchisee's existing franchise agreement.

21 (e) ASSIGNMENT.—A franchisee may assign the  
22 franchisee's interest in the franchise for the unexpired  
23 term of the franchise agreement, and a franchisor shall  
24 not require the franchisee or the transferee to enter into

1 a franchise agreement that has different material terms  
2 or financial requirements as a condition of the transfer.

3 (f) CONSENT TO PUBLIC OFFERING.—A franchisor  
4 may not withhold its consent to a franchisee’s making a  
5 public offering of its securities without good cause if the  
6 franchisee, or the owner of the franchisee’s interest in the  
7 franchise, retains control over more than 25 percent of  
8 the voting power as the franchisee.

9 (g) CONSENT TO POOLING INTERESTS, OR TO SALE  
10 OR EXCHANGE.—A franchisor may not withhold its con-  
11 sent to a pooling of interests, to a sale or exchange of  
12 assets or securities, or to any other business consolidation  
13 amongst its existing franchisees, provided the constituents  
14 are each in material compliance with their respective obli-  
15 gations to the franchisor.

16 (h) NONINTERFERENCE.—The following occurrences  
17 shall not be considered transfers requiring the consent of  
18 the franchisor under a franchise agreement, and a  
19 franchisor shall not impose any fees, payments, or charges  
20 in excess of a franchisor’s cost to review the relevant mat-  
21 ter:

22 (1) The succession of ownership or management  
23 of a franchise upon the death or disability of a  
24 franchisee, or of an owner of a franchise, to the sur-  
25 viving spouse, heir, or partner active in the manage-

1       ment of the franchise unless the successor objec-  
2       tively fails to meet within 1 year or the then current  
3       reasonable qualifications of the franchisor for  
4       franchisees.

5           (2) Incorporation of a proprietorship franchisee,  
6       provided that the franchisor may require a personal  
7       guarantee by the franchisee of obligations related to  
8       the franchise.

9           (3) A transfer within an existing ownership  
10      group of a franchise provided that more than 50  
11      percent of the franchise is held by persons who meet  
12      the franchisor's reasonable current qualifications for  
13      franchisees. If less than 50 percent of the franchise  
14      would be owned by persons who objectively meet the  
15      franchisor's reasonable current qualifications, the  
16      franchisor may refuse to authorize the transfer.

17          (4) A transfer of less than a controlling interest  
18      in the franchise to the franchisee's spouse or child  
19      or children, provided that more than 50 percent of  
20      the entire franchise is held by those who meet the  
21      franchisor's reasonable current qualifications. If less  
22      than 50 percent of the franchise would be owned by  
23      persons who objectively meet the franchisor's reason-  
24      able current qualifications, the franchisor may refuse  
25      to authorize the transfer.

1           (5) A grant or retention of a security interest  
2           in the franchised business or its assets, or an owner-  
3           ship interest in the franchisee, if the security agree-  
4           ment establishes an obligation on the part of the se-  
5           cured party enforceable by the franchisor to give the  
6           franchisor simultaneously with notice to the  
7           franchisee, notice of the secured party's intent to  
8           foreclose on the collateral, and a reasonable oppor-  
9           tunity to redeem the interest of the secured party  
10          and recover the secured party's interest in the fran-  
11          chise or franchised business by satisfying the se-  
12          cured obligation.

13          (6) A franchisor may not exercise any pur-  
14          ported right of first refusal or right to purchase with  
15          regard to any franchise, or interest or assets of a  
16          franchisee, upon the happening of any event de-  
17          scribed in paragraphs (1) through (5).

18          (i) EFFECT OF CERTAIN COVENANTS.—

19               (1) IN GENERAL.—After the transfer of a  
20               transferor's complete interest in a franchise, a  
21               franchisor may not enforce against the transferor  
22               any covenant of the franchise purporting to prohibit  
23               the transferor from engaging in any lawful occupa-  
24               tion or enterprise.



1           (2) EXCEPTION.—This subsection shall not  
2       limit the franchisor from enforcing a contractual  
3       covenant against the transferor not to exploit the  
4       franchisor’s trade secrets or intellectual property  
5       rights (including protection of trade dress) except by  
6       agreement with the franchisor.

7   **SEC. 9. TRANSFER OF FRANCHISE BY FRANCHISOR.**

8       A franchisor shall not transfer, by sale or otherwise,  
9       its interest in a franchise unless—

10           (1) the franchisor provides, not less than 30  
11       days before the effective date of transfer, notice to  
12       every franchisee of the intent to transfer the  
13       franchisor’s interest in the franchise or of substan-  
14       tially all of the franchises held by the franchisor;

15           (2) such notice is accompanied by a complete  
16       description of the business and financial terms of  
17       the proposed transfer or transfers; and

18           (3) upon the transfer, the entity assuming the  
19       franchisor’s obligations has the business experience  
20       and financial means to perform all of the  
21       franchisor’s obligations in the ordinary course of  
22       business.

1 **SEC. 10. INDEPENDENT SOURCING OF GOODS AND SERV-**  
2 **ICES.**

3 (a) IN GENERAL.—Except as provided in subsection  
4 (e) a franchisor, either directly or indirectly through any  
5 affiliate, officer, employee, agent, representative or attor-  
6 ney, shall not prohibit or restrict a franchisee from obtain-  
7 ing equipment, fixtures, supplies, goods, or services used  
8 in the establishment or operation of the franchised busi-  
9 ness from sources of the franchisee’s choosing, except that  
10 such goods or services may be required to meet reasonable  
11 established uniform system-wide quality standards pro-  
12 mulgated or enforced by the franchisor.

13 (b) APPROVED VENDORS.—Without limiting the  
14 rights of the franchisee under subsection (a), if the  
15 franchisor approves vendors of equipment, fixtures, sup-  
16 plies, goods, or services used in the establishment or oper-  
17 ation of the franchised business, the franchisor shall pro-  
18 vide and continuously update an inclusive list of approved  
19 vendors and shall promptly and objectively evaluate and  
20 respond to reasonable requests by franchisees for approval  
21 of competitive sources of supply. The franchisor shall ap-  
22 prove not fewer than 2 vendors for each piece of equip-  
23 ment, each fixture, each supply, good, or service.

24 (c) BENEFITS.—A franchisor, and its affiliates, shall  
25 fully disclose whether or not it receives any rebates, com-  
26 missions, payments, or other benefits from vendors as a

1 result of the purchase of goods or services by franchisees.

2 All such rebates, commissions, payments, and other bene-

3 fits shall be distributed directly to such franchisees.

4 (d) REPORTING.—A franchisor shall report not less

5 frequently than annually, using generally accepted ac-

6 counting principles, the amount of revenue and profit it

7 earns from the sale of equipment, fixtures, supplies, goods,

8 or services to the franchisees of the franchisor.

9 (e) EXCEPTION.—Subsection (a) does not apply to

10 reasonable quantities of equipment, fixtures, supplies,

11 goods, or services, including display and sample items,

12 that the franchisor requires the franchisee to obtain from

13 the franchisor or its affiliate, but only if the equipment,

14 fixtures, supplies, goods, or services are central to the

15 franchised business and incorporate a trade secret, patent,

16 or copyright owned by the franchisor or its affiliate.

17 **SEC. 11. ENCROACHMENT.**

18 (a) IN GENERAL.—A franchisor may not place, or li-

19 cense another to place, 1 or more new outlets for a fran-

20 chised business in unreasonable proximity to an estab-

21 lished outlet of a similar kind of franchised business, if—

22 (1) the intent or probable effect of establishing

23 the new outlets is to cause a diminution of gross

24 sales by the established outlet of more than 5 per-

1 cent in the 12 months immediately following estab-  
2 lishment of the new outlet; and

3 (2) the established outlet—

4 (A) offers goods or services identified by  
5 the same trademark as those offered from the  
6 new outlet; or

7 (B) has premises that are identified by the  
8 same trademark as the new outlet.

9 (b) EXCEPTION.—This section shall not apply with  
10 respect to an established outlet if, before a new outlet de-  
11 scribed in subsection (a) opens for business, a franchisor  
12 offers in writing to each franchisee of the franchisor of  
13 an established outlet to pay to the franchisee involved an  
14 amount equal to 50 percent of the gross sales (net of sales  
15 taxes, returns, and allowances) of the new outlet for the  
16 1st 24 months of operation of the new outlet if the sales  
17 of the established outlet decline by more than 5 percent  
18 in the 12 months immediately following establishment of  
19 the new outlet as a consequence of the opening of the new  
20 outlet.

21 (c) BURDEN OF PROOF.—A franchisor shall have the  
22 burden of proof to show that, or the extent to which, a  
23 decline in sales of an established outlet described in sub-  
24 section (a) occurred for reasons other than the opening  
25 of the new outlet for goods or services concerned—

1           (1) if the franchisor makes a written offer  
2           under subsection (b); or

3           (2) in an action or proceeding brought under  
4           section 12.

5 **SEC. 12. PRIVATE RIGHT OF ACTION.**

6           (a) IN GENERAL.—A party to a franchise who is in-  
7           jured by a violation or threatened violation of this Act,  
8           or of section 438.1 of title 16, Code of Federal Regula-  
9           tions (relating to disclosure requirements and prohibitions  
10          concerning franchising and business opportunity ventures)  
11          as in effect on the date of the enactment of this Act, shall  
12          have a right of action for rescission and restitution, as well  
13          as for all damages and injunctive relief, including costs  
14          of litigation and reasonable attorney’s fees and expert wit-  
15          ness fees, against any person found to be liable for such  
16          violation.

17          (b) LIABILITY.—Every person who directly or indi-  
18          rectly controls a person liable under subsection (a), every  
19          partner in a firm so liable, every principal executive officer  
20          or director of a corporation so liable, every person occupy-  
21          ing a similar status or performing similar functions and  
22          every employee of a person so liable who materially aids  
23          in the act or transaction constituting the violation is also  
24          liable jointly and severally with and to the same extent  
25          as such person, unless the person who would otherwise be

1 liable hereunder had no knowledge of or reasonable  
2 grounds to know of the existence of the facts by reason  
3 of which the liability is alleged to exist.

4 (c) ALTERNATIVE DISPUTE RESOLUTION.—Except  
5 as otherwise provided in subsection (d), nothing contained  
6 in this Act shall be construed to limit the right of a  
7 franchisor and a franchisee to engage in arbitration, medi-  
8 ation, or other nonjudicial resolution of a dispute, either  
9 in advance of after a dispute arises, provided that the  
10 standards and protections applied in any binding non-  
11 judicial procedure agreed to by the parties are not less  
12 than the requirements set forth in this Act.

13 (d) STATUTE OF LIMITATIONS.—No action may be  
14 commenced pursuant to this section or this Act more  
15 than—

16 (1) 5 years after the date on which the violation  
17 occurs; or

18 (2) 3 years after the date on which the violation  
19 is discovered or should have been discovered through  
20 exercise of reasonable diligence.

21 (e) VENUE.—A franchisee may commence a civil ac-  
22 tion, or arbitration proceedings, to enforce any provision  
23 of this Act within the jurisdiction wherein the applicable  
24 franchise business is located.

1 (f) CUMULATIVE RIGHT.—The private rights pro-  
2 vided for in this section are in addition to and not in lieu  
3 of other rights or remedies created by Federal or State  
4 law.

5 **SEC. 13. SCOPE AND APPLICABILITY.**

6 (a) PROSPECTIVE APPLICATION.—Except as pro-  
7 vided in subsection (b), the requirements of this Act shall  
8 apply to franchise agreements entered into, amended, ex-  
9 changed, transferred, assigned, or renewed after the date  
10 of enactment of this Act.

11 (b) DELAYED EFFECT.—The requirements of section  
12 3 of this Act shall take effect 90 days after the date of  
13 enactment of this Act and shall apply only to actions,  
14 practices, disclosures, and statements occurring on or  
15 after such date.

16 **SEC. 14. DEFINITIONS.**

17 For purposes of this Act:

18 (1) The term “affiliate” has the meaning given  
19 the term “affiliated person” in section 436.2(i) of  
20 title 16 of the Code of Federal Regulations as in ef-  
21 fect on January 1, 1998.

22 (2) The term “franchise” has the meaning  
23 given such term in section 436.2(a) of title 16 of the  
24 Code of Federal Regulations as in effect on January  
25 1, 1998, but does not include any contract otherwise

1 regulated by the Federal Petroleum Marketing Prac-  
2 tices Act (15 U.S.C. 2801 et. seq.) except as to fran-  
3 chise relationships that do not involve the sale of pe-  
4 troleum products.

5 (3) The term “franchise broker” has the mean-  
6 ing given such term in section 436.2(j) of title 16  
7 of the Code of Federal Regulations as in effect on  
8 January 1, 1998.

9 (4) The term “franchisee” has the meaning  
10 given such term in section 436.2(d) of title 16 of the  
11 Code of Federal Regulations as in effect on January  
12 1, 1998.

13 (5) The term “franchisor” has the meaning  
14 given such term in section 436.2(c) of title 16 of the  
15 Code of Federal Regulations as in effect on January  
16 1, 1998.

17 (6) The term “good faith” means honesty in  
18 fact and the observance of reasonable standards of  
19 fair dealing in the trade.

20 (7) The terms “material” and “material fact”  
21 includes—

22 (A) any fact, circumstance, or set of condi-  
23 tions which a reasonable franchisee or a reason-  
24 able prospective franchisee would consider im-  
25 portant in making a significant decision relat-



1           ing to entering into, remaining in, or abandon-  
2           ing a franchise relationship; and

3           (B) any fact, circumstance, or set of condi-  
4           tions which has, or may have, any significant fi-  
5           nancial impact on a franchisor, franchisee or a  
6           prospective franchisee.

7           (8) The term “offer” or “offering” means any  
8           effort to offer or to dispose of, or solicitation of an  
9           offer to buy, a franchise or interest in a franchise  
10          for value.

11          (9) The term “outlet” means a point of sale,  
12          temporary or permanent, fixed or mobile, from  
13          which goods or services are offered for sale.

14          (10) The term “person” means an individual or  
15          any other legal or commercial entity.

16          (11) The term “State” means a State, the Dis-  
17          trict of Columbia, and any territory or possession of  
18          the United States.

19          (12) The term “subfranchise” means a contract  
20          or an agreement by which a person pays a  
21          franchisor for the right to sell, negotiate the sale, or  
22          provide service franchises.

23          (13) The term “subfranchisor” means a person  
24          who is granted a subfranchise.

1           (14) The term “trade secret” means informa-  
2           tion, including a formula, pattern, compilation, pro-  
3           gram, device, method, technique, or process, that—

4                   (A) derives independent economic value,  
5                   actual or potential, from not being generally  
6                   known to, and not being readily ascertainable  
7                   by proper means by, other persons who can ob-  
8                   tain economic value from its disclosure or use;  
9                   and

10                   (B) is the subject of efforts that are rea-  
11                   sonable under the circumstances to maintain its  
12                   secrecy.

○