



FRANCHISE LAW ALERT

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REPURCHASE REQUIREMENTS UNDER NEW AMENDMENTS TO CALIFORNIA FRANCHISE RELATIONS ACT

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On October 12, 2015, California Governor Jerry Brown signed Assembly Bill 525 into law, which makes significant amendments to the California Franchise Relations Act. The amendments to the Act, which take effect on January 1, 2016, will apply to any new franchise agreements entered into (or renewed) on or after January 1, 2016. The new amendments will also apply to any franchise agreements that have an indefinite duration which may be terminated by the franchisee or franchisor without cause.

The main changes to the Act address issues in connection with termination, nonrenewal, and transfer of franchises. Several of the changes are relatively straightforward and not inconsistent with franchise relationship laws in other states. For example, except as otherwise provided by the Act, amendments to Section 20020 of the Act would only permit franchisors to terminate a franchise for good cause, which would be limited to the failure of the franchisee to substantially comply with the lawful requirements of the franchise agreement after being given 60 days' notice (as opposed to 30 days as currently provided) in advance of such termination. Additionally, under the new Section 20028 of the Act, franchisors will be prohibited from restricting the sale or transfer of a franchise to another person provided that the transferee is qualified under the franchisor's then-existing standards for new or renewing franchisees.

The one portion of the new law that will arguably have the greatest effect on franchisor-franchisee relationships are the repurchase requirements of new Section 20022 and amended Section 20035. Prior to the enactment of these amendments, a franchisor could terminate a franchise or not renew a franchise without any requirement to repurchase the franchise's assets so long as such transfer or nonrenewal was done pursuant to the terms of the franchise agreement and the Act. Under the newly enacted Section 20022, upon a lawful termination or nonrenewal of a franchise, franchisors will be required to purchase from the franchisee, at the value of price paid (minus depreciation), all inventory supplies, equipment, fixtures, and furnishings purchased or paid for by the franchisee under the terms of the franchise agreement or any ancillary agreements. A franchisor would not be required to repurchase any personalized assets of the franchise, assets that the franchisee cannot grant clear title and possession, or in certain defined circumstances, including, when a franchisee declines a bona fide offer of renewal or if the franchisor and franchisee mutually agree in writing to terminate or not renew the franchise.

These amendments represent a significant departure from the current Section 20035 of the Act which only requires that a franchisor repurchase the franchisee's resalable current inventory upon a termination or failure to renew in violation of the Act. The new law would additionally amend Section 20035 to require franchisors that terminate or fail to renew a franchise in violation of the Act to pay the franchisee the fair market value of the franchised business and assets plus any other damages incurred by the franchisee. In both the new Section 20022 and amended Section 20035, a franchisor may offset against amounts owed to a franchisor under this section any amounts owed by the franchisee to the franchisor.

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With the recent changes to the Act, additional considerations should be taken by franchisors with California franchisees and franchisors considering offering franchises in California after January 1, 2016.

Under certain circumstances, a lawful and justifiable decision to terminate or not renew a franchise agreement will trigger a requirement for the franchisor to repurchase a franchise's assets—an obligation that did not exist prior to enactment of the amendments to the Act. In addition, a finding that a termination of a California franchise was not lawful would require the Franchisor to pay the franchisee the fair market value of the franchise business plus additional damages. As such, franchisors considering terminating a California franchise, or not renewing an expiring California franchise will need to evaluate (among other factors) and prepare for the expense in purchasing such assets from the franchisee and proceed cautiously with such decisions in light of the additional risks associated with terminations.

Because the law only applies to franchise agreements entered into or renewed after January 1, 2016, the real analysis will need to occur before a franchisor enters into a new or renewed California franchise agreement. The cost of terminating non-performing or non-compliant California franchises will increase after January 1, 2016 because, at a minimum, such a decision will require the purchase of business assets at their depreciated value. In certain industries, where the cost of required assets is significant (including those systems that require the purchase of vehicles, trailers, large equipment, etc.), the potential additional expense upon termination or non-renewal is significant.

A decision to terminate or not to renew that is found to be unlawful will require the payment of the fair market value of the franchise business. Some will argue that the damages for an unlawful termination are the value of the business but California, unlike other states, have made this calculation of damages part of the Act.

A link to the amended Act is below. Franchisors operating in California or considering future franchise sales in California should discuss the changes to the Act with counsel to evaluate and prepare for the potential additional risks and expense associated with franchising in California.

http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB525

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