

103^D CONGRESS
1ST SESSION

H. R. 1316

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

IN THE HOUSE OF REPRESENTATIVES

MARCH 11, 1993

Mr. LAFALCE introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To establish minimum standards of fair conduct in 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.**

4 This Act may be cited as the “Federal Fair Franchise
5 Practices Act”.

6 **SEC. 2. FINDINGS AND PURPOSE.**

7 (a) The Congress makes the following findings:

8 (1) Franchise business relationships represent a
9 large and growing segment of the Nation’s retail and
10 service businesses and are rapidly replacing more

1 traditional forms of small business ownership in the
2 American economy.

3 (2) Franchise relationships involve a joint en-
4 terprise between the franchisor and franchisees and
5 each party has a vested interest in the franchised
6 business.

7 (3) Many franchises reflect a profound imbal-
8 ance of contractual power in favor of the franchisor,
9 and fail to give due regard to the legitimate business
10 interests of the franchisee, as a result of the
11 franchisor reserving pervasive contractual rights over
12 the franchise relationship.

13 (4) Franchisees may suffer substantial financial
14 losses where the franchisor does not act in good
15 faith, or with due care.

16 (5) Traditional common law doctrines have not
17 evolved sufficiently to protect franchisees adequately
18 from fraudulent or unfair practices, and significant
19 contractual and procedural restrictions have denied
20 franchisees viable legal recourse against franchisors.

21 (b) It is the purpose of this Act to promote greater
22 fairness and equity in franchise relationships, to establish
23 minimum standards of conduct in franchise practices, to
24 strengthen private remedies against fraudulent or unlaw-
25 ful actions, and to provide to consumers the greater bene-

1 fits which would flow from equitable franchise relation-
2 ships.

3 **SEC. 3. PROHIBITED ACTIONS.**

4 (a) In connection with the promotion, sale, licensing,
5 performance, enforcement and termination of any fran-
6 chise agreement, or of an agreement for any relationship
7 which is represented either orally or in writing to be a
8 franchise, it shall be unlawful for a franchisor or
9 subfranchisor, either directly or indirectly through any of-
10 ficer, employee, agent, representative or attorney:

11 (1) to engage in an act, practice, course of busi-
12 ness, or pattern of conduct which operates or is in-
13 tended to operate as a fraud or deceit upon any per-
14 son;

15 (2) to employ unlawful or deceptive acts or
16 practices in the operation of the franchisor's enter-
17 prise or method of business;

18 (3) to discriminate among franchisees on the
19 basis of race, sex, religion, disability or national ori-
20 gin, except that, and then only to the extent that,
21 any discrimination between franchisees is reasonable
22 and is related to a program under which franchises
23 are made available to a class of persons who may
24 have been denied franchise opportunities in the past

1 based on suspect classifications including race, sex,
2 religion or national origin;

3 (b) It shall be unlawful for any franchisor or
4 subfranchisor, either directly or indirectly through any of-
5 ficer, employee, agent, representative or attorney:

6 (1) to prohibit a franchisee from obtaining
7 equipment, fixtures, supplies or services used in the
8 establishment or operation of the franchised business
9 from sources of the franchisee's choosing, except
10 that such goods or services may be required to meet
11 uniform system-wide quality standards which are not
12 arbitrarily promulgated or enforced by the
13 franchisor. This paragraph shall not apply to reason-
14 able quantities of inventory of goods or services (in-
15 cluding display and sample items) that the
16 franchisee is required to obtain from the franchisor
17 and/or its affiliate(s), where such goods or services
18 are integrally related to a trademark, trade name,
19 trade secret or patent owned by or licensed to the
20 franchisor or its affiliate(s), provided the franchisor
21 shall not withhold a franchisee's right to obtain such
22 goods and services without providing a notice of de-
23 fault and a thirty-day period to cure the default;

24 (2) to terminate or otherwise cancel a franchise
25 prior to its expiration without good cause for such

1 termination or cancellation. For purposes of this
2 paragraph, good cause shall exist only where:

3 (A) the franchisee fails to comply with a
4 material provision of the franchise agreement
5 after notice specifying the default and a thirty-
6 day period to cure the default, or if the default
7 can not be cured within thirty days, the
8 franchisee fails to initiate within thirty days
9 and diligently pursue substantial continuing ac-
10 tion to cure the default;

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

13 (i) voluntarily abandons the franchise
14 business, except that loss or termination of
15 a leasehold for the franchise business prior
16 to the term of a franchise agreement by
17 reason of eminent domain, foreclosure sale,
18 natural disaster or other termination not
19 the fault of the franchisee shall not be con-
20 sidered abandonment by the franchisee;

21 (ii) is convicted of a crime that sub-
22 stantially impairs the good will associated
23 with the franchisor's trade mark, service
24 mark, trade name, logotype, advertising or
25 other commercial symbol;

1 (iii) repeatedly fails to comply with
2 the same material provision of the fran-
3 chise agreement, where the enforcement of
4 such provision is substantially similar to
5 enforcement of that provision with other
6 franchisees; or

7 (iv) operates the franchised business
8 in a manner that creates an imminent dan-
9 ger to public health or safety; and

10 (C) the franchisor, whether or not as a re-
11 sult of bankruptcy or reorganization, withdraws
12 from a marketing area, provided the franchisor
13 pays the franchisee reasonable compensation for
14 damages incurred from the shortened term of
15 the franchise, or agrees not to enforce any con-
16 tractual prohibition against the franchisee con-
17 tinuing to engage in the business at the licensed
18 location, except as provided in subsection
19 (3)(B) of this section.

20 (3) to prohibit, or enforce a prohibition against,
21 any franchisee from engaging in any business at any
22 location after expiration of a franchise or after ter-
23 mination of the franchise prior to its expiration for
24 good cause. This paragraph shall not:

1 (A) apply to enforcement of any such pro-
2 hibition where the franchisor, not less than ten
3 days before the effective date of such termi-
4 nation or expiration, offers in writing to pur-
5 chase the assets of the franchised business for
6 its fair market value as a going concern, pro-
7 vided that:

8 (i) the fair market value of such busi-
9 ness be determined as if it were to be re-
10 sold or renewed for a period of years equal
11 to the contract term being offered by the
12 franchisor for new or renewed franchises;

13 (ii) the fair market value of such busi-
14 ness is ascertained by an impartial ap-
15 praiser, whose appointment is acceptable to
16 both parties; and

17 (iii) forgiveness of debt shall not be
18 considered a purchase of assets by the
19 franchisor for purposes of this section.

20 (B) prohibit enforcement of any provisions
21 of a franchise obligating a franchisee after expi-
22 ration or termination of a franchise—

23 (i) to cease or refrain from using a
24 trademark, trade secret or other intellec-
25 tual property owned by the franchisor or

1 its affiliate, except that the existence of
2 language in the franchise agreement pur-
3 porting to determine ownership of a trade-
4 mark, trade secret or other intellectual
5 property shall not be binding upon any
6 court or forum for purposes of this para-
7 graph, but may be considered by such
8 court or forum as evidence of such owner-
9 ship; or

10 (ii) to alter the appearance of the
11 premises and the manner of operation of
12 the franchised business to avoid any likeli-
13 hood of confusion as to the affiliation of
14 the business with its former franchisor.

15 (4) to hinder or prohibit, directly or indirectly,
16 the free association of franchisees for any lawful
17 purpose, including the formation of or participation
18 in any trade association made up of franchisees, or
19 to discriminate by imposing requirements not im-
20 posed on other similarly situated franchisees, or re-
21 taliate, directly or indirectly, against any franchisee
22 for membership or participation in a franchisee asso-
23 ciation.

1 **SEC. 4. ENCROACHMENT.**

2 (a) A franchisor shall not establish a new outlet or
3 point of sale of goods or services similar to that offered
4 by a franchisee and identified by the same trade name
5 or trademark or advertising used by a franchisee, in such
6 unreasonable proximity to an outlet or business owned or
7 licensed to such franchisee that the effect or probable ef-
8 fect of establishing such new outlet or point of sale is to
9 cause a reduction in gross sales of the existing franchise
10 of more than 10 percent during the twelve month period
11 immediately following establishment of the new outlet or
12 point of sale.

13 (b) Where a franchisor has established a new outlet
14 or point of sale in such unreasonable proximity to an exist-
15 ing franchise, the franchisor shall—

16 (1) compensate the franchisee for lost sales
17 caused by the new outlet or point of sale in an
18 amount equal to the loss of sales in excess of 10 per-
19 cent for any period in which the new outlet or point
20 of sale has been open for business and remains open
21 for business;

22 (2) change the location or manner of operation
23 of the new outlet or point of sale to mitigate its im-
24 pact upon the franchise business to diminish the di-
25 version of sales to less than 10 percent during any

1 period in which the new outlet or point of sale is
2 open for business; or

3 (3) close the new outlet or point of sale.

4 (c) This section shall not apply if, before a new outlet
5 or point of sale is opened for business, a franchisor offers
6 in writing to each franchisee which owns or licenses a
7 franchise in close proximity to the site of such new outlet
8 or point of sale to pay to such franchisee or franchisees
9 an amount equal to 10 percent of the gross sales (net of
10 sales taxes, returns and allowances) of the new outlet or
11 point of sale for the first twenty-four months of operation
12 of such new outlet or point of sale, if the sales of such
13 existing franchises are reduced by more than 10 percent
14 during the twelve month period immediately following es-
15 tablishment of the new outlet or point of sale as a con-
16 sequence of the opening of such outlet or point of sale.

17 (d) A franchisor shall have the burden of proof to
18 show that, or the extent to which, a decline in sales of
19 an existing franchise occurred for reason other than the
20 establishment in close proximity to the franchise of the
21 new outlet or point of sale.

22 **SEC. 5. STANDARDS OF CONDUCT.**

23 (a) DUTY OF GOOD FAITH.—A franchise contract
24 imposes on each party thereto a duty to act in good faith
25 in its performance and enforcement. This duty of good

1 faith obligates a party to a franchise to do nothing that
2 will have the effect of destroying or injuring the right of
3 the other party to receive the fruits of the contract and
4 to do everything required under the contract to accomplish
5 such purpose.

6 (b) DUTY OF DUE CARE.—A franchise relationship
7 imposes on the franchisor a duty of due care. Unless a
8 franchisor represents that it has greater skill or knowledge
9 in its undertaking with its franchisees, or conspicuously
10 disclaims that it has skill or knowledge, the franchisor is
11 required to exercise the skill and knowledge normally pos-
12 sessed by franchisors in good standing in the same or simi-
13 lar types of business. For purposes of this subsection—

14 (1) the phrase “skill or knowledge” means
15 something more than the mere minimum level of
16 skill or knowledge required of any person engaging
17 in a service or business and involves a special level
18 of expertise—

19 (A) which is the result of acquired learning
20 and aptitude developed by special training and
21 experience in the business to be conducted
22 under the franchise, or the result of extensive
23 use and experience with the products or services
24 or the operating system of the franchise;

1 (B) which is the result of experience in or-
2 ganizing a franchise system and in providing
3 training, assistance and services to franchisees;
4 and

5 (C) which a prospective franchisee would
6 expect in reasonable reliance on the written and
7 oral commitments and representations of the
8 franchisor; and

9 (2) a franchisor shall be permitted to show that
10 it contracted for, hired or purchased the expertise
11 necessary to comply with the requirements of this
12 subsection and that such expertise was incorporated
13 in the franchise or communicated or provided to the
14 franchisee.

15 The requirement of this subsection may not be waived by
16 agreement or by conduct, but the franchisor may limit in
17 writing the nature and scope of its skill and knowledge,
18 and of its undertaking with a prospective franchisee: *Pro-*
19 *vided*, That no inconsistent representation, whether writ-
20 ten or oral, is made to the prospective franchisee.

21 (c) LIMITED FIDUCIARY DUTY.—Without regard to
22 whether a fiduciary duty is imposed generally on the
23 franchisor by virtue of a franchise relationship, the
24 franchisor owes a fiduciary duty to its franchisees and is

1 obligated to exercise the highest standard of care for
2 franchisee interests where the franchisor:

3 (1) undertakes to perform bookkeeping, collec-
4 tion, payroll or accounting services on behalf of the
5 franchisee; or

6 (2) requires franchisees to make contributions
7 to any pooled advertising or promotional fund to be
8 administered or supervised by the franchisor.

9 While not limiting the ability of any court to identify other
10 circumstances for which a fiduciary duty may also exist,
11 this subsection does not create or extend a fiduciary duty
12 by implication to other aspects of a franchise.

13 **SEC. 6. PROCEDURAL FAIRNESS.**

14 (a) It shall be unlawful for any franchisor or
15 subfranchisor, either directly or indirectly through any of-
16 ficer, employee, agent, representative or attorney to:

17 (1) Require any term or condition in a fran-
18 chise agreement, or in any agreement ancillary or
19 collateral to a franchise, which directly or indirectly
20 violates any provision of this Act; or

21 (2) Require a franchisee to assent to any dis-
22 claimer, waiver, release, stipulation or other provi-
23 sion which would purport—

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

4 (B) to protect any person against any li-
5 ability to which he would otherwise be subject
6 under the Act by reason of willful misfeasance,
7 bad faith, or gross negligence in the perform-
8 ance of duties, or by reason of reckless dis-
9 regard of obligations and duties under the fran-
10 chise agreement.

11 (b) Any condition, stipulation, provision, or term of
12 any franchise agreement, or any agreement ancillary or
13 collateral to a franchise, which would purport to waive or
14 restrict any right granted under this Act shall be void and
15 unenforceable.

16 (c) No stipulation or provision of a franchise agree-
17 ment or of an agreement ancillary or collateral to a fran-
18 chise shall—

19 (1) deprive a franchisee of the application and
20 benefits of this Act or of any Federal law or the law
21 of the State in which the franchisee's principal place
22 of business is located;

23 (2) deprive a franchisee of the right to com-
24 mence an action (or, if the franchise provides for ar-
25 bitration, initiate an arbitration) against the

1 franchisor for violation of the Act, or for breach of
2 the franchise agreement or of any agreement or stip-
3 ulation ancillary or collateral to the franchise, in a
4 court (or arbitration forum) in the state of the
5 franchisee's principal place of business; or

6 (3) exclude collective action by franchisees to
7 settle like disputes arising from violation of this Act
8 either by civil action or arbitration.

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

17 **SEC. 7. ACTIONS BY PRIVATE PERSONS.**

18 (a)(1) Any person injured by a violation of any provision
19 or standard of this Act shall have a right of action for
20 all damages caused by the violation, including costs of liti-
21 gation and reasonable attorney's fees, against any person
22 found to be liable for such violation.

23 (2) An action may be brought, without regard to the
24 amount in controversy, in any United States district court

1 or in any other court of competent jurisdiction, before the
2 later of:

3 (A) Five years after the date on which the vio-
4 lation occurred; or

5 (B) Three years after the date on which the
6 violation was discovered or should have been discov-
7 ered through exercise of reasonable diligence.

8 (b) Any person injured by a violation of this Act, or
9 threatened with injury by an impending violation of this
10 Act, may bring an action in a United States district court
11 to obtain a declaratory judgement that an act or conduct
12 constitutes or would constitute a violation of this Act and
13 to enjoin a person who has violated, is violating, or who
14 is otherwise likely to violate any provision of this Act. In
15 such actions, the court may issue a temporary restraining
16 order or preliminary injunction to protect the public inter-
17 est by halting a recurring or likely violation of this Act,
18 prior to a final determination on the merits, in conformity
19 with the principles governing the granting of preliminary
20 relief in other civil actions, except that no showing of spe-
21 cial or irreparable damage to such person shall have to
22 be made.

23 (c)(1) In any action brought under subsection (a) or
24 (b) of this section, a court shall have the power to inter-
25 pret any benefit conferred, duty imposed, or restriction ap-

1 plied in favor of or against any party to a franchise agree-
2 ment as reciprocal and equally applicable to the other
3 party to the agreement and to provide an identical or simi-
4 lar benefit, impose an identical or similar duty, or apply
5 an identical or similar restriction on such other party to
6 the agreement, provided that such reciprocal application
7 is consistent with the laws of the State in which the fran-
8 chise business is located.

9 (2) A court shall apply any provision contained in a
10 franchise agreement which purports to restrict the ability
11 of one party to compete with the other party during the
12 term of the franchise agreement reciprocally to the extent
13 deemed fair and appropriate.

14 (d)(1) Except as otherwise provided in paragraph (2)
15 of this subsection, nothing contained in this Act shall limit
16 the right of a franchisor and a franchisee to agree to arbi-
17 tration, mediation or other nonjudicial resolution of a dis-
18 pute, either in advance or after a dispute arises: *Provided,*
19 That the standards and protections applied in any binding
20 nonjudicial procedure agreed to by the parties are not less
21 than the requirements set forth in this Act.

22 (2) Any stipulation or provision of a franchise agree-
23 ment requiring use of arbitration or other nonjudicial res-
24 olution to resolve disputes arising under the agreement
25 shall not apply to bar an action brought in a United States

1 district court or in any other court of competent jurisdic-
2 tion pursuant to this section involving a request for dam-
3 ages and/or equitable relief for an alleged violation of any
4 provision of this Act, except where such request is frivo-
5 lous or insubstantial. A determination of whether a re-
6 quest for damages and/or equitable relief is frivolous or
7 insubstantial shall be made by the court in which the ac-
8 tion is filed at any hearing at which all parties are present
9 or represented by counsel.

10 **SEC. 8. EFFECT ON OTHER LAW.**

11 (a) This Act preempts State law only to the extent
12 that State law is inconsistent with any provision of this
13 Act, in terms of providing less protection to the franchisee
14 than provided by this Act, and then only to the extent
15 of such inconsistency.

16 (b) Nothing in this Act shall be interpreted—

17 (1) to alter or relieve any franchisor or
18 subfranchisor from the obligation to comply with the
19 laws of any State, except to the extent that such
20 laws are inconsistent with any provision of this Act;
21 or

22 (2) to preclude a State from enacting any law
23 or regulation that affords a greater level or broader
24 range of protections to franchisees.

1 **SEC. 9. SCOPE AND APPLICABILITY.**

2 The requirements of this Act shall apply to franchise
3 agreements entered into, amended, exchanged or renewed
4 after the date of enactment of this Act.

5 **SEC. 10. DEFINITIONS.**

6 For purposes of this Act:

7 (1) The term “affiliate” means a natural or
8 legal person controlling, controlled by, or under com-
9 mon control with a franchisor.

10 (2) The term “franchise” means—

11 (A) any continuing commercial relationship
12 created by a contract or agreement, either ex-
13 pressed or implied, whether oral or written,
14 where—

15 (i) one person (the franchisor) grants
16 to another person (the franchisee) the
17 right to engage in the business of offering,
18 selling or distributing goods or services, in
19 which—

20 (I) the goods and services of-
21 fered, sold or distributed by the
22 franchisee are substantially associated
23 with the trademark, service mark,
24 trade name, logotype, advertising, or
25 other commercial symbol owned or

1 used by the franchisor (hereafter “the
2 franchisor’s mark”); or

3 (II) the franchisee must conform
4 to quality standards established by
5 the franchisor with respect to the
6 goods and services being distributed,
7 and operate under a name that in-
8 cludes, in whole or in part, the
9 franchisor’s mark;

10 (ii) the franchisor—

11 (I) communicates to the
12 franchisee knowledge, experience, ex-
13 pertise, know-how, trade secrets or
14 other non-patented information, re-
15 gardless of whether it is proprietary
16 or confidential;

17 (II) provides significant assist-
18 ance to the franchisee in areas relat-
19 ing to the franchisee’s method of op-
20 eration; or

21 (III) exercises significant controls
22 over the franchisee’s method of oper-
23 ation of the business; and

24 (iii) the franchisee, as a condition for
25 obtaining or commencing operation of a

1 franchise, is required to make, or to com-
2 mit to make, payment or other consider-
3 ation to the franchisor, or an affiliate of
4 the franchisor, other than payment for
5 commercially reasonable quantities of
6 goods for resale at a bona fide wholesale
7 price.

8 (B) a subfranchise; or

9 (C) any commercial relationship entered
10 into in reasonable reliance on representations,
11 either oral or written, that the criteria of para-
12 graph (A) of this subsection will be met.

13 (3) The term “franchisee” means a person to
14 whom a franchise is granted.

15 (4) The term “franchisor” means a person who
16 grants a franchise or a subfranchise.

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

20 (6) The term “person” means an individual or
21 any other legal or commercial entity.

22 (7) The term “State” means a State, the Dis-
23 trict of Columbia, and any territory or possession of
24 the United States.

1 (8) The term “subfranchise” means a contract
2 or an agreement by which a person pays a
3 franchisor for the right to sell, negotiate the sale, or
4 provide services franchises.

5 (9) The term “subfranchisor” means a person
6 who is granted a subfranchise.

7 (10) The term “trade secret” means informa-
8 tion, including a formula, pattern, compilation, pro-
9 gram, device, method, technique, or process, that:

10 (i) derives independent economic value, ac-
11 tual or potential, from not being generally
12 known to, and not being readily ascertainable
13 by proper means by, other persons who can ob-
14 tain economic value from its disclosure or use,
15 and

16 (ii) is the subject of efforts that are rea-
17 sonable under the circumstances to maintain its
18 secrecy.

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