

**REPORT OF THE
JOINT SUBCOMMITTEE STUDYING**

The Virginia Retail Franchising Act

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



SENATE DOCUMENT NO. 16

**COMMONWEALTH OF VIRGINIA
RICHMOND
1991**

MEMBERS OF THE JOINT SUBCOMMITTEE

The Honorable Johnny S. Joannou, *Chairman*
The Honorable Edward R. Harris, Jr., *Vice Chairman*
The Honorable Richard J. Holland
The Honorable W. Onico Barker
The Honorable Alson H. Smith, Jr.
The Honorable Harvey B. Morgan
The Honorable Lewis W. Parker, Jr.

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**Report of the Joint Subcommittee Studying the
Virginia Retail Franchising Act
to
the Governor and the General Assembly of Virginia**

Richmond, Virginia
January 1991

TO: The Honorable L. Douglas Wilder, Governor of Virginia
and
The General Assembly of Virginia

Senate Joint Resolution No. 52 of the 1990 Acts of Assembly established a joint subcommittee to study the Virginia Retail Franchising Act and to report its findings to the Governor and the General Assembly.

SENATE JOINT RESOLUTION NO. 52

Establishing a joint subcommittee to study the Virginia Retail Franchising Act and the feasibility and desirability of conforming the Commonwealth's franchise laws with those of other states.

Agreed to by the Senate, March 10, 1990

Agreed to by the House of Delegates, March 10, 1990

WHEREAS, franchises play an important role in state and local economies; and

WHEREAS, the Virginia Retail Franchising Act, enacted in 1972, contains provisions that vary, in part, from similar laws of other states; and

WHEREAS, the lack of uniformity in franchise laws among the states may impose unreasonable burdens on franchisors and franchisees alike; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study the Virginia Retail Franchising Act and whether it is feasible or desirable to conform the Commonwealth's franchise laws with those of other states. The joint subcommittee shall consist of seven members to be appointed as follows: two members from the Senate Commerce and Labor Committee and one member from the Senate Courts of Justice Committee, to be appointed by the Senate Committee on Privileges and Elections; and four members from the House Corporations, Insurance and Banking Committee, to be appointed by the Speaker of the House.

The joint subcommittee shall complete its work in time to submit its findings and recommendations to the Governor and the 1991 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

The indirect costs of this study are estimated to be \$10,650; the direct costs of this study shall not exceed \$5,040.

Senator Johnny S. Joannou of Portsmouth was elected Chairman of the joint subcommittee and Delegate Edward R. Harris, Jr., of Lynchburg was elected Vice Chairman. Serving with them on the Subcommittee were Senator W. Onico Barker of Danville, Senator Richard J. Holland of Windsor, Delegate Alson H. Smith, Jr., of Winchester, Delegate Harvey B. Morgan of Gloucester, and Delegate Lewis W. Parker, Jr., of South Hill.

The purpose of the study was to determine whether Virginia's Retail Franchising Act should be conformed to franchise laws of other states. Franchised businesses have a significant impact on the economy of the state and the nation. Laws should facilitate the conduct of franchised business, ensuring fair dealing between franchisor and franchisee while not unduly intruding on the business relationship.

The joint subcommittee, in the course of its deliberations, received valuable information and advice from personnel of the Division of Securities and Retail Franchising of the State Corporation Commission, the International Franchising Association, and legal practitioners that specialize in franchise law. Their suggestions and advice are reflected in the subcommittee's recommendations.

Virginia enacted its Retail Franchising Act (§§ 13.1-557 et seq.) in 1972 pursuant to a study and recommendation of the Virginia Advisory Legislative Council (*see* House Document 2, 1972). The Act has not been extensively amended except for the amendments made in 1978 when the thrust of the Act was redirected from registration of the franchisor to registration of the franchise.

Fifteen states have some form of franchise registration or disclosure law, leaving thirty-five states having no franchise registration or disclosure law of general applicability.

There are two uniform franchise laws either in existence or being drafted. The Uniform Franchise and Business Opportunities Act, drafted by the Uniform Law Commissioners and approved by the American Bar Association (February 1988), has not been enacted by any state. The other uniform law is being drafted by the North American Securities Administrators Association, Inc., and has not yet been finalized.

Members of the joint subcommittee have concluded that Virginia has a good retail franchise act, one that is being fairly administered by the Division of Securities and Retail Franchising of the State Corporation Commission. The joint subcommittee has further concluded that it would be premature to recommend that Virginia adopt any uniform law on the subject in view of the facts that (i) a majority of the states have no general law on the subject, (ii) no state has adopted the one completed uniform law, and (iii) the other uniform law remains to be finished.

However, due to the experience gained in administering Virginia's Retail Franchising Act, certain amendments to the Act would be of benefit. The proposed amendments are:

§ 13.1-559. Definitions.--As used in this chapter, unless the context otherwise requires, the term:

...

(b) "Franchise" means a written contract or agreement, ~~whether or not a franchise fee is required,~~ between two or more persons, by which:

...

(3) The franchisee is required to pay, directly or indirectly, a franchise fee of \$500 or more.

...

(g) "Franchise fee" means a fee or charge for the right to enter into or maintain a business under a franchise, including a payment or deposit for goods, services, rights, or training, but not including: (i) the payment of a bona fide wholesale price for starting and continuing inventory of goods for resale; or (ii) the payment at fair market value for the purchase or lease of real property, fixtures, equipment, or supplies necessary to enter into or maintain the business.

...

(h) "Control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

COMMENT: Imposes payment of a "franchise fee" of \$500 or more as an element of the definition of franchise and defines the term in subsection (g) of this section. This change aids in determining whether a business relationship is a franchise. Federal law and the law of many of the states that regulate franchises have a monetary floor, thus the addition of a \$500 floor in Virginia law is a step toward conformity. The addition of "control" to the list of definitions is warranted because this word is being added to § 13.1-561 (a), and it is currently used in § 13.1-562 ("any person directly or indirectly controlling such franchisor"). An identical amendment to the definitions section of the Securities Act was enacted in 1990.

§ 13.1-561. Procedure for registration; bond; renewal; fees.--(a) A franchise may be registered after the filing with the Commission of an application containing such relevant information as the Commission may require. The franchise shall be registered if the Commission finds that the franchisor (and, in the case of a corporation, ~~or partnership or other entity~~, each natural person who is ~~the~~ an officers, directors or partners, or who otherwise controls such corporation, partnership or entity) is a person of good character and reputation, that ~~he has supplied~~ all information required of the applicant by the Commission has been supplied, that none of the grounds for revocation enumerated in § 13.1-562 are applicable to the franchise, and that ~~he has paid~~ the required fee has been paid.

...

(d) Each application for the registration of a franchise shall be accompanied by a fee of ~~\$250~~ \$500, payable to the Treasurer of Virginia. Each application for the renewal of a franchise registration, including any amendments to the registration application which accompany or are part of the application for renewal, shall be accompanied by a fee of ~~\$100~~ \$250, payable to the Treasurer of Virginia. ~~A fee of fifty dollars, payable to the Treasurer of Virginia shall accompany any amendments to the registration of the franchise. Unless submitted in connection with an application for renewal, each amendment or group of amendments to a registration application submitted after the application has been granted shall be accompanied by a fee of \$100, payable to the Treasurer of Virginia. If the application for registration, or renewal is withdrawn or is not granted, or amendments are not granted if the registration application is not amended, the application fee shall not be returnable.~~

COMMENT: The major changes to subsection (a) enhance protection of the public by adding as additional reasons for denying an application for registration (i) lack of good character and reputation of any person who controls a franchisor and (ii) any of the grounds which permit revocation under § 13.1-562. The other changes are for purposes of clarification.

The major change to subsection (d) increases the fees to be paid in conjunction with submitting applications for initial registration and for renewal of registration or submitting amendments to an application. The increased fees are more in line with the costs incurred by the State Corporation Commission in processing each type of document as well as with the charges for similar filings imposed by other jurisdictions. The textual change to the second sentence is intended to make it clear that a separate fee is not due when amendments are submitted as part of an application for renewal. The remaining amendments are for purposes of clarification.

§ 13.1-562. Revocation of or refusal to renew registration; suspension.--(a) The Commission may

...

(b) If it appears to the Commission that it is in the public interest and that there exists one or more of the grounds enumerated in paragraphs (1) - (6) of subsection (a) of this section, the Commission may summarily issue an order suspending the effectiveness of a franchise registration pending final determination of any proceeding under this section. The Commission shall promptly give notice of the suspension to the franchisor and its subfranchisors, if any are known to the Commission, affected by the order. The notice shall set forth the basis for the suspension as well as the franchisor's and subfranchisor's right to file a petition for a hearing. Such franchisor or subfranchisor may file a petition for a hearing in respect to any matter determined by the order within fifteen days after the date of the order. A hearing on the petition shall be held as soon as practicable after the filing thereof. The filing of such petition shall have no effect on the operation of the suspending order unless the Commission, by order, provides otherwise.

COMMENT: The new provisions allow the Commission, upon a finding of the specified grounds, to summarily suspend a franchise registration while a revocation proceeding is pending. Such public protection seems appropriate, when, for example, the State Corporation Commission learns that a franchisor whose registered franchise is being offered in Virginia has become insolvent, but the State Corporation Commission, because of a busy docket, must wait 45, 60, or more days to hold a hearing on the issue of revocation.

§ 13.1-563. Unlawful offers.--It shall be unlawful for any person, ~~in making an connection with the grant or offer to grant a franchise in this Commonwealth, whether or not a franchise fee is required,~~ directly or indirectly:

...

~~(d) To not register the franchise as required by § 13.1-560, or~~

(e) To fail to provide the franchisee a copy of (i) the franchise agreement and (ii) such disclosure documents pursuant to § 13.1-572 of the Code of Virginia document as may be required by rule or order of the Commission.

COMMENT: The primary purpose of the changes to the introductory sentence is to conform this language to the language of §§ 13.1-559 and 13.1-560. Subsection (d) is deleted because it does not fit well in the context of § 13.1-563. The substance of subsection (d) is retained by the addition of "§ 13.1-560" to § 13.1-565 (a). The changes to subsection (e) are for purposes of clarification.

§ 13.1-565. Voidable franchises.--Any franchise may be declared void by the franchisee at his option by sending a written declaration of that fact and the reasons therefor to the franchisor by registered or certified mail if:

(a) The franchisor's offer to grant a franchise was unlawful, as provided in § 13.1-560 or § 13.1-563, provided that the franchisee send such written declaration within seventy-two hours after discovery thereof but not more than ninety days after execution of the franchise;

(b) The franchisee was not afforded the opportunity to negotiate with the franchisor on all provisions within the franchise, except that such negotiations shall not ~~impair~~ result in the impairment of the uniform image and quality standards of the franchise, provided that the franchisee send such written declaration within thirty days after execution of the franchise; or

(c) The franchisee was not furnished a copy of the franchise agreement and disclosure documents at least seventy-two hours prior to execution of the franchise, provided that the franchisee send such written declaration within thirty days after execution of the franchise, ~~and provided further that within thirty days after receiving such a declaration from a franchisee, the franchisor shall deliver a copy of the declaration to the Commission.~~

COMMENT: The changes to subsections (a) and (b) are primarily for purposes of clarification. The second proviso in subsection (c), if applied literally, gives the franchisor the opportunity to thwart a franchisee's attempt to void a franchise. Furthermore, no franchisor has made a filing pursuant to this provision since it was enacted in 1978. Consequently, deletion of the proviso seems appropriate.

§ 13.1-570. Offenses punishable by the Commission.--The Commission may, by judgment entered after a hearing on notice duly served on the defendant not less than thirty days before the date of the hearing, if it be proved that the defendant has knowingly made any misrepresentation of a material fact for the purpose of inducing the Commission to take any action or to refrain from taking action, or has violated any provision of this chapter or any order, rule, or regulation of the Commission issued pursuant to this chapter, impose a penalty not exceeding ~~\$5,000~~ \$25,000, which shall be collectible by the process of the Commission as provided by law.

COMMENT: The amount of the penalty has not been changed since the enactment of the Retail Franchising Act in 1972, and does not provide a deterrent under today's conditions. A penalty of \$25,000 is in line with the fees and other costs expended by a franchisee in starting a franchise. Among the other states that regulate the offering and granting of retail franchises, the penalty amounts range from zero (North Dakota) to \$100,000 (Hawaii). There is a \$50,000 penalty provision in the Model Franchise Investment Act proposed for adoption by the North American Securities Administrators Association, Inc., in June 1990.

Respectfully submitted,

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Edward R. Harris, Jr., *Vice Chairman*

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