

Legal Corner

Negotiating Franchise Sales in California

By Matthew J. Kreutzer, Esq.



One of the most misunderstood aspects of California's franchise law is its regulation of negotiated sales. Under the law, if a California franchisee has been given a "special deal" that is not part of the franchisor's standard offering, then the franchisor may be required to disclose the terms of that deal to subsequent California franchisees during the following year.

The purpose of the law is to control favoritism among franchisees by attempting to level the playing field between franchisees that are sophisticated enough to negotiate their contracts and those that are not. However, the law can act as a trap, ensnaring a franchisor that is unaware of its requirements. The problem is a significant one because California state administrators are given wide latitude in the statute to assess penalties for violations, no matter how large or small the amount of actual damage caused to franchisees.

Of all the states that have franchise sales laws, California is the only one that so heavily regulates negotiations between a franchisor and prospective franchisee. The Federal Trade Commission and other states, to the extent that they do address the possibility of negotiated changes, give franchisors and franchisees wide latitude to negotiate agreements as they see fit. This hands-off policy encourages free negotiation between the parties, which is consistent with the goals of franchise regulations in general.

While the law was originally intended to permit or even facilitate negotiation, it presents business and economic issues that have resulted in this unintended consequence: Many franchisors refuse to negotiate any terms with California franchisees. Because franchisors may be required to disclose all such negotiated terms, they are less likely to provide a particular franchisee a special deal because they fear others will demand the same terms. As a result, instead of protecting California franchisees, the law arguably disadvantaged them by taking the negotiability out of their deals.

If you do want to negotiate with a California prospect, what should you do to comply with the law? If your negotiation is the first one within a twelve-month period, then you do not need to make any special filing or disclosure to your prospect. After the deal has closed, however, you will need to determine whether the negotiated terms, on the whole, confer additional benefits to the franchisee. This is usually the case.

Depending on how you answer the benefits question, either you may need to prepare a "summary description" of the negotiated terms and provide that description to any California prospects that ask for it, or you may need to file a "Notice of Negotiated Sale of Franchise" with the California Department of Corporations and amend your franchise disclosure document. In any event, because negotiation with a California prospect necessarily implicates the state's negotiated sales law, you should consult your franchise attorney to ensure that you remain in compliance.

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