

106TH CONGRESS
1ST SESSION

H. R. 3308

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

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 10, 1999

Mr. COBLE (for himself, Mr. CONYERS, Mr. JONES of North Carolina, Mr. ANDREWS, Mr. JENKINS, Mr. PICKERING, Mr. JOHN, Mr. TOWNS, Mr. WAMP, Mr. DICKEY, Mr. COBURN, Mr. LATOURETTE, Mr. NORWOOD, Mr. HILLEARY, Mr. ROTHMAN, Mr. GRAHAM, Mr. CANNON, Ms. ESHOO, Mr. CRAMER, Mr. GALLEGLY, Mr. PHELPS, Mr. SPENCE, and Mr. HERGER) 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 1999”.

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 bar-
14 gaining power and generally invest substantial
15 amounts to obtain a franchise business when they
16 are unfamiliar with operating a business, with the
17 business being franchised and with industry prac-
18 tices in franchising.

1 (4) Many franchises reflect a profound imbalance
2 of contractual power in favor of the franchisor,
3 and fail to give due regard to the legitimate business
4 interests of the franchisee, as a result of the
5 franchisor reserving pervasive contractual rights over
6 the franchise relationship.

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

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

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

1 impeding entry into industries and markets domi-
2 nated by franchise systems.

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

8 **SEC. 3. FRANCHISE SALES PRACTICES.**

9 (a) IN GENERAL.—In connection with the adver-
10 tising, offering, sale or promotion of any franchise, it shall
11 be unlawful for any person—

12 (1) to employ a device, scheme, or artifice to
13 defraud;

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

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

21 (b) MISREPRESENTATIONS IN REQUIRED DISCLO-
22 SURE.—

23 (1) In connection with any disclosure document,
24 notice, or report required by any law, it shall be un-
25 lawful for any franchisor, subfranchisor, or franchise

1 broker, either directly or indirectly through another
2 person—

3 (A) to—

4 (i) make an untrue statement of ma-
5 terial fact;

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

7 (iii) fail to state any fact which would
8 render any required statement or disclo-
9 sure either untrue or misleading;

10 (B) to fail to furnish any prospective
11 franchisee with—

12 (i) all information required to be dis-
13 closed by law and at the time and in the
14 manner required; and

15 (ii) a written statement specifying,
16 prominently and in not less than 14-point
17 type, whether the franchise agreement in-
18 volved contains a right to renew such
19 agreement; or

20 (C) to make any claim or representation to
21 a prospective franchisee whether orally or in
22 writing, which is inconsistent with or con-
23 tradicts such disclosure document.

24 (2) For purposes of this subsection, the term
25 “disclosure document” means either the disclosure

1 statement required by the Federal Trade Commis-
2 sion in Trade Regulation Rule 436 (16 C.F.R.
3 § 436) as amended from time to time, or any offer-
4 ing format allowed or required by State law.

5 **SEC. 4. UNFAIR FRANCHISE PRACTICES.**

6 (a) DECEPTIVE AND DISCRIMINATORY PRACTICES.—

7 In connection with the performance, enforcement, renewal,
8 or termination of any franchise agreement, it shall be un-
9 lawful for a franchisor or subfranchisor, either directly or
10 indirectly through another person—

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

14 (2) to hinder, prohibit, or penalize (or threaten
15 to hinder, prohibit, or penalize), directly or indi-
16 rectly, the free association of franchisees for any
17 lawful purpose, including the formation of or partici-
18 pation in any trade association made up of
19 franchisees or of associations of franchises; or

20 (3) to discriminate against a franchisee by im-
21 posing requirements not imposed on other similarly
22 situated franchisees or otherwise retaliate, directly
23 or indirectly, against any franchisee for membership
24 or participation in a franchisee association.

25 (b) TERMINATION WITHOUT GOOD CAUSE.—

1 (1) It shall be unlawful for a franchisor, either
2 directly or indirectly through an affiliate or another
3 person, to terminate a franchise agreement prior to
4 its expiration without good cause for such termi-
5 nation.

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

8 (A)(i) the franchisee fails to comply with a
9 material provision of the franchise agreement
10 after receiving notice that specifies the precise
11 basis for the default, each material term of the
12 franchise agreement with which the franchise is
13 not in compliance, and a 30-day period to cure
14 the default; and

15 (ii) if the nature of the default is such that
16 it cannot be cured through reasonably diligent
17 conduct, the franchisee fails to initiate within
18 30 days, and diligently pursue substantial con-
19 tinuing action to cure the default;

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

22 (i) voluntarily abandons the business
23 licensed by the franchise agreement, except
24 that loss or termination of a leasehold for
25 the business prior to the term of a fran-

1 chise agreement by reason of eminent do-
2 main, foreclosure sale, natural disaster or
3 other termination not the fault of the
4 franchisee shall not be considered abandon-
5 ment by the franchisee;

6 (ii) is convicted of a felony, for which
7 imprisonment of 1 year or more can be im-
8 posed, which substantially impairs the
9 good will associated with the franchisor's
10 trade mark, service mark, trade name, log-
11 otype, advertising, or other commercial
12 symbol;

13 (iii) is repeatedly in default of the
14 same material provision of the franchise
15 agreement, where the enforcement of such
16 provision is substantially similar to en-
17 forcement of that provision with other
18 franchisees; or

19 (iv) operates the business licensed by
20 the franchise agreement in a manner that
21 creates an imminent danger to public
22 health or safety; or

23 (C) the franchisor withdraws from the
24 marketing area of the business licensed by the
25 franchise agreement and pays the franchisee

1 reasonable compensation for damages incurred
2 from the shortened term of the agreement and
3 agrees in writing not to enforce any contractual
4 prohibition against the franchisee continuing to
5 engage in the business at the franchised loca-
6 tion.

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

8 (1) A franchisor shall not prohibit, or enforce
9 a prohibition against, any franchisee from engaging
10 in any business at any location after expiration of a
11 franchise agreement.

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

16 (A) to cease or refrain from using a trade-
17 mark, trade secret, or other intellectual prop-
18 erty owned by the franchisor or its affiliate;

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

8 SEC. 5. STANDARDS OF CONDUCT.

9 (a) DUTY OF GOOD FAITH.—

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

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

1 in such a way as to obfuscate a party's duty to act
2 reasonably and in good faith with the other, or oth-
3 erwise allow a disparate result in the franchise rela-
4 tionship.

5 (b) DUTY OF DUE CARE.—

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

14 (2) For purposes of this subsection—

15 (A) the term “skill or knowledge” means
16 something more than the mere minimum level
17 of skill or knowledge required of any person en-
18 gaging in a service or business and involves a
19 special level of expertise—

20 (i) which is the result of acquired
21 learning and aptitude developed by special
22 training and experience in the business to
23 be licensed under the franchise agreement,
24 or the result of extensive use and experi-

1 ence with the goods or services or the oper-
2 ating system of such business;

3 (ii) which is the result of experience in
4 organizing a franchise system and in pro-
5 viding training, assistance and services to
6 franchisees; and

7 (iii) which a prospective franchisee
8 would expect in reasonable reliance on the
9 written and oral commitments and rep-
10 resentations of the franchisor; and

11 (B) a franchisor shall be permitted to show
12 that it contracted for, hired or purchased the
13 expertise necessary to comply with the require-
14 ments of this subsection and that such expertise
15 was incorporated in the franchise or commu-
16 nicated or provided to the franchisee.

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

1 (c) LIMITED FIDUCIARY DUTY.—

2 (1) Without regard to whether a fiduciary duty
3 is imposed generally on the franchisor by virtue of
4 a franchise agreement, the franchisor owes a fidu-
5 ciary duty to its franchisees and is obligated to exer-
6 cise the highest standard of care for franchisee in-
7 terests where the franchisor—

8 (A) undertakes to perform bookkeeping,
9 collection, payroll, or accounting services on be-
10 half of the franchisee; or

11 (B) administers, controls or supervises (ei-
12 ther directly or through any subsidiary or affil-
13 iate) any advertising, marketing, or promotional
14 fund or program to which franchisees are re-
15 quired to, or routinely, contribute.

16 (2) A franchisor that administers or supervises
17 the administration of any fund or program described
18 in paragraph (1)(B) shall—

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

21 (B) provide an independent certified audit
22 of such fund within 60 days following the close
23 of the franchisor's fiscal year, which shall in-
24 clude full disclosure of all fees, expenses, or
25 other payments from the account to the

1 franchisor or to any subsidiary, affiliate, or
2 other entity controlled in whole or in part by
3 the franchisor; and

4 (C) disclose the source and amount of, and
5 deliver to such fund or program, any discount,
6 rebate, compensation, or payment of any kind
7 from any person or entity with whom such fund
8 or program transacts.

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

14 **SEC. 6. PROCEDURAL FAIRNESS.**

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

17 (1) require any term or condition in a franchise
18 agreement, or in any agreement ancillary or collat-
19 eral to a franchise, which directly or indirectly vio-
20 lates 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 this 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; or

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

23 (b) Any condition, stipulation, provision, or term of
24 any franchise agreement, or any agreement ancillary or
25 collateral to a franchise, which would purport to waive or

1 restrict any right granted under this Act shall be void and
2 unenforceable.

3 (c) No stipulation or provision of a franchise agree-
4 ment, or of an agreement ancillary or collateral to a fran-
5 chise, shall—

6 (1) deprive a franchisee of the application and
7 benefits of this Act, of any other Federal law, or of
8 the law of the State in which the franchisee's prin-
9 cipal place of business is located;

10 (2) deprive a franchisee of the right to com-
11 mence an action (or, if the franchise provides for ar-
12 bitration, initiate an arbitration) against the
13 franchisor for violation of this Act, or for breach of
14 the franchise agreement, or of any agreement or
15 stipulation ancillary or collateral to the franchise, in
16 a court (or arbitration forum) in the State of the
17 franchisee's principal place of business; or

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

21 (d) Compliance with this Act or with an applicable
22 State franchise law is not waived, excused, or avoided, and
23 evidence of violation of this Act or of such State law shall
24 not be excluded, by virtue of an integration clause, any
25 provision of a franchise agreement, or an agreement ancil-

1 lary or collateral to a franchise, the parol evidence rule,
2 or any other rule of evidence purporting to exclude consid-
3 eration of matters outside the franchise agreement.

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

5 (a) CIVIL ACTION.—Whenever an attorney general of
6 any State has reason to believe that the interests of the
7 residents of that State have been or are being threatened
8 or adversely affected because any person has engaged or
9 is engaging in a pattern or practice which violates any pro-
10 vision of this Act, the State, as parens patriae, may bring
11 a civil action on behalf of its residents in an appropriate
12 district court of the United States to enjoin such viola-
13 tions, to obtain damages, restitution or other compensa-
14 tion on behalf of residents of such State or to obtain such
15 further and other relief as the court may deem appro-
16 priate.

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

1 (c) VENUE.—Any civil action brought under sub-
2 section (a) in a district court of the United States may
3 be brought in the district in which the defendant is found,
4 is an inhabitant, or transacts business or wherever venue
5 is proper under section 1391 of title 28, United States
6 Code. Process in such action may be served in any district
7 in which the defendant is an inhabitant or in which the
8 defendant may be found.

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

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

14 (a) IN GENERAL.—A franchisee may assign an inter-
15 est in a franchised business or in a franchise to a trans-
16 feree provided the transferee satisfies the reasonable qualifi-
17 cations then generally applied by the franchisor in deter-
18 mining whether or not a current franchisee is eligible for
19 renewal. If the franchisor does not renew a significant
20 number of its franchisees, then the transferee may be re-
21 quired to satisfy the reasonable conditions generally ap-
22 plied to new franchisees. For the purpose of this section,
23 a reasonable current qualification for a new franchisee is
24 a qualification based upon a legitimate business reason.
25 If the proposed transferee does not meet the reasonable

1 current qualifications of the franchisor, the franchisor
2 may refuse to permit the transfer, provided that the re-
3 fusal of the franchisor to consent to the transfer is not
4 arbitrary or capricious and the franchisor states the
5 grounds for its refusal in writing to the franchisee.

6 (b) NOTICE OF PROPOSED TRANSFER.—A franchisee
7 shall give a franchisor not less than 30 days written notice
8 of a proposed transfer of a transferable interest, and on
9 request shall provide in writing the ownership interests of
10 all persons holding or claiming an equitable or beneficial
11 interest in the franchise subsequent to the transfer or the
12 franchisee, as appropriate.

13 (c) CONSENT TO PROPOSED TRANSFER.—A transfer
14 by a franchisee is deemed to have been approved 30 days
15 after the franchisee submits the request for permission to
16 transfer the franchise involved unless, within that time the
17 franchisor refuses to consent to the transfer as evidenced
18 in writing in accordance with subsection (a). A statement
19 of the grounds for refusal to consent to the transfer is
20 privileged against a claim of defamation.

21 (d) CONDITIONS OF TRANSFER.—

22 (1) PERMISSIBLE CONDITIONS.—A franchisor
23 may require as a condition of a transfer that—
24 (A) the transferee successfully complete a
25 reasonable training program;

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

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

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

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

1 reasonably required under the terms of the
2 franchisee's existing franchise agreement.

3 (e) ASSIGNMENT.—A franchisee may assign the
4 franchisee's interest in the franchise for the unexpired
5 term of the franchise agreement, and a franchisor shall
6 not require the franchisee or the transferee to enter into
7 a franchise agreement that has different material terms
8 or financial requirements as a condition of the transfer.

9 (f) CONSENT TO PUBLIC OFFERING.—A franchisor
10 may not withhold its consent to a franchisee's making a
11 public offering of its securities without good cause if the
12 franchisee, or the owner of the franchisee's interest in the
13 franchise, retains control over more than 25 percent of
14 the voting power as the franchisee.

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

22 (h) NONINTERFERENCE.—The following occurrences
23 shall not be considered transfers requiring the consent of
24 the franchisor under a franchise agreement, and a
25 franchisor shall not impose any fees, payments, or charges

1 in excess of a franchisor's cost to review the relevant mat-
2 ter:

3 (1) The succession of ownership or management
4 of a franchise upon the death or disability of a
5 franchisee, or of an owner of a franchise, to the sur-
6 viving spouse, heir, or partner active in the manage-
7 ment of the franchise unless the successor objec-
8 tively fails to meet within 1 year or the then current
9 reasonable qualifications of the franchisor for
10 franchisees.

11 (2) Incorporation of a proprietorship franchisee,
12 provided that the franchisor may require a personal
13 guarantee by the franchisee of obligations related to
14 the franchise.

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

23 (4) A transfer of less than a controlling interest
24 in the franchise to the franchisee's spouse or child
25 or children, provided that more than 50 percent of

1 the entire franchise is held by those who meet the
2 franchisor's reasonable current qualifications. If less
3 than 50 percent of the franchise would be owned by
4 persons who objectively meet the franchisor's reason-
5 able current qualifications, the franchisor may refuse
6 to authorize the transfer.

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

19 (6) A franchisor may not exercise any pur-
20 ported right of first refusal or right to purchase with
21 regard to any franchise, or interest or assets of a
22 franchisee, upon the happening of any event de-
23 scribed in paragraphs (1) through (5).

24 (i) EFFECT OF CERTAIN COVENANTS.—

1 (1) IN GENERAL.—After the transfer of a
2 transferor's complete interest in a franchise, a
3 franchisor may not enforce against the transferor
4 any covenant of the franchise purporting to prohibit
5 the transferor from engaging in any lawful occupa-
6 tion or enterprise.

7 (2) EXCEPTION.—This subsection shall not
8 limit the franchisor from enforcing a contractual
9 covenant against the transferor not to exploit the
10 franchisor's trade secrets or intellectual property
11 rights (including protection of trade dress) except by
12 agreement with the franchisor.

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

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

16 (1) the franchisor provides, not less than 30
17 days before the effective date of transfer, notice to
18 every franchisee of the intent to transfer the
19 franchisor's interest in the franchise or of substan-
20 tially all of the franchises held by the franchisor;

21 (2) such notice is accompanied by a complete
22 description of the business and financial terms of
23 the proposed transfer or transfers; and

24 (3) upon the transfer, the entity assuming the
25 franchisor's obligations has the business experience

1 and financial means to perform all of the
2 franchisor's obligations in the ordinary course of
3 business.

4 **SEC. 10. INDEPENDENT SOURCING OF GOODS AND SERV-**
5 **ICES.**

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

16 (b) **APPROVED VENDORS.**—Without limiting the
17 rights of the franchisee under subsection (a), if the
18 franchisor approves vendors of equipment, fixtures, sup-
19 plies, goods, or services used in the establishment or oper-
20 ation of the franchised business, the franchisor shall pro-
21 vide and continuously update an inclusive list of approved
22 vendors and shall promptly and objectively evaluate and
23 respond to reasonable requests by franchisees for approval
24 of competitive sources of supply. In order to promote com-
25 petition, the franchisor shall approve not fewer than 2 ven-

1 dors for each piece of equipment, each fixture, each sup-
2 ply, good, or service unless otherwise agreed to by both
3 the franchisor and a majority of the franchisees.

4 (c) BENEFITS.—A franchisor, and its affiliates, shall
5 fully disclose whether or not it receives any rebates, com-
6 missions, payments, or other benefits from vendors as a
7 result of the purchase of goods or services by franchisees.
8 All such rebates, commissions, payments, and other bene-
9 fits shall be distributed directly to such franchisees.

10 (d) REPORTING.—A franchisor shall report not less
11 frequently than annually, using generally accepted ac-
12 counting principles, the amount of revenue and profit it
13 earns from the sale of equipment, fixtures, supplies, goods,
14 or services to the franchisees of the franchisor.

15 (e) EXCEPTION.—Subsection (a) does not apply to
16 reasonable quantities of equipment, fixtures, supplies,
17 goods, or services, including display and sample items,
18 that the franchisor requires the franchisee to obtain from
19 the franchisor or its affiliate, but only if the equipment,
20 fixtures, supplies, goods, or services are central to the
21 franchised business and incorporate a trade secret, patent,
22 copyright, or other intellectual property owned by the
23 franchisor or its affiliate.

1 **SEC. 11. ENCROACHMENT.**

2 (a) IN GENERAL.—A franchisor may not place, or li-
3 cense another to place, 1 or more new outlets for a fran-
4 chised business in unreasonable proximity to an estab-
5 lished outlet of a similar kind of franchised business, if—

6 (1) the intent or probable effect of establishing
7 the new outlets is to cause a diminution of gross
8 sales by the established outlet of more than 5 per-
9 cent in the 12 months immediately following estab-
10 lishment of the new outlet; and

11 (2) the established outlet—

12 (A) offers goods or services identified by
13 the same trademark as those offered from the
14 new outlet; or

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

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

1 the new outlet as a consequence of the opening of the new
2 outlet.

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

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

10 (2) in an action or proceeding brought under
11 section 12.

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

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

24 (b) LIABILITY.—Every person who directly or indi-
25 rectly controls a person liable under subsection (a), every

1 partner in a firm so liable, every principal executive officer
2 or director of a corporation so liable, every person occu-
3 pying a similar status or performing similar functions and
4 every employee of a person so liable who materially aids
5 in the act or transaction constituting the violation is also
6 liable jointly and severally with and to the same extent
7 as such person, unless the person who would otherwise be
8 liable hereunder had no knowledge of or reasonable
9 grounds to know of the existence of the facts by reason
10 of which the liability is alleged to exist.

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

20 (d) STATUTE OF LIMITATIONS.—No action may be
21 commenced pursuant to this section or this Act more
22 than—

23 (1) 5 years after the date on which the violation
24 occurs; or

1 (2) 3 years after the date on which the violation
2 is discovered or should have been discovered through
3 exercise of reasonable diligence.

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

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

12 **SEC. 13. SCOPE AND APPLICABILITY.**

13 (a) PROSPECTIVE APPLICATION.—Except as pro-
14 vided in subsection (b), the requirements of this Act shall
15 apply to franchise agreements entered into, amended, ex-
16 changed, transferred, assigned, or renewed after the date
17 of enactment of this Act.

18 (b) DELAYED EFFECT.—The requirements of section
19 3 of this Act shall take effect 90 days after the date of
20 enactment of this Act and shall apply only to actions,
21 practices, disclosures, and statements occurring on or
22 after such date.

23 **SEC. 14. DEFINITIONS.**

24 For purposes of this Act:

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

5 (2) The term “franchise” has the meaning
6 given such term in section 436.2(a) of title 16 of the
7 Code of Federal Regulations as in effect on January
8 1, 1998, but does not include any contract otherwise
9 regulated by the Federal Petroleum Marketing Prac-
10 tices Act (15 U.S.C. 2801 et seq.) except as to fran-
11 chise relationships that do not involve the sale of pe-
12 troleum products.

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

17 (4) The term “franchisee” has the meaning
18 given such term in section 436.2(d) of title 16 of the
19 Code of Federal Regulations as in effect on January
20 1, 1998.

21 (5) The term “franchisor” has the meaning
22 given such term in section 436.2(c) of title 16 of the
23 Code of Federal Regulations as in effect on January
24 1, 1998.

1 (6) The term “good faith” means honesty in
2 fact and the observance of reasonable standards of
3 fair dealing in the trade.

4 (7) The terms “material” and “material fact”
5 includes—

6 (A) any fact, circumstance, or set of condi-
7 tions which a reasonable franchisee or a reason-
8 able prospective franchisee would consider im-
9 portant in making a significant decision relat-
10 ing to entering into, remaining in, or aban-
11 doning a franchise relationship; and

12 (B) any fact, circumstance, or set of condi-
13 tions which has, or may have, any significant fi-
14 nancial impact on a franchisor, franchisee or a
15 prospective franchisee.

16 (8) The term “offer” or “offering” means any
17 effort to offer or to dispose of, or solicitation of an
18 offer to buy, a franchise or interest in a franchise
19 for value.

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

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

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

4 (12) The term “subfranchise” means a contract
5 or an agreement by which a person pays a
6 franchisor for the right to sell, negotiate the sale, or
7 provide service franchises.

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

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

13 (A) derives independent economic value,
14 actual or potential, from not being generally
15 known to, and not being readily ascertainable
16 by proper means by, other persons who can ob-
17 tain economic value from its disclosure or use;
18 and

19 (B) is the subject of efforts that are rea-
20 sonable under the circumstances to maintain its
21 secrecy.

