FisherZucker

BUSINESS LAWYERS

October 21, 2015

The Honorable Robert W. Godshall, Chairman
Pennsylvania House of Representatives
Committee on Consumer Affairs
Capitol Building
Harrisburg, PA 17120

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Re: Opposition to HB 1620

Dear Chairman Godshall and Members of the Pennsylvania House Consumer Affairs Committee:

On behalf of myself and my partners, we urge you to oppose HB 1620 as it seeks to remedy with an unnecessary and vague law a problem that is not pervasive in the Commonwealth. If passed, HB 1620 will unduly interfere in the freedom of contract between parties to a business transaction and create uncertainty as to the rights and obligations of those parties. Existing law provides a sufficient framework to protect franchisees without disrupting the relationship between franchisors and franchisees. If passed, HB 1620 will undoubtedly have a negative impact on franchising within the Commonwealth.

Who We Are and Why We Oppose HB 1620

FisherZucker, LLC is a boutique law firm located in Philadelphia specializing in franchise law. We represent over 120 franchise brands as well as multi-unit and single unit franchisees. HB 1620 would profoundly affect franchising in Pennsylvania by creating an anticompetitive and inhospitable business climate built on bad policy and unnecessary restrictions. Only a small minority of states has laws that affect the franchise relationship, and HB 1620 would by far be the most intrusive—making the Commonwealth an unattractive outlier for franchisors. Moreover, HB 1620 is vague in many critical respects, which will inevitably lead to spurious litigation in no one's best interest.

Existing Law Provides Sufficient Rights and Protections without the Need to Intrude into the Private Contractual Relationships of Business Parties

The Federal Trade Commission ("FTC") Rule on Franchising, 16 C.F.R. 436 et seq., governs the offer and sale of franchises in the United States (the "FTC Franchise Rule"). The FTC Franchise Rule requires a franchisor to provide a prospective franchisee with a presale franchise disclosure document (an "FDD"). The FDD contains 23 items of information and copies of the forms of franchise agreement. The FDD contains

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fees associated with purchasing a franchise and other key terms of the franchisor's franchise offering. Franchisors must give prospective franchisees a 14-day opportunity to review the FDD before they can accept money from or enter into a franchise agreement with a prospect.

The FTC Rule was last revised in 2007. At that time, in the 2007 FTC Statement of Basis and Purpose, the FTC noted that many wanted the FTC to address post-sale franchise contractual "relationship issues," such as those that HB 1620 seeks to address. The FTC found that while some franchisees have suffered post-sale harm that may be ascribable to the acts or practices of the franchisor, the record did not demonstrate that such acts were prevalent and whether the injury was substantial when viewed from the standpoint of the franchising industry as a whole, not just a particular franchise system. Finally, the FTC found that in their law enforcement experience investigating relationship issues in individual franchise systems, it has been the case that the franchisor actions allegedly causing harm to individual franchisees also frequently generate countervailing benefits to the system as a whole or to consumer welfare overall, which the alleged harm to franchisees may or may not outweigh.

My view based on over 25 years of practice representing both franchisors and franchisees is consistent with the FTC's findings in 2007. I am not aware of any evidence to the contrary of industry-wide practices that would warrant the kind of disruption that HB 1620 would cause. While it is certainly true that franchise disputes exist, and that problems may arise within certain franchise systems, existing law already provides the framework for a remedy.

A franchise purchase is voluntary, and the FTC Rule ensures that each prospective franchisee receives a disclosure document, expanded in key respects in 2007. Aside from the pre-sale protections provided by the FDD, Pennsylvania law provides ample remedies for an aggrieved franchisee. Under certain facts, franchisees may have claims for breach of contract as well as fraud and misrepresentation. Moreover, Pennsylvania law has long recognized the implied covenant of good faith and fair dealing contained in every contract.

Only 18 states have adopted any law that intrudes on the franchise relationship after the execution of the franchise agreement. Adoption of any bill providing for a relationship law would place Pennsylvania in the minority and make the business climate here more restrictive and anticompetitive than others. To make matters worse, HB 1620 contains a number of provisions foreign even to those states that have adopted relationship laws. Due to these differences, adoption of HB 1620 would make Pennsylvania an outlier among the minority of states that touch on the franchise relationship.

Specific Provisions in HB 1620

Below are some of the provisions contained within the bill that, by preventing a franchisor from fulfilling its necessary role and by creating numerous points for litigation, would place a significant burden on developing a healthy and thriving franchise environment in Pennsylvania.

The Varying and Vague Uses of "Good Faith." Section 5503 vaguely defines "Good Faith" as "[h]onesty in fact and the observance of commercial standards of fair dealing." Section 5510 of the bill states "[e]ach franchisor shall owe a duty of good faith and fair dealing to each franchisee," which, according to Section 5506(c)(2)(ii), means to "do nothing that will have the effect of destroying or injuring the right of the other party to the obtain and receive the expected fruits of the contract." The varying uses and vague definition of the term "Good Faith" in HB 1620 insert a significant amount of uncertainty into the contractual relationship of the parties. Rather than the rights and obligations of the parties being set forth in the franchise agreement, coupled with the long standing and understood existing legal protections found in the implied covenant of good faith and fair dealing, HB 1620 makes the interpretation of the franchise agreement dependent on the subjective intent of one of the parties. Depending on the individual involved, it could encompass everything or nothing. If enacted, these provisions will make even the most clear contractual right the subject of a dispute and will create significant litigation issues.

Termination by a Franchisee. Section 5505(f) allows for a franchisee to unilaterally terminate the franchise agreement based on changes in the franchise system that "cause substantial negative impact or substantial financial hardship to the franchisee in the operation of the franchise." This provision is entirely unprecedented across all state franchise relationship laws, and it hugely impairs the role of a franchisor by impeding the ability to make necessary changes to the system. This provision will negatively impact all franchisees by stifling system development as the changes that might provide cause to terminate are so vaguely defined, which also invites disruptive and expensive litigation.

Termination by Franchisor. Section 5505 further prohibits the franchisor from terminating or "substantially chang[ing] the competitive circumstances of a franchise agreement except for good cause." The prohibition on changing the "competitive circumstances" of the franchise is vague and undefined and, similar to the franchisee right to terminate, will unduly chill innovation because of a fear of litigation.

Moreover, most, if not all, franchise agreements already provide for prior notice and an opportunity to cure before termination. Few agreements, if any at all, provide the franchisor with the ability to terminate without cause. Additionally, most franchise agreements set out the numerous and specific grounds for termination. By requiring "good cause" for termination, when most franchise agreements otherwise specifically set forth the

breaches that may result in the termination of the agreement, the bill offers a solution to a non-existent problem. In doing so, it creates another point for the parties to litigate because the definition is unclear.

General Application of Pennsylvania Law. Section 5512(b) provides that Pennsylvania law generally, not just the proposed revisions contained in HB 1620, will govern the interpretation of a franchise agreement of a franchise located in this Commonwealth. While seemingly benign, this provision will cause substantial problems in practice. Uniformity is an important element in a franchise system. Requiring that a single state's law govern the interpretation of a franchise agreement is important so that there are not 50 different interpretations of the same contractual terms. Courts, in this Commonwealth as well as in our sister states, are well-versed in conflict of laws and in applying, where appropriate, a particular state's public policy to a particular question. This provision is unnecessary and has the potential to seriously disrupt the operation of franchise systems.

Negotiation with Franchisee Associations. Section 5507(b)(4) requires franchisors to deal "fairly and in good faith" with franchisee associations in any matter. The relationship between a franchisor and a franchisee is specifically defined and governed by the terms of the franchise agreement. Each franchisee has different needs and interests. While franchisees are, and should be, free to associate and to form associations—indeed, such associations are required to be disclosed in the FDD—requiring franchisors to negotiate directly with associations is an unwarranted intrusion into the private dealings of the contractual parties. Moreover, the vague nature of the language, "deal fairly and in good faith," will no doubt generate much litigation paid for by the system franchisees contributing to the association who may have no interest in the outcome of any particular dispute.

Prohibition on Class Action Waivers. Section 5513(b) prohibits the parties from mutually agreeing to waive participation in class action claims and consolidated actions. Franchise disputes, unlike mass product liability or securities fraud claims, are inherently fact-specific, arising from the particular agreement and circumstances of each franchisee. Maintaining a class or consolidated action blurs relevant distinctions between the parties and claims at issues in their individual disputes. Moreover, the possibility of bringing a class action invites litigious attorneys to instigate claims, draw in hesitant plaintiffs, and subject businesses to massive and vexatious litigation. If class actions result in a recovery, the plaintiffs' attorneys typically benefit more than the plaintiff. Class actions are waivable in most contracting scenarios, and no other state has a prohibition on class action waivers in the context of franchising. As such, Pennsylvania should not be the first state to enact such a restriction.

Ambiguous and Overly-Broad Terms. In addition to the above-described provisions and others, HB 1620 contains numerous ambiguities and overly broad

statements that will create many points for unnecessary litigation. For example, one provision prohibits franchisors from "coercing" franchisees to sign mutual releases, but "coercion" is left undefined. Also, as noted, "good cause" is used throughout the bill without a standard definition. By writing these provisions into law, the legislature would be turning this ambiguity into unpredictability in the courts, as well as in the minds of both Pennsylvania franchisors and franchisees.

Conclusion

HB 1620 is great for us as franchise lawyers because it will create more opportunity for work. Otherwise, HB 1620 is not great for the Commonwealth of Pennsylvania. This bill will negatively affect franchisors, consumers, and, despite the good intentions behind the bill, franchisees. By forcing contract terms on a business relationship already governed by disclosure laws and regulated by market forces, the bill impedes the ability of a healthy Pennsylvania franchise system to grow and function.

I look forward to addressing any issues or questions that you may have.

Very truly yours,

FISHER ZUCKER LLC

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