

## **Rhode Island Fair Dealership Act – PL 2007-36** *Flawed Policy that's Bad for Business*

*According to a 2004 study, Rhode Island had 2,609 franchise establishments, employing 31,003 workers and generating an economic output of \$1.88 billion.\**

---

### **Background**

Taking effect June 14, 2007, the Rhode Island Fair Dealership Act (Public Law 2007-36) is the result of legislation enacted during the 2007 session of the Rhode Island General Assembly.

- The key provision of the law requires 90 days notice of termination, non-renewal or substantial change in competitive circumstances. Because the law mandates a 60 day cure period before the franchisor can take any of the foregoing actions against a franchisee, it can be interpreted as impliedly creating a good cause standard;
  - The law includes a very narrow definition of "good cause" (essentially stating that good cause exists only if there is a serious default), although the term "good cause" is not otherwise used in the statute;
  - The Act covers non-renewals and thus impliedly creates in perpetuity contracts;
  - The Act applies to a "substantial change in competitive circumstances," which is undefined in the statute; and
  - The Act requires the repurchase of branded inventory at fair wholesale market value.
- 

### **Analysis**

- **This Act hurts both franchisors and franchisees alike** since it will undermine the ability of franchise systems to enforce uniform standards of quality and integrity, thereby hurting the brand's value and reputation. The bill would make it extremely difficult to end a relationship with a particular operator even when there are serious violations, such as safety and health code problems, violations of state or local laws, or failure to obtain and maintain insurance. The brand as well as the consuming public would therefore suffer the consequences.
- **This Act will lead to an avalanche of litigation over the contractual relationship of franchisors and franchisees.** The bill defines "good cause" as "failure by a dealer to comply substantially with essential and reasonable requirements." Defining the vague terms "essential" and "reasonable" would be left to the courts to decide. The Act is similar to existing law in Wisconsin, which has proven to be one of the most heavily litigated franchise regulations in the country.
- **This Act is very likely unconstitutional.** In November 1994, the U.S. Supreme Court refused to hear an appeal regarding a law in Iowa with provisions similar to the Rhode Island Fair Dealership Act. The court agreed with two lower courts that the Act's retroactivity, according to U.S. District Judge Harold D. Vietor, "materially changes the rights to which the parties agreed and for which they gave consideration," and therefore violates the Constitution.
- **Over-regulating the relationship and termination procedures between franchisors and franchisees will hurt the economy of Rhode Island.** According to a December 2006 study, state mandates on the termination rights of the franchisor lead to a reduction

in franchising, which is not offset by new franchisor-operated outlets. Additionally, employment in franchised industries is “significantly reduced when states enact restrictions on franchisor termination rights and the effect is larger when states limit the ability to contract around these restrictions.” (*The Effect of Contract Regulation: The Case of Franchising*; Klick, Kobayashi, Ribstein; 2006; <http://ssrn.com/abstract=951464>)

- **One law can not effectively regulate over 80 different industries that operate within the franchise model of doing business.** This flawed attempt to address a concern within one industry will have lasting, negative repercussions on industries as varied as hotels/lodging, car rental, tax preparation, convenience stores, lawn care/landscaping, senior care, restaurants, florists and travel agents.

---

### Why franchise?

- **There is perhaps no other business investment where more information is available to the investors prior to making a commitment.** Franchise companies are required to disclose their litigation and bankruptcy histories, the initial investment required, royalties and advertising fees to be collected, the rights and obligations of both parties, and the conditions under which the franchise can be transferred, terminated or not renewed, among other information.
- **Existing franchise regulations protect franchise investors.** For more than two decades, the Federal Trade Commission’s Franchise Rule has required extensive pre-sale disclosure of information about every franchise investment. After more than 12 years of contemplation, the FTC released in March 2007 an overhaul of the Franchise Rule. While many of the changes were technical in nature, the FTC considered and specifically decided against creating any type of federal rule further regulating the relationship between franchisees and franchisors, as this Act seeks to do. Recognizing the impact that such over-regulation would have on the broad array of franchised industries, the FTC concluded in its final rule notification: “Therefore, the Commission declines to impose industry-wide provisions mandating substantive terms of private franchise contracts that would impact on the entire franchise industry, not just those franchise systems that are the subject of commenters’ complaints.” (*Federal Register*, Vol. 72, No. 61, March 30, 2007)