

ACT 242

H.B. NO. 227

A Bill for an Act Relating to the Franchise Investment Law.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. Section 482E-2, Hawaii Revised Statutes, is amended by repealing the definitions of “Advertisement” and “publish”.

SECTION 2. Section 482E-2, Hawaii Revised Statutes, is amended by amending the definition of “Franchise” to read as follows:

“‘Francise’ means an oral or written contract or agreement, either expressed or implied, in which a person grants to another person, a license to use a

trade name, service mark, trade mark, logotype or related characteristic in which there is a community interest in the business of offering, selling, or distributing goods or services at wholesale or retail, leasing, or otherwise, and in which the franchisee is required to pay, directly or indirectly, a franchise fee.

SECTION 3. Section 482E-2, Hawaii Revised Statutes, is amended by amending the definition of "sale or sell" to read as follows:

"Sale or sell" includes every contract of sale, contract to sell, or disposition of a franchise.

SECTION 4. Section 482E-3, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-3. Offering circular. (a) It is unlawful for any person to sell a franchise in this State unless such person has presented to the prospective franchisee or his representative, at least seven days prior to the sale of the franchise, an offering circular containing the following information:

- (1) The name of the franchisor, the name under which the franchisor is doing or intends to do business, and the name of any parent or affiliated company that will engage in business transactions with franchisees.
- (2) The franchisor's principal business address and the name and address of his agent in the State authorized to receive process.
- (3) The business form of the franchisor whether corporate, partnership, or otherwise.
- (4) Such other information concerning the identity and business experience of persons affiliated with the franchisor including franchise brokers and selling agents as the director may by rule prescribe.
- (5) A statement whether any person identified in the offering circular, within ten years preceding the date of the offering circular:
 - (A) Has been found guilty of a felony or held liable in a civil action by final judgment if the civil action involved fraud, embezzlement, fraudulent conversion, or misappropriation of property; or
 - (B) Is subject to any currently effective order of the Securities and Exchange Commission or the securities administrator of any state denying registration to or revoking or suspending the registration of such person as a securities broker or dealer or investment advisor or is subject to any currently effective order or any national security association or national securities exchange (as defined in the Securities and Exchange Act of 1934) suspending or expelling such person from membership of such association or exchange; or
 - (C) Is subject to any currently effective order or ruling of the Federal Trade Commission or is subject to any currently effective order relating to the business activity as a result of an action brought by any public agency or department.

Such statement shall set forth the court, the date of conviction or judgment, any penalty imposed, or damages assessed, or the date, nature, and issue of such order.

- (6) A statement of when, where, and how long the franchisor has:
 - (A) Conducted a business of the type to be operated by the franchisees;
 - (B) Has granted franchises for such business; and
 - (C) Has granted franchises in other lines of business.
- (7) A recent financial statement of the franchisor, together with a statement of any material changes in the financial condition of the franchisor from the date thereof. The director may describe:
 - (A) Form and content of the financial statements required under this chapter;
 - (B) The circumstances under which consolidated financial statements can be filed; and
 - (C) The circumstances under which financial statements shall be audited by independent, certified public accountants.
- (8) A copy of the typical franchise contract or agreement proposed for use in this State.
- (9) A statement of the franchise fee charged, the proposed application of the proceeds of the fee by the franchisor, and the formula by which the amount of the fee is determined if the fee is not the same in all cases.
- (10) A statement describing a payment of fees other than franchise fees that the franchisee or subfranchisor is required to pay to the franchisor including royalties and payments or fees which the franchisor collects in whole or in part on behalf of a third party or parties.
- (11) A statement of the conditions under which the franchise agreement may be terminated or renewed or renewal refused, or repurchased at the option of the franchisor.
- (12) A statement of the conditions under which the franchise may be sold, transferred, or assigned.
- (13) A statement of the conditions imposed by the franchisor whether by the terms of the franchise agreement or by other device or practice whereby the franchisee or subfranchisor is required to purchase services, supplies, products, fixtures, or other goods relating to the establishment or operation of the franchise business from the franchisor or his designee.
- (14) A statement of any restriction or condition imposed by the franchisor whether by the terms of the franchise agreement or by other device or practice whereby the franchisee is limited or required in the goods and services offered by him.
- (15) A statement of the terms and conditions of any financing arrangements when offered directly or indirectly by the franchisor or his agent or affiliate.
- (16) A statement of any intent of the franchisor to sell, assign, or discount to a third party any note, contract, or other obligation of the franchisee in whole or in part.
- (17) A copy of any financial statement prepared for presentation to prospective franchisees or other persons together with a statement setting forth the basis for such statements.

- (18) A statement of the number of franchise businesses in each of the following categories which within the three-year period preceding the date of the offering circular have:
 - (A) Been canceled or terminated by either the franchisor or franchisee;
 - (B) Not been renewed by either the franchisor or franchisee;
 - (C) Been reacquired through purchase by the franchisor;
 - (D) Been otherwise reacquired by the franchisor; and
 - (E) Been transferred or sold by the franchisee to persons other than a corporation or other business entity controlled by the transferring or selling franchisee.
- (19) A statement describing the training program, supervision, and assistance the franchisor has and will provide the franchisee.
- (20) A statement as to whether franchisees or subfranchisors receive an exclusive area or territory.
- (21) A statement of any compensation or other benefit given or promised to a public figure arising, in whole or in part, from
 - (A) the use of the public figure in the name or symbol of the franchise or
 - (B) the endorsement or recommendation of the franchise by the public figure in advertisements.
- (22) Such other information as the director may reasonably require.
- (23) Such other information as the franchisor may wish to present.
- (24) When the person selling the franchise is a subfranchisor, the offering circular shall also include the same information concerning the subfranchisor as is required from the franchisor pursuant to this subsection.
- (25) List of names and addresses of all franchisees of the franchisor whose franchise businesses are situated in this State.

(b) If any material change occurs in the information contained in the offering circular, the offering circular shall be amended by the franchisor or subfranchisor before further sales of the franchise are made in this State and the amended offering circular shall be presented to a prospective franchisee at least seven days before a sale of a franchise is made to the prospective franchisee. The director may define by rule material changes which require amendment of an offering circular.

(c) There shall be filed with the director a copy of the offering circular required under section 482E-3(a) or the amended offering circular required under section 482E-3(b) at least seven days prior to the sale of a franchise.

(d) In lieu of an offering circular meeting the requirements set forth in this section, franchises may be sold in this State by means of an offering circular or disclosure statement required by a federal or government agency of another state, or an offering circular or disclosure statement meeting the requirements approved by an association of state regulatory agencies; provided that the director determines that such offering circular or disclosure statement substantially meets the disclosure requirements set forth in this section.

SECTION 5. Section 482E-4, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-4 Exemptions. (a) Sections 482E-3, 482E-5(a) and 482E-5(c) shall not apply to:

- (1) Any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator.
- (2) Any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit sharing trust, or other financial institution or institutional buyer or to a broker dealer where the purchaser is acting for itself or in some fiduciary capacity.
- (3) Any motor vehicle franchise subject to chapter 437.
- (4) The offer or sale is to a franchisee or prospective franchisee where the franchisee or prospective franchisee is not domiciled in this State and where the franchise business will not be operated in this State.
- (5) The extension or renewal of an existing franchise or the exchange or substitution of a modified or amended franchise agreement or the transfer of the location of a franchise where there is no interruption in the operation of the franchise business of the franchisee, and no material change in the franchise relationship.
- (6) The offer or sale of an additional franchise to an existing franchisee of the same franchisor.
- (7) The offer or sale of a franchise by a franchisee for his own account, or the issuance of a new franchise agreement pursuant to a sale by a franchisee for his own account, if the sale is an isolated sale and not part of a plan of distribution of franchises.

(b) The director may by rule or order exempt from sections 482E-3, 482E-5(a) and 482E-5(c) in whole or in part, any transaction or person, firm, corporation, or industry. In determining whether such exemption shall issue, the director shall consider whether information which would be required to be disclosed would be material in determining whether the prospective franchise has a reasonable chance of success and whether the exemption is in the public interest."

SECTION 6. Section 482E-5, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-5 General Provisions. (a) Every person selling franchises in this State shall at all times keep and maintain a complete set of books, records and accounts of such sales and shall thereafter at such times as are required by the director make and file in the office of the director a report setting forth the franchises sold by it and the proceeds derived therefrom.

(b) It is unlawful for any person in connection with the offer, sale, or purchase of any franchise directly or indirectly:

- (1) To make any untrue statement of a material fact in any offering circular or report filed with the director under this chapter or wilfully to omit to state in any offering circular or report, any material fact which is required to be stated therein.

- (2) To sell or offer to sell a franchise in this State by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made not misleading.
- (3) To employ any device, scheme, or artifice to defraud.
- (4) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.
- (5) To violate any order of the director.
- (c) Any person who is engaged or hereafter engaged directly or indirectly in the sale of a franchise or in business dealings concerning a franchise, either in person or in any other form of communication, shall be subject to this chapter, shall be amenable to the jurisdiction of the courts of this State and shall be amenable to the service of process as provided by law and rule. Every person who sells a franchise in this State, other than a Hawaii corporation, shall file with the director in such form as he by rule prescribes, an irrevocable consent appointing the director or his successor in office to be his attorney, to receive service or any lawful process in any noncriminal suit, action, or proceeding against him or his successor, executor, administrator, or personal representative which arises under this chapter or any rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the person filing consent. A person who has filed such a consent in connection with a previous sale under this law need not file another. Service may be made by leaving a copy of the process in the office of the director but it is not as effective unless:
 - (1) The plaintiff, who may be the director, in a suit, action, or proceeding instituted by him forthwith sends notice of the service and a copy of the process by registered or certified mail to the defendant or respondent at his last address on file with the director; and
 - (2) The plaintiff's affidavit of compliance with this section is filed in the case on or before the return day of the process, if any, or within such further times as the court allows.
- (d) In any proceeding under this chapter, the burden of proving an exception or an exemption from a definition is upon the person claiming it."

SECTION 7. Section 482E-6, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-6 Relationship between franchisor or subfranchisor and franchisee. Without limiting the other provisions of this chapter, the following specific rights and prohibitions shall govern the relation between the franchisor or subfranchisor and its franchisees:

- (1) The parties shall deal with each other in good faith.
- (2) For the purposes of this chapter and without limiting its general application, it shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor or subfranchisor to:
 - (A) Restrict the right of the franchisees to join an association of franchisees.
 - (B) Require a franchisee to purchase or lease goods or services of the

franchisor or from designated sources of supply unless such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds. Suppliers suggested or approved by a franchisor as meeting its standards and requirements shall not be deemed designated sources of supply.

- (C) Discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing, unless and to the extent that any classification of or discrimination between franchisees is:
 - (i) based on franchises granted at materially different times, and such discrimination is reasonably related to such differences in time;
 - (ii) is related to one or more programs for making franchises available to persons with insufficient capital, training, business experience, education or lacking other qualifications;
 - (iii) is related to local or regional experimentation with or variations in product or service lines or business formats or designs;
 - (iv) is related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or
 - (v) is based on other reasonable distinctions considering the purposes of this chapter and is not arbitrary.
- (D) Obtain money, goods, services, anything of value, or any other benefit from any other person with whom the franchisee does business on account of such business unless the franchisor advises the franchisee in advance of the franchisor's intention to receive such benefit.
- (E) Establish a similar business or to grant a franchise for the establishment of a similar business at a location within a geographical area specifically designated as the exclusive territory in a franchise previously granted to another franchisee in a currently effective agreement, except under the circumstances or conditions prescribed in such agreement. The fact that other franchisees or the franchisor may solicit business or sell goods or services to people residing in such geographical territory shall not constitute the establishment of a similar business within the exclusive territory.
- (F) Require a franchisee at the time of entering into a franchise to assent to a release, assignment, novation, or waiver which would relieve any person from liability imposed by this chapter. Any condition, stipulation or provision binding any person acquiring any franchise to waive compliance with any provision of this chapter or a rule promulgated hereunder shall be void. This paragraph shall not bar or affect the settlement of disputes, claims or civil suits arising or brought under this chapter.

- (G) Impose on a franchisee by contract, rule, or regulation, whether written or oral, any unreasonable and arbitrary standard of conduct.
- (H) Terminate or refuse to renew a franchise except for good cause, or in accordance with the current terms and standards established by the franchisor then equally applicable to all franchisees, unless and to the extent that the franchisor satisfies the burden of proving that any classification of or discrimination between franchisees is reasonable, is based on proper and justifiable distinctions considering the purposes of this chapter, and is not arbitrary. For purposes of this paragraph, good cause in a termination case shall include, but not be limited to, the failure of the franchisee to comply with any lawful, material provision of the franchise agreement after having been given written notice thereof and an opportunity to cure the failure within a reasonable period of time.
- (I) Refuse to permit a transfer of ownership of a franchise, or of a proprietorship, partnership, corporation or other business entity that is a franchisee or subfranchisor, except for good cause. For purposes of this paragraph good cause shall include, but not be limited to:
 - (i) the failure of a proposed transferee to meet any of the franchisor's or subfranchisor's reasonable qualifications or standards then in effect for a franchisee or subfranchisor;
 - (ii) the fact that the proposed transferee or any affiliated person of the proposed transferee is a competitor of the franchisor or subfranchisor;
 - (iii) the inability or unwillingness of the proposed transferee to agree in writing to comply with and be bound by all lawful obligations imposed by the franchise, including without limitation all instruction and training obligations, and to sign the current form of franchise agreement used by the franchisor or subfranchisor; and
 - (iv) the failure of the franchisee or proposed transferee to pay any sums owing to the franchisor and to cure any default in the franchise agreement or other agreements with the franchisor existing at the time of the proposed transfer.

A franchisor or subfranchisor shall have thirty days after being notified in writing of a proposed transfer to approve or disapprove in writing a proposed transfer of ownership or control of a franchise, or of a proprietorship, partnership, corporation or other business entity that is a franchisee or subfranchisor, stating its reason for disapproval. If a franchisor or subfranchisor fails to approve or disapprove a proposed transfer in writing within such period, the franchisor or subfranchisor shall be deemed to have approved such transfer.

- (3) Upon termination or refusal to renew the franchise the franchisee shall

be compensated for the fair market value, at the time of the termination or expiration of the franchise, of the franchisee's inventory, supplies, equipment and furnishings purchased from the franchisor or a supplier designated by the franchisor; provided that personalized materials which have no value to the franchisor need not be compensated for. If the franchisor refuses to renew a franchise for the purpose of converting the franchisee's business to one owned and operated by the franchisor, the franchisor, in addition to the remedies provided in this paragraph, shall compensate the franchisee for the loss of goodwill. The franchisor may deduct from such compensation reasonable costs incurred in removing, transporting and disposing of the franchisee's inventory, supplies, equipment, and furnishings pursuant to this requirement, and may offset from such compensation any moneys due the franchisor.

- (4) The provisions of this chapter shall apply to all written or oral arrangements with the franchisee including but not limited to the franchise offering, the franchise agreement, sales of goods or services, leases and mortgages of real or personal property, promises to pay, security interest, pledges, insurance contracts, advertising contracts, construction or installation contracts, servicing contracts, and all other such arrangements in which the franchisor or subfranchisor has any direct or indirect interest.
- (5) In any proceedings damages may be based on reasonable approximations but not on speculation.

SECTION 8. Section 482E-7, Hawaii Revised Statutes, is repealed.

SECTION 9. Section 482E-8, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-8 Duties of the director. (a) The director may issue a stop order prohibiting the sale of a franchise if he finds that the order is in the public interest and that:

- (1) The offering circular is incomplete in any material respect or contains any statement which in the light of the circumstances under which it is or may be made false or misleading with respect to any material fact;
- (2) Any provision of this chapter or any rule or order or condition lawfully imposed under this chapter has been violated in connection with the sale of a franchise by the franchisor, any partner, officer or director of a franchisor, or any person occupying a similar status or performing similar functions or any person directly or indirectly controlling or controlled by the franchisor.
- (3) The offer or sale of the franchise is the subject of a permanent or temporary injunction of any court of competent jurisdiction or an administrative order prohibiting offer or sale of the franchise entered under any federal or state act applicable to the franchise, but the director may not enter an order under this subparagraph on the basis of an injunction entered under any other law unless that order or injunction is based on facts that currently constitute a ground for a stop order under

this section.

- (4) A franchisor's enterprise or method of business includes or would include activities which are illegal where performed;
- (5) The offer or sale of the franchise has worked or tended to work a fraud upon purchasers or would so operate;
- (6) The franchisor or subfranchisor has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate improvements, equipment, training, or other items included in the offering; and the franchisor or subfranchisor is unable or unwilling to comply with an order of the director under subsection (e) of this section to escrow or impound franchise fees and other funds paid by the franchisee or subfranchisor, or to furnish a surety bond approved by the director;

(b) Upon the entry of a stop order under any part of subsection (a), the director shall promptly notify the franchisor or subfranchisor that the order has been entered and the reasons therefor and that within fifteen days after receipt of a written request, the matter will be set down for hearing. If no hearing is requested within fifteen days and none is ordered by the director, the director shall enter his written findings of fact and conclusions of law and the order will remain in effect until it is modified or vacated by the director. If a hearing is requested or ordered, the director after notice of an opportunity for hearings to the franchisor or subfranchisor shall enter his written findings of fact and conclusions of law and may modify or vacate the order. The director may modify or vacate a stop order if he finds that the conditions which prompted his entry have changed or that it is otherwise in the public interest to do so.

(c) The director shall refer such evidence as may be available concerning violations of this chapter or any rule or order hereunder to the attorney general or the proper prosecuting attorney who may in his discretion with or without such a reference institute the appropriate criminal proceeding under this chapter.

(d) The director may, in accordance with chapter 91, from time to time make, amend, and rescind such rules, forms, and orders as are necessary to carry out this chapter including rules and forms governing offering circulars and reports and defining any terms whether or not used in this chapter insofar as the definitions are consistent with this chapter.

(e) If the director finds that the applicant has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training, or other items included in the franchise proposed to be sold, the director may require the escrow or impoundment of franchise fees and other funds paid by the franchisee or subfranchisor, until the obligations are fulfilled, or the furnishing of a surety bond approved by the director, if he finds that the requirement is necessary and appropriate to protect prospective franchisees or subfranchisors."

SECTION 10. Section 482E-9, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-9 Civil Liability. (a) The commission of any unfair or deceptive acts or practices or unfair methods of competition prohibited by section

482E-6 shall constitute an unfair or deceptive act or practice under chapter 480.

(b) Any person who sells or offers to sell a franchise in violation of this chapter shall be liable to the franchisee or subfranchisor who may sue for damages caused thereby or for rescission or other relief as the court may deem appropriate. In the case of a violation of section 482E-5 (b) rescission is not available to the plaintiff if the defendant proves that the plaintiff knew the facts concerning the untruth or admission or that the defendant exercised reasonable care and did not know or if he had exercised reasonable care would not have known of the untruth or admission.

(c) The suit authorized under subsection (b) may be brought to recover the actual damages sustained by the plaintiff together with the cost of the suit including reasonable attorneys' fees and the court may in its discretion increase the award of damages to an amount not to exceed three times the actual damages sustained.

(d) Any person who becomes liable to make payments under this section may recover contributions as in cases of contracts from any persons who, if sued separately, would have been liable to make the same payment.

(e) A final judgment, order, or decree heretofore or hereafter rendered against a person in any civil, criminal, or administrative proceedings under the United States anti-trust laws, under the Federal Trade Commission Act, or this chapter shall be regarded as evidence against such persons in an action brought by any party against such person under subsections (a) and (b) as to all matters which said judgment or decree would be an estoppel between the parties thereto."

SECTION 11. Section 482E-10, Hawaii Revised Statutes, is amended to read as follows:

"Section 482E-10 Penalties. (a) The attorney general may bring an action in the name of the State against any person to restrain and prevent the doing of any act herein prohibited or declared to be unlawful and the prevailing party may in the discretion of the court recover the costs of such action including a reasonable attorneys' fee.

(b) Every person who violates the terms of any injunction issued as provided by this chapter shall forfeit and pay a civil penalty of not more than \$25,000.

Every person who violates section 482E-3 (a) or 482E-5 (e) shall forfeit a civil penalty of not more than \$2,000 for each violation.

For the purpose of this section the court issuing an injunction shall retain jurisdiction and the cause shall be continued and in such cases the attorney general acting in the name of the State may petition for the recovery of civil penalties.

(c) Any person who wilfully violates any provision of this chapter or who wilfully violates any rule or order under this chapter shall be fined not more than \$5,000 or imprisoned not more than ten years, or both, but no person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order. No indictment or information may be returned under this chapter more than five years after the alleged violation.

(d) Nothing in this chapter limits the power of the State to punish any person for any conduct which constitutes a crime.

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SECTION 12. Section 482E-11, Hawaii Revised Statutes, is amended to read as follows:

“Section 482E-11 Fees. The director shall charge and collect a fee of \$50 at the time of the filing of the offering circular or the amended offering circular pursuant to section 482E-3 (c).”

SECTION 13. Statutory material to be repealed is bracketed. New material is underscored. In printing this Act, the revisor of statutes need not include the brackets, the bracketed material, or the underscoring.*

SECTION 14. This Act shall take effect upon its approval.

(Approved June 17, 1978.)

*Edited accordingly.