

Analyzing the New York Franchise Act of 1980

Q&A with Thomas M. Pitegoff, New York Bar Association, Business Law Section

In August 2005, the New York Bar Association authorized the formation of a subcommittee of the Business Law section to review, analyze, and possibly revise or rewrite the New York Franchise Act of 1980 to better reflect the current franchising landscape. The subcommittee has held several meetings and is soliciting input from all interested parties.

In this interview, Thomas M. Pitegoff (White Plains, NY) discusses the initial goals of the subcommittee, its progress to date, and its continued interest in receiving comments from franchisors, franchisees, and their representatives, and others who may be affected by the New York franchise law.

The other members of the subcommittee are David J. Kaufmann (Kaufmann, Feiner, Yamin, Gildin & Robbins, New York), who wrote the original Act in 1980; Thomas C. Bailey (Phillips Lytle LLP, Buffalo, NY); Robert B. Calihan (Nixon Peabody LLP, Rochester, NY); Cory J. Covert (Hauppauge, NY); Harold L. Kestenbaum (Farrel Fritz PC, Uniondale, NY); Lee J. Plave (DLA Piper Rudnick Gray Cary US LLP, Washington, D.C.); and Richard L. Rosen (Richard L. Rosen Law Firm, PLLC, New York).

FBLA: New York's franchise law has been around for a quarter-century, and apparently it has worked rather well. What are the primary issues that you hope to address?

Pitegoff: The New York Franchise Act has been very effective in eliminating the wide-scale franchise fraud that existed in New York before the Act became effective.

However, a number of us who work in the field of franchise law have long noted certain aspects of the New York Franchise Act may deter some companies from doing business in New York. For example, the New York law defines "franchise" more broadly than the franchise sales laws of any other state. In New York, a business arrangement falls within the definition of a "franchise" if it meets only two of the three "prongs" that all other franchise sales laws require in defining a franchise. To be a "franchise" in New York requires the payment of a fee, but only one of the other two prongs: use of a trademark, and a marketing plan that is prescribed in substantial part by the franchisor.

This broad definition of a "franchise" does not have an effect on companies that know they are franchisors, nor does it affect prospective franchisees. But companies that are merely licensing a brand may be surprised to find they are covered by New York law. The New York law appears to cover many license and distribution arrangements that would not be franchises in other states, and that people unfamiliar with the New York law would never expect to be considered "franchises." In other words, there is a large "gray" area in which it is not clear whether the arrangement is a franchise. Most business people want to comply with the laws. In order to do so, they need clarity on what those laws mean.

FBLA: Are there other significant reasons to review the law?

Pitegoff: Another aspect of the New York Franchise Act that sets it apart from the franchise sales laws of other states is the Act's extraterritorial effect. New York's law applies if

the offer to sell a franchise merely originates from the state, even if all of the franchisees are located outside of the state. A federal court in New York held this to be the proper reading of the New York law in the 1984 case of *Mon-Shore Management v. Family Media*.

Some states have specific out-of-state exemptions. California says that if a franchisor is based in California, but its franchisees are all located in other states, the California law does not apply in those other states. Several other states have similar out-of-state sales exemptions. New York lacks this exemption; in fact, the New York law even affects franchises operating in other countries.

I fear that the extraterritorial application of the New York law is one reason companies might think twice about coming to New York to set up business. On the other hand, one might argue that higher standards for New York companies maintain New York's standing as a home to reputable businesses. In any event, I think we need to ask whether it is a good idea to apply New York law when the franchisee is outside of New York.

FBLA: These sound like significant issues, but they do not seem as if they will require wholesale rewriting of the law. Is that a correct impression?

Pitegoff: Yes. This is an opportunity for us to look at the law in its entirety and to update it. But we are not looking to make radical changes. We are not motivated by any agenda either to weaken or strengthen the New York Franchise Act, nor to do anything as radical as to either eliminate registration requirements altogether or to add relationship

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provisions. Instead, we want to take a fresh look at the Act to see what's working and what can be improved. If we decide to recommend changes, I would expect that these would be in the nature of fine-tuning or technical corrections.

FBLA: Why are you reviewing the law now? Has something occurred that raises its urgency?

Pitegoff: The Federal Trade Commission ("FTC") is in the process, or is getting close to finalizing its revisions to the Franchise Rule. We want to be ready to recommend changes in the New York law that might be advisable in light of the new FTC Franchise Rule. We will be in a better position to act quickly after the new rule becomes effective if we initiate this study before the rule becomes effective rather than afterward. NASAA, the North American Securities Administrators Association, will almost certainly revise the UFOC disclosure requirements in light of the new Franchise Rule. We may decide to wait until both the FTC and NASAA have acted, or we may decide to recommend changes in advance.

Other states have modified their franchise laws over the years. California, for example, amended its franchise law in 2004. New York has not changed its Franchise Act in 25 years. We may determine that no changes have been made because none are needed. On the other hand, we may find that this is an opportunity to improve the law.

FBLA: You talked about fine-tuning New York's rule, rather than embarking on major changes. The FTC Franchise Rule doesn't seem to be a radical revision, either.

Pitegoff: Correct. The FTC Franchise Rule, *as it is proposed*, is more of a series of technical improvements than a radical change. For example, the FTC has decided to write a sepa-

rate rule covering business opportunities rather than including business opportunities in the rule governing franchise sales. The FTC staff has proposed modest changes in the timing of disclosure and in certain disclosure requirements, and it would now explicitly state that the Franchise Rule does not apply to the sale of franchises abroad. The staff has also proposed new exemptions for large investments and sophisticated franchisees.

But the FTC staff is not recommending a relationship provision. We might decide that New York should make modest changes, too, at least for the sake of uniformity. For example, a change in the timing of disclosure would require legislative change in New York. New York might be able to make other changes through regulation rather than legislation.

FBLA: What is your role in the subcommittee?

Pitegoff: I suggested that the subcommittee be formed, and I was "rewarded" by being named the subcommittee chair. In my practice, I represent both franchisors and franchisees, as well as companies that want to know whether they are covered by the franchise laws. Our entire committee is, of course, trying to do what's best for the franchising industry as a whole and for business in New York. In my humble opinion, I think I'm well positioned to provide a balanced view and to work with subcommittee members, many of whom represent either franchisors or franchisees exclusively.

FBLA: The subcommittee has been operating since August. What has happened so far? Any surprises?

Pitegoff: When we started this project, I had the impression that the Franchise Rule would be promulgated within a year. The FTC staff issued its final Notice of Proposed Rulemaking in August 2004. However, it now appears that this timetable will be extended. At the American Bar Association's Forum on Franchising in October 2005, Steven

Toporoff stated that the accepted view at the FTC is that franchising is not in crisis and that there is no sense of urgency to enact the new rule. (Steven Toporoff is the principal attorney on the FTC staff responsible for coordinating the FTC's Franchise Enforcement Program.) For this reason, our subcommittee is feeling less pressure to complete our study of the New York law by the end of the first half of 2006.

The second surprise is the small number of comments we have received so far. When we announced our project, we let it be known broadly in the franchise bar that we welcome comments from franchise lawyers and others with anything to say about the New York franchise law. We did receive valuable comments, some of which agreed with my concerns about the broad scope of the New York law. Other recommendations included specific changes to make the New York registration requirements more uniform with those of other states. These comments are posted on the New York State Bar Association Web site at www.nysba.org/franchise. However, the number of comments received so far is small. We continue to welcome comments. Comments should be submitted to Lee Plave by e-mail at lee.plave@DLAPiper.com.

FBLA: Can attorneys, franchisors, and franchisees still get involved in the discussion?

Pitegoff: Yes. Even those who are not franchisors or franchisees but may be affected by the law are encouraged to submit comments. The subcommittee would like to receive comments before the end of 2005 ... but we would not stop accepting them even after that point. It's a continuous discussion and evaluation process, but the sooner the comments are received, the more likely we will have time to discuss them fully.

