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"CHOICE OF LAW" IN FRANCHISE CONTRACTS

House Bill 4235 as passed the House Second Analysis (8-22-97)

Sponsor: Rep. Mary Schroer
Committee: Regulatory Affairs

THE APPARENT PROBLEM:

The Michigan Franchise Investment Law was enacted in 1974 to impose certain regulations and requirements on those who sell franchises (franchisors) to persons who reside in the state. Most other states have franchise laws that contain provisions similar, though not always identical, to Michigan's law. This has led to problems for parties to a franchise agreement in Michigan when franchisors include in the contract a provision known as "choice of law," which provides that the laws of another state govern the agreement. One franchisor, for instance, did include such a clause in a franchise contract it entered into with a Michigan franchisee, which essentially stated that the laws of Georgia would govern all rights and obligations of the two parties to the agreement. This contract, in fact, became the source of a legal dispute which led the Sixth Circuit Court of Appeals to conclude, in Banek, Inc. v Yogurt Ventures, U.S.A., Inc., 6 F3d 357 (CA 6 (Mich) 1993), that because the Georgia law did not violate a specific fundamental policy of Michigan law, it would govern any and all claims between the parties. Some franchise law experts believe the ruling, in effect, has rendered Michigan's franchise law virtually meaningless as franchisors can simply add a choice of law provision to franchise agreements offered in Michigan that select other states' laws to govern those contracts. Some people believe Michigan's law should be amended to clarify that its provisions governing a franchisee's rights would not in any way be limited or impaired by a choice of law provision added to a franchise agreement.

THE CONTENT OF THE BILL:

The Franchise Investment Law currently provides that certain provisions added to any document relating to a franchise are void and unenforceable. For documents relating to a franchise executed after the bill's effective date, the bill would specify that a "choice of law" provision that required the franchisor's and franchisee's rights under the franchise agreement to be determined

under the laws of a state other than Michigan would not limit, reduce, or restrict a franchisee's rights under the act.

In addition, the act requires a franchisor, before selling a franchise in the state, to provide to the prospective franchisee a copy of a disclosure statement that includes certain information pertaining to the franchisor and the proposed agreement. Among other things, the disclosure statement must include "an exact copy" of those provisions within a franchise contract that are void and unenforceable under the act. The bill specifies that the requirement to disclose an exact copy of these prohibited provisions would apply to offering circulars distributed or renewed within one year of the bill's effective date. For offering circulars distributed or renewed one year or more after the bill's effective date, the bill would require the disclosure statement either to include an exact copy of prohibited items, or a reference to the section of law prohibiting them along with a statement in 12-point boldfaced type that read: "This franchise agreement does not limit or restrict any of the rights or benefits that you are entitled to under Michigan's Franchise Investment Law."

MCL 445.1527

BACKGROUND INFORMATION:

House Bill 4235 (H-1) is nearly identical to legislation that passed the House in the 1995-96 legislative session (House Bill 5553).

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would have no fiscal impact on state or local government as it would amend certain disclosure requirements to be included in the sale of franchises, and clarify provisions for choice of law to ensure franchisee rights under Michigan law. (8-22-97)

House Bill 4235 (8-22-97)

ARGUMENTS:

For:

Despite the fact Michigan has in place a franchise law that governs all aspects of the contractual relationship between franchisors and franchisees in this state, a 1993 ruling in a U.S. Circuit Court of Appeals concluded that a "choice of law" provision contained in a franchise agreement--which essentially gave Georgia franchise law precedence over Michigan law relative to the rights and obligations of the parties involved--was valid and enforceable. People familiar with the ruling and knowledgeable about franchise law believe the ruling effectively renders Michigan's Franchise Investment Law meaningless and may put Michigan franchisees in a precarious position when other states' laws do not provide as much protection to them as does Michigan's. The bill would solve the problem by adding language to the act that essentially would permit a choice of law provision to be added to a franchise agreement, but would specify that the provision could not limit, reduce, or restrict a franchisee's rights under Michigan's law.

For:

The bill includes language to prevent a problem that arose the last time Section 27 of the franchise investment law, which specifies void and unenforceable provisions of franchise documents, was amended. The 1984 amendments to the act both expanded the number of items prohibited by this section and added a provision requiring the exact provisions of Section 27 to be disclosed in any offering circular distributed to a Michigan resident considering purchasing a franchise. After this provision was added, a number of franchisors--unaware of the requirement, which apparently is unique among franchise laws--inadvertently failed to provide an exact disclosure of this section of the act. This prompted Michigan's attorney general to rule that franchisees who had not received the notice could rescind the contract, whether or not evidence existed to show that people were misled or that any damage resulted from the omission. The bill would avoid this problem by specifying that if a circular were distributed or renewed within one year of the bill's effective date, an exact copy of the current provisions of Section 27 would have to be provided. If a circular were distributed or renewed one year or more after the bill's effective date, it would have to contain either an exact copy of Section 27 with the changes proposed by the bill or a notice referencing this section along with the statement, "This franchise agreement does not limit or restrict any of the rights or benefits that you are entitled to under Michigan's Franchise Investment Law."

POSITIONS:

The Department of Attorney General supports the bill.
(3-17-97)

Analyst: S. Stutzky
