

Amending New York's Franchise Law to Promote Franchise Growth

ALM | *New York Law Journal*

August 23, 2024

Since at least 2008 the authors of this article have noted and expressed their collective concern about the antiquated state of New York's 1981 franchise law, which has never been amended for consistency with other state or federal franchise laws. New York prides itself on being the world's center of trade, finance, and culture, but the New York Franchise Sales Act (NYFSA) discourages international franchising in New York. Thomas M. Pitegoff, "How New York Can Be a Center for International Franchising" (New York Bar Association NY Business Law Journal, Summer 2020, Vol. 24, No. 1). And the NYFSA falls short in specifically defining a franchise in a manner that avoids ensnaring the unknowing parties to almost any brand license or other commercial agreement involving a marketing plan and a fee, e.g., distribution and supply agreements.

The authors believe that the NYFSA should be amended and updated to address the issues noted above. The suggested amendments would address the two anomalous aspects of the NYFSA, namely: (1) with regard to out of state sales, to remove the requirement that New York based franchisors must register their franchise offerings for sales to prospective franchisees located in other states and countries, which is contrary to the Model Franchise Investment Act adopted by the North American Securities Administrators Association (NASAA); and (2) with regard to the definition of "franchise," to amend the NYFSA definition to avoid converting every trademark license agreement to a "franchise" and make New York's law consistent with the accepted "franchise" definition in every other state that regulates franchise sales, as well as NASAA's Model Franchise Sales Act and the Federal Trade Commission's trade regulation rule on franchising (the FTC Rule).

With regard to out of state franchise sales, the suggested amendment would only add an exemption to the NYFSA Section 683 registration and disclosure requirements for franchise offers. Notably, this amendment would not limit in any way the department's or a private party's authority to bring legal action for violation of NYFSA's Section 687 anti-fraud provisions against franchisors who make or accept an offer in this state, even if the franchisor is exempt from the registration requirement.

There is little doubt that the current NYFSA registration requirements for out of state franchise offers stifles New York's ability to compete with other states that have no such requirements or restrictions for franchisors who set up headquarters in those other states. As one well-respected franchise commentator explained, franchisors who plan to make New York their place of business have to think twice before opening an office in New York if they are not planning to sell franchises here. Rupert M. Barkoff, "New York Franchise Act: Out in Left Field" (NYLJ, May 1, 2012). And there is data that illustrates the harm this is doing to New York as a commercial hub. According to FranData and the U.S. Census Bureau, New York has proportionately fewer franchisors based in New York than many other states, and New York ranks 25th of all 50 states in the number of franchisors located in this state in relation to the population of each state. Twenty-four states have more franchisors per capita than New York.

The need to fix this anomaly in the NYFSA is supported by the NY Department of Law's regular granting of discretionary exemptions to franchisors based in New York who want to sell franchises overseas. But many franchisors are not even aware that they can petition for such an exemption, and if they don't, they could be subject to the department's enforcement and to private actions. And the fact that the department routinely grants these out of state franchise exemption requests for international sales demonstrates that there is no compelling public policy interest for requiring registration for a franchisor's out of state/foreign sales.

With regard to the NYFSA definition of a "franchise"—it only requires the presence of two elements in any agreement: 1) a trademark license and a fee; or 2) a marketing plan and a fee. As noted by one of the authors of this article in 2008, while "no New York cases were found in which a court converted a trademark license into a franchise ... it would seem such a conversion could occur under a variety of circumstances." Marc Lieberstein and Rebecca Griffith, "How to Avoid the Franchise Surprise" (National Law Journal, May 12, 2008). As recently as Dec. 12, 2023, the New York Law Journal published "The Exceptionally Broad Reach of New York's Franchise Law," by Marisa Rauchway and Joseph Saphia, and they cautioned "manufacturers, distributors, patent holders, consultants, retailers and others ... who operate in New York ... to be particularly careful in light of New York's broad [NYFSA] language." And New York courts appear to jump through hoops just to avoid the NYFSA broad "franchise" definition. See *Keeney v. Kemper National Insur.*, 960 F.Supp. 617, 625 (E.D.N.Y. 1997); *The Matterhorn Group v. Swatch U.S.A.*, 2000 WL 1174215 (Bankr. S.D.N.Y. 2000); *Marcella & Co. v. Avon Cometic Products*, 724 N.Y.S.2d 192 (2d Dept. 2001).

New York stands alone with its NYFSA "franchise" definition, so it's easy to find support for how it should be amended. A suggested amendment to the NYFSA Section 681 "franchise" definition would define "franchise" as including three elements, namely: a contract or agreement between two or more persons by which a prospective franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services (a) substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate, (b) under a marketing plan or system prescribed in substantial part by a franchisor, and (c) is required to pay, directly or indirectly, a franchise fee. This suggested amendment would merely bring New York's

“franchise” definition in line with the NASAA Model Franchise Sales Act and the franchise laws of every other state and the FTC Rule.

New York businesses, and those who would like to do business in New York, should not have to conduct themselves under the cloud and uncertainty of New York's NYFSA. New York and its laws should be clear and serve to welcome and encourage new businesses to headquarters themselves here, hire New York citizens as employees, pay taxes and maintain New York as the center of international trade and business.

Marc A. Lieberstein *is partner at Kilpatrick Townsend*; David T. Azrin *is partner at Wuersch & Gering*; and Thomas M. Pitegoff *is principal at Offit Kurman*.