

# **Franchise Act Interpretive Statement FIS-02**

## **RE: Restrictions On Transfer Of Franchises**

### **Questions Presented:**

**What restrictions on transfer of a franchise by a franchisee may be allowed consistent with RCW 19.100.180?**

### **Discussion**

Many franchise agreements include provisions restricting transfer of the franchise by the franchisee. These provisions often prohibit certain types of transfers, create rights of first refusal in favor of the franchisor, or require consent of the franchisor prior to the transfer. The restrictions on transfer may be so severe that they greatly reduce or eliminate the value of the franchise to the franchisee. The provisions in the franchise agreement may allow the franchisor unlimited discretion to decide whether to allow a transfer.

Transfers of franchises can be categorized in two ways: whether a transfer is voluntary or involuntary and whether a transfer is of the entire interest in a franchise or of less than the entire interest in the franchise.

### **Involuntary Transfers**

The permissibility of some involuntary transfers has already been specifically dealt with in the statute itself or in other interpretive statements. RCW 9.100.180(2)(j) permits the franchisor to terminate a franchise without prior notice if the franchisee is adjudicated bankrupt or insolvent. This provision is, of course, subject to the provisions of the federal Bankruptcy Act. The issue of transfer of the franchise upon death of the franchisee has already been dealt with in Franchise Act Interpretive Statement FIS-3. Other involuntary transfers should be viewed in a similar manner. Examples include property division in marriage, dissolution's, imposition of guardianships, and other court ordered transactions.

### **Voluntary Transfers**

Voluntary, either complete or partial, transfers of a franchise by the franchisee and voluntary transfers of ownership interests in the franchise are often subject to restrictions in the franchise agreement. In order to meet the good faith standard of subsection (1) and the fair practices standard of (2) (c) and (h) of RCW 19.100.180, the restrictions on transfer in the franchise agreement may not allow the franchisor to unreasonably withhold its consent to a transfer of otherwise unreasonably restrict transfer., In this context, it is unreasonable for a franchisor to withhold consent to any transfer where the transferee meets the franchisor's criteria for purchase of an initial franchise. For example, if the franchisor will initially sell its franchises to corporations, it may not prohibit a franchisee from incorporating and may not prohibit the franchisee from transferring the franchise to a corporate franchisee. The same principle applies to restrictions on transfer of the stock of a corporate franchisee and transfer of less than the entire interest of the franchise. In addition to the "initial franchisee" criteria used by the franchisor, franchise agreement provisions which require personal participation of the franchisee in the franchise business are relevant in determining whether restrictions on transfers are reasonable.

### **Transfer Fee and Release Requirements**

Franchisors may also attempt to restrict transfers indirectly by imposing exorbitant transfer fees and requiring the transferor to sign a release of all claims against the franchisor. The transferee may be required to sign the current franchise agreement rather than take an assignment of the franchisee's existing agreement.

Restrictions on transfer may only be imposed in good faith and must be reasonable. RCW 19.100.180(1) and (2)(h). Transfer fees are permissible only to the extent they compensate the franchisor for expenses directly incurred as a result of transfer. The franchise agreement may specify the amount of the transfer fee so long as such amount is a reasonable estimate of anticipated transfer expenses. The requirement of a release by the franchisee to the franchisor is acceptable so long as it does not include a release of the franchisee's claims under the Washington Franchise Investment Protection Act. Requiring inclusion of such claims in the release violated RCW 19.100.180(2) (g). However, RCW 19.100.220 provides that a release or waiver, executed pursuant to a negotiated settlement after the agreement is in effect, is not void where the parties are represented by independent legal counsel.

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