

# REGULATING FRANCHISES IN PUERTO RICO

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## INTRODUCTION

In the past few years, numerous endeavors to regulate the franchise industry in Puerto Rico have proven futile. A recent attempt was initiated by the House of Representatives in 2017, but it was met with resistance from the business sector, due to the excessive constraints it sought to impose. This article argues that any regulations on franchises should focus on the initial steps of registration, sales, and regulatory updates, and not on ongoing operations. To support this argument, it will examine the concept of a franchise, as well as provide an analysis of the legislations and regulations enacted by both federal and state governments, including the limitations incorporated within the proposed 2017 bill. Lastly, this article will investigate the ramifications of these issues and provide potential resolutions.

### I. DEFINITION OF A FRANCHISE

Franchising is a prevalent concept within the realm of business and commerce, yet its intricacies often remain elusive to many. Enterprises, both sizable and modest, regard franchising as a viable avenue for expanding their operations. While some franchisees may only manage a singular unit that has been operational for a brief period, others oversee thousands of units that have been functioning for many years. The appeal of franchising lies in the delegation of financial investment and operational responsibilities to franchisees, while the parent company gains a steady stream of revenue through monthly royalties.<sup>1</sup>

The conceptualization of the term franchise is contingent upon the legal jurisdiction and forum in which it is assessed, as there currently exists no universally accepted notion of a franchise agreement.<sup>2</sup> This term encompasses an extensive range of commercial associations between the parties. Distinct definitions are provided by states and the federal

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<sup>1</sup> A distinction must be made between regular franchisee agreements and master franchise agreements, where the master franchisee pays the franchisor an initial fee for the rights to franchise, as well as an ongoing royalty on the revenue generated by the master franchise from fees and royalties obtained from franchise units sold.

<sup>2</sup> *Franquicias Martin's BBQ, Inc. v. Luis García*, 178 DPR 978, 985 n.5 (2010).

government, often varying and occasionally contingent upon the specific business category.<sup>3</sup> Consequently, when addressing franchising, it's essential to consider regulatory frameworks, the business paradigm, and any pertinent legal documents that underpin its structure, such as the franchise agreement.

In a simplified definition with common characteristics, we can describe a franchise as an agreement between two or more parties. Such an agreement grants the franchisee the right to operate a business using the franchisor's marketing plan and affiliated commercial symbols or trademarks. In return, the franchisee is obligated to pay a franchise fee or other consideration to the franchisor. This basic framework captures the essence of what constitutes a franchise and provides a foundation for further discussion.

## II. THE LEGAL FRAMEWORK OF A FRANCHISE

Franchisee contracts comprise one of many contractual modalities employed in Puerto Rico to achieve analogous objectives. Distribution and concession,<sup>4</sup> representation,<sup>5</sup> agency,<sup>6</sup> supply,<sup>7</sup> and general licensing agreements,<sup>8</sup> all exist with the intent to facilitate the marketing of products and services, yet each method possesses its own unique characteristics. Agents and sales representatives operate as intermediaries, transacting on behalf of their principal's offerings. Meanwhile, a licensing agreement manifests in an array of forms contingent on the respective industry; however, its primary focus, lies within the trademark being licensed for royalty. Distributors function with increased autonomy and collaborate with an assortment of suppliers, typically not identifying themselves with the specific brand being provided, unless permitted. The distributor's role encompasses the circulation of goods from various brands, while the supplier concentrates on the provision of said goods.

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<sup>3</sup> 16 C.F.R. § 436.1(h) (2023) (franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate).

<sup>4</sup> Ley de Contratos de Distribución, Ley Núm. 75 de 24 de junio de 1964, 10 LPRC § 278-278(e) (2013 & Supl. 2023) (These are contracts between the principal and dealer or distributor, that are granted for the distribution of a given merchandise or service. The concessionaire or distributor agrees to dispose of their resources, in their name and on their own account, and to provide their services to market the products provided by the grantor, who in turn agrees to pay a remuneration and to provide the products, as agreed. It is regulated by the Puerto Rico Civil Code of 2020, 31 LPRC §§ 10471-93. Act 75-1964 regulates the termination of distribution agreement without cause).

<sup>5</sup> Ley para Reglamentar los Contratos del Representante de Ventas, Ley Núm. 21 de 5 de diciembre de 1990, 10 LPRC § 279-279h (2013 & Supl. 2023) (Sales or manufacturing representatives are independent entrepreneurs, that undertake reasonable efforts and due diligence to create or expand the market for the products sold by the principal, through sales representation agreements granted by the principal for a defined market or territory. This contract is regulated by Act 21-1991).

<sup>6</sup> *Id.*; In the agency contract, the agent agrees, in exchange for the remuneration paid by the principal, to continuously promote the latter's business. The agent is an independent intermediary that does not assume the risk of the operations, nor does he represent the principal. The agency contract is regulated by the Puerto Rico Civil Code of 2020, 31 LPRC §§ 1421-38. Consider also Act 21-1991, regulating sales agents under exclusivity agreements.

<sup>7</sup> Código Civil de Puerto Rico de 2020, Ley Núm. 55 de 1 junio de 2020, 31 LPRC §§ 10021-28 (In the supply contract, the supplier undertakes the task to deliver goods periodically or continuously to the supplier, who to pays a price for each benefit or series of benefits).

<sup>8</sup> A licensing agreement is a legal contract generally between two parties, known as the licensor and the licensee whereby the licensor grants the licensee the right to use, produce, or sell a product, service, or intellectual property owned or controlled by the licensor. In return, the licensee typically pays the licensor a fee or royalty.

Though distribution may be an element within a franchise organization (such as supplier-dealer relationships), the predominant structure of franchising is the notion referred to as “business format franchise.” In this model, a franchisor devises a distinct commercial methodology (referred to as the “commercial format”), aimed at either the distribution of products or the provision of services, subsequently granting usage rights to franchisees. Most regulations and guidelines primarily concentrate on business format franchises. To structure a commercial format, the franchise agreement necessitates the integration of essential components within a single contract, thereby generating an intricate and overlapping, interconnected network comprised of autonomous entrepreneurs, who collectively pursue a shared overarching goal.

Irrespective of the diverse legal frameworks that may exhibit similarities to a franchise, certain fundamental components consistently appear in most franchises, encompassing the rights and responsibilities acquired by the franchisee from the franchisor, through contractual agreements. Generally, these components can be delineated into five categories: (i) the entitlement to offer and vend a product or service; (ii) the authorization to utilize the associated identification and branding pertaining to said services and products; (iii) the privilege of obtaining requisite assistance and technical support; (iv) the mandate to adhere to specific operational guidelines; and (v) the commitment to remit a fee in exchange for these rights. In addition to consolidating these elements within a comprehensive agreement, compliance with relevant industry regulations, legislation governing trade secrets, trademarks, copyrights, and – contingent upon the intricacy of the operation – matters such as bonds, security interests, loans, lease contracts, antitrust provisions, supply agreements, non-competition clauses, and an array of preliminary arrangements with other business entities must also be ensured.

### III. FRANCHISE REGULATION IN PUERTO RICO

The precise number of franchisors and franchisees operating in Puerto Rico remains undetermined, primarily due to the absence of a dedicated registry for such entities (unlike the registries available for companies). Franchises are often registered as corporations or limited liability companies, rendering it difficult to ascertain whether they follow the franchise model. Consequently, these businesses function without any local legislation mandating disclosure regarding their operations, profitability, offerings, and the contractual terms extended both during and after the termination of their relationships.

Beyond the limited provisions of Law 75-1964, franchise contracts are not explicitly governed.<sup>9</sup> The Puerto Rico Civil Code remains silent on this matter, even though it encompasses more than twenty distinct contract classifications.<sup>10</sup> Pertaining to Law No. 75-1964, its provisions primarily emphasize the arbitrary cessation of distribution arrangements between suppliers and their respective distributors. The applicability of Law 75-1964 comes into play when a franchisee is considered as functioning in the capacity of a distributor. In this role, the franchisee might cultivate a propitious market for the franchisor's products and services in a manner that activates the enforcement of legal provisions prohibiting detrimental acts against the franchisee, the refusal to renew, and unwarranted dissolution of contractual agreements.<sup>11</sup>

The Puerto Rico Supreme Court (“PRSC”) has affirmed the validity of franchise agreements, provided they adhere to contractual principles, and do not contravene legal

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<sup>9</sup> 10 LPRR § 278-278e.

<sup>10</sup> 31 LPRR §§ 9941-10686; *See also*, Exposición de Motivos del Código Civil de Puerto Rico, Ley Núm. 55 de 1 de junio de 2020, 2020 LPR 55.

<sup>11</sup> 10 LPRR § 278a; *See also*, Next Step Medical Co., Inc.; Jorge Iván Dávila Nieves, Madeline Rodríguez Muñoz y la Sociedad Legal de Gananciales compuesta por ambos v. Biomet, In.; Biomet International, LTD.; Biomet 31, LLC; Biomet Orthopedics Puerto Rico, Inc.; Fulano de Tal, 195 DPR 739, 746-47 (2016).

statutes, ethical considerations, or public order.<sup>12</sup> The court characterizes such agreements as atypical contracts, which have hitherto received insufficient scrutiny in legal discourse. Moreover, the Court acknowledges its purpose as a means for business expansion via agreements, which can be defined by the allocation of rights to autonomous entrepreneurs, thus allowing them to distribute specific branded products or deliver services under specific names. The PRSC identifies that the franchising model grants the franchisee with the entitlement to utilize and capitalize on certain products and services:

[The] privilege is exploited by the franchisee, usually within a specific and exclusive geographic area, by virtue of financial compensation provided by the franchisee and according to the method or system prescribed by the franchisor. On the other hand, the franchisor undertakes in many cases to provide certain knowledge and business strategies, assistance, supervision regarding the uniformity between the businesses of the system and other services to the franchisee.<sup>13</sup>

The analysis of franchise arrangements by the PRSC has centered, predominantly, on assessing the legal validity of the principal contract, whilst overlooking other integral elements of the franchise business model, and its correlated legal transactions. These transactions encompass negotiations, representations, warranties, obligations, and various ancillary agreements contingent on the specific transaction.<sup>14</sup> The Court does acknowledge the potential for exploitative practices by franchisors and the benefits of implementing legislation to regulate such actions:

However, its rapid development, in response to the enactment of antitrust laws and its potential abuse, led different states in the United States to regulate franchises in the early 1970s, particularly with respect to the disclosure of information, registration, as well as the relationship between the franchisor and the franchisee . . . Thus, in 1978 the Federal Trade Commission (F.T.C.) enacted the Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 CFR secs. 436 *et seq.*, as amended, also known as the "F.T.C." Rule, through which the franchisor is required to disclose certain information prior to the sale of a franchise . . . From a legislative analysis we can infer that it has been considered that a convenient way to protect the franchisee from the abuses experienced in the past -against uninformed and inexperienced franchisees in business- is through the transmission of the necessary information to the franchisee to analyze the business before committing.<sup>15</sup>

#### IV. STATE LAWS

The inception of legislative regulation for franchise agreements can be traced back to California in 1970. The State required registration, disclosure of the offer and specificity of

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<sup>12</sup> *Franquicias Martin's BBQ, Inc. v. Luis García*, 178 DPR 978, 989-90 (2010) (They are generally accepted and governed by contract law and are agreed between independent entrepreneurs).

<sup>13</sup> *Id.* at 985 (translation supplied).

<sup>14</sup> There are related agreements that may be tied to the franchise transaction, such as non-competition, non-disclosure and confidentiality obligations, personal and spousal guaranties, collaterals, promissory notes, development and construction, leasing, and post termination arrangements.

<sup>15</sup> *Martin's BBQ, Inc.*, 978, at 987-88 (translation supplied).

the contractual terms, including termination provisions.<sup>16</sup> Other states followed soon and today, at least 22 states have some type of legislation regulating the registration, disclosure, or termination of the contract. Legislative requirements exhibit significant variation among jurisdictions. However, they can be broadly classified into two principal categories: registration and filing states. The former generally necessitates a comprehensive examination, whereas the latter customarily mandates only the submission of a notification. For example, New York requires registration review of the petition for a franchise by the New York State Department before it is approved, and a sale can take place.<sup>17</sup> A sale must only be completed if detailed disclosures about the business is provided to the applicant. Any marketing and sales information addressed to prospective franchisees must be submitted to the Department prior to its intended use.<sup>18</sup> Furthermore, the franchise must file annual reports listing franchises sold, price paid and a copy of the franchise' independent audited financial statements.<sup>19</sup> In addition to compliance with federal disclosure regulations the law prohibits franchisors from terminating a franchise agreement without good cause.<sup>20</sup> The law also allows franchisees to sue for damages and other relief if a franchisor violates the law. On the other hand, Michigan, for example, just requires a notice of intent and does not review the business offer or disclosure documents.<sup>21</sup>

## V. FEDERAL REGULATION

The Federal Trade Commission (hereinafter referred to as "FTC") exercises authority over franchise operations through the implementation of the Franchise Rule.<sup>22</sup> The FTC has established a clear and distinct delineation of what constitutes a franchise. While this definition shares similarities with those of other states, it also excludes certain businesses and industries, making it comprehensive and intricate in nature. Given the scope of this article, a detailed examination of the full definition is beyond its focus. Nevertheless, the FTC does offer a general definition, and for the purpose of this article, we will suffice with a simplified explanation they have provided based on three key factors.<sup>23</sup> First, the franchisor must "promise to provide a trademark or other commercial symbol . . . promise to exercise significant control or provide significant assistance in the operation of the business; and . . . require a minimum payment of at least \$500 during the first six months of operations."<sup>24</sup>

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<sup>16</sup> Cal. Corp. Code §§ 3110-4, 31158 (West 2006) (The California Franchise Investment Law requires franchisors to register with the Department of Financial Protection & Innovation before offering or selling franchises).

<sup>17</sup> New York Franchise Sales Act, N.Y. Gen. Bus. Law § 683 (McKinney 2009); *See also* N.Y. Comp. Codes R. & Regs. tit.13 § 200.3.

<sup>18</sup> N.Y. Comp. Codes R. & Regs. tit.13 § 200.9.

<sup>19</sup> *Id.*, at § 200.8(c).

<sup>20</sup> N.Y. Gen. Bus. Law § 691 (The good cause requirement is specified in Section 691 of the New York Franchise Sales Act, which states that a franchisor may not terminate a franchise agreement prior to the expiration of its term, except for "good cause," which is defined as the franchisee's failure to comply with any lawful requirement of the franchise agreement that is both reasonable and of material significance to the franchise relationship).

<sup>21</sup> Mich. Comp. Laws § 445.1507a (The State does not review documents however, prior to offering or selling franchises, franchisors must register a "Notice of Intent" once a year, with the Department of Attorney General, Franchise Section).

<sup>22</sup> 16 C.F.R. §§ 436.5 (2023).

<sup>23</sup> 16 C.F.R. § 436.1(h) (2023) provides that a "Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate."

<sup>24</sup> FTC, Franchise Rule Compliance Guide, 16 C.F.R. Part 436 (May 2008),

<https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>.

The primary aim of the Franchise Rule is not to regulate the contractual provisions inherent within franchise relationships. Instead, it serves as a preemptive measure to alleviate unjust or deceptive actions perpetuated by individuals who neglect to reveal crucial information. The overarching objective is to equip franchisees with pertinent data, deemed necessary by the FTC to enable prospective franchisees to make well-founded investment decisions prior to engaging in a franchise agreement.<sup>25</sup> This is achieved by establishing comprehensive guidelines regarding the preparation and presentation of disclosure documents for prospective franchisees. Upon fulfillment of these requirements, franchisors are not obligated to submit any documentation to the FTC.

The guidelines include an extensive array of detailed disclosures and required updates, with pertinent details concerning the legal and financial structure of the franchisor, the business offered under the franchise, and the agreement to be executed before entering a sale. This information is compiled and presented in the format of a Franchise Disclosure Document (“FDD”), which must be provided to the franchisee a minimum of fourteen calendar days prior to any financial transactions or signing of the franchise contract. The FDD serves as an instrument for appraising the opportunity from an objective standpoint, encompassing data and statistics systematically organized across twenty-three distinct categories, utilizing comprehensible language.<sup>26</sup> Furthermore, it cautions franchisors that making unsubstantiated financial performance representations, or failing to grant requested refunds, will be deemed deceptive practice under its purview.<sup>27</sup>

The FTC possesses the authority to initiate enforcement proceedings against any franchise seller who, among other transgressions, neglects to provide a prospective franchisee with a copy of the FDD. These enforcement measures encompass civil litigation proceedings, granting injunctive relief, imposition of monetary penalties, and an array of equitable remedies, such as the dissolution of contractual arrangements and the dispensation of restitution.<sup>28</sup>

Debates persist regarding the necessity for additional federal oversight and the prospect of federal preemption.<sup>29</sup> Nevertheless, the FTC has opted for a restrained approach, abstaining from enacting regulations that would predominantly supplant existing state franchise statutes. FTC regulations do not encroach upon the substance of state law, except in instances where said law contradicts provisions offering equal or superior protection to franchisees.<sup>30</sup> Furthermore, Congress has contemplated the implementation of a comprehensive franchise law, an opportunity perceived by multi-state franchisors aiming to streamline operations by negating the need for compliance with disparate state regulations.<sup>31</sup>

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<sup>25</sup> Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 43 Fed. Reg. at 59614 (Dec. 21, 1978).

<sup>26</sup> 16 C.F.R. § 436-7 (Some of these categories require the franchisor to disclose its main corporate entity, its business experience, previous or pending litigation, bankruptcies, initial payment fees, royalties, advertising fees, initial investment, restriction on the purchase of products, contractual obligations, financial agreements, franchisor assistance, territory, trademarks, proprietary information, renewal, termination, financial representations, information from other franchisees with telephone numbers, financial statements and copies of all documents to be signed and so forth, as stated in the FTC’s Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, which applies to the sale of franchises in the US, its territories, and possessions).

<sup>27</sup> *Id.* at § 436.9.

<sup>28</sup> 15 U.S.C. §§ 45(b), (m), 53(b), 57(b).

<sup>29</sup> 43 Fed. Reg. 59719-21 (Dec. 21, 1978) (In 1978 and 2007 the FTC considered proposals to apply broader regulations and preemption but were rejected).

<sup>30</sup> 16 C.F.R. § 436.10(b) (The FTC has stated that it “does not intend to preempt the franchise practices laws of any state or local government except to the extent of an inconsistency with part 436. A law is not inconsistent with part 436 if it affords prospective franchisees equal or greater protection, such as a registration of disclosure documents or more extensive disclosures).

<sup>31</sup> Rochelle Spandorf, *Can Federal Preemption Solve What’s Wrong with Franchise Sales Laws?* 39 FRANCHISE L. J. Vol. 39, 477, 480-1 (2020).

## VI. A LAW REGULATING FRANCHISES IN PUERTO RICO

While well-established franchise organizations typically deliver their business propositions through compliant FDDs, it is imperative to recognize that certain smaller or nascent developers may not exhibit a proclivity towards crafting a thorough disclosure document that adheres to the stringent standards mandated by federal regulations and in registered states. Undoubtedly, these prerequisites serve as a filtration mechanism for franchises that ought not to be available for market participation or sale. I am referring to those franchisors inclined to circumvent the necessary expenditure of time and effort needed to fulfill these disclosures in detriment to the prospective franchisee.

A correlated concern to consider is that, in numerous instances, even when the franchisor furnishes all requisite disclosures, the prospective party may neglect to scrutinize the information due to an already established predisposed decision to buy. Ordinarily, the sales process transpires well in advance of the concrete facts and legal agreements being presented. As a result, for a significant segment of the population, the disclosure procedure may materialize as either an impediment to their idyllic commencement with their nascent enterprise or a gratuitous and distracting formality.

The potential for incurring substantial losses due to the acquisition of a franchise that subsequently falters is significant. Numerous elements contribute to this outcome. It is possible that the prospective franchisee failed to thoroughly examine the pertinent documents, or that disclosure was not provided in a timely or comprehensive manner. Alternatively, the franchise model may have been poorly implemented or ill-suited to the particularities of the local market and it did not show up in the disclosures.

Furnishing comprehensive information and advocating for candidates to engage in thorough due diligence prior to advancing with the prospective opportunity, serves to mitigate potential risks of failure. The FDD serves as a valuable instrument in this regard, contingent upon proper disclosure and the candidate's diligent utilization of the information therein for assessing the opportunity's viability. Should the franchisor merely seek to adhere to baseline requirements, the probability of the prospective franchisee making an uninformed acquisition becomes elevated, as does their risk of failure in the absence of comprehensive evaluations pertaining to contractual obligations, personal guarantees, and associated financial risks.

It is important to consider that numerous franchises yield a substantial percentage of their revenue through unit sales, irrespective of the success achieved. To procure a franchise unit, the buyer is generally obliged to remit a non-refundable fee to the franchisor, which is distinct from the required financial investment and the subsequent and recurring royalty. The outcome of this transaction remains unaffected even if the unit sold fails eventually. This income source proves alluring with minimal constraints, save for the FDD and its insufficient enforcement mechanisms. Aggrieved entities lack recourse to civil litigation at the federal level against those failing to furnish an FDD or those providing it in a flawed or improper fashion. Federal legislation does not account for such situations, and while affected parties may lodge an administrative complaint, the FTC has not communicated to the public of any designated and specialized task force responsible for conducting investigations and enforcing penalties upon infringing franchisors.

Franchisors may contend that disclosure provisions serve as an ancillary advantage to the inherent responsibility of the purchaser in ensuring they conduct a thorough due diligence process prior to entering any novel business venture. Nonetheless, the Franchise Disclosure Document (FDD) and supplementary state regulations serve a critical function in expediting the prospective buyer's evaluation process. In furtherance of the franchisor's interests, the more actively a vendor assumes the role of a transparent and accurate collaborator, the better equipped the potential purchaser will be in making well-informed

decisions and circumventing erroneous judgments that may ultimately play against the franchisor.

The precise financial implications of disclosure infringements or misinformed franchisees remain undetermined due to a lack of relevant data. Nonetheless, the observable failures of numerous franchises suggest that this issue warrants legislative attention.

A comprehensive study focusing on Puerto Rican franchises could provide crucial insights into the well-being of the commercial sector and ascertain the adequacy of the self-regulated federal disclosure mandates and existing laws in Puerto Rico such as the Civil Code and Law 75. These provide actionable provisions against franchisors that fail to disclose or breach a contract. The injured party could file under these statutes with arguments of breach of the FDD and contract, fraud, misrepresentation and/or deceptive information, inconsistency between documents, lack of consent, adhesion clauses, unjustified termination, and others, but it's all generally after the fact. The franchisee is already invested and is trying to salvage its business and savings. These are damages that will continue drag and increment along the endless judicial process that characterizes the protracted procedures of the Puerto Rico judicial system. Perhaps, preventive legislation could fill the gap that exists within the early stages of the contractual relationship.

The 2017 attempt to craft a franchise law, was wrongly focused on the commercial relationship.<sup>32</sup> Franchisors could not terminate the agreement with the franchisee without just cause nor refuse to renew the contract under the same terms. Offerings would have to be similar as the ones offered in the rest of the United States and all regulations and requirements imposed on franchisees had to be applied to any outlets administered by the franchisor. With certain exceptions, franchisors could not require franchisees to buy goods and services through designated channels without demonstrating reasonable necessity. Neither could they make distinctions on royalties and other fees between franchisees. There was also restriction as to encroachment on the existing territories. Civil action could be filed against a franchisor for different reasons. Expectedly, two of the major food industry organizations objected, citing excessive and existing regulations. Curiously, many of their constituents were franchisees themselves licensed locally by large U.S. Corporations.

In considering any new franchise law, it is crucial to ensure it complements existing contractual laws without disrupting the internal business model of the franchise. Furthermore, it should align with federal regulations and those from other jurisdictions.<sup>33</sup> Precise definition of the franchise agreement, distinguishing it from distribution or trademark licensing agreements, becomes essential. The focus should be on facilitating thorough and timely information sharing between buyers and sellers while preserving the autonomy of contracts and business operations. To achieve this, particular attention should be given to the initial stages of the relationship. Strengthening existing disclosure regulations with stringent penalties will act as a deterrent, discouraging those seeking shortcuts at the expense of compliant businesses. By promoting transparency and accountability, the law will foster a more equitable franchise landscape, benefitting both franchisors and franchisees in their business endeavors.

In other jurisdictions, franchising activities that fail to comply with registration and disclosure provisions may face various sanctions, including: (i) penalties for not registering; (ii) consequences for letting the registration expire without annual renewal; (iii) repercussions for failing to provide required disclosures in a timely manner; (iv) addressing material omissions or misrepresentations in the Franchise Disclosure Document (FDD); (v) facing consequences for providing false, incomplete, incorrect, or untimely data. The specific remedies vary from state to state but may involve regulatory enforcement such as denial,

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<sup>32</sup> P. de la C. 656 de 24 de enero de 2017, 1ra Ses. Ord., 18va Asam. Leg., at 2.

<sup>33</sup> Avoiding unnecessary diverse regulatory roadblocks that would discourage franchisors from offering their business opportunity to local entrepreneurs.



revocation, or suspension of the franchise registration, administrative penalties, and prosecution through civil actions. Additionally, injured franchisees may seek restitution for investigative expenses and other remedies. Certain states also allow private litigation against franchisors, providing statutory remedies such as contract termination, restitution, treble damages, costs, attorney's fees, and interest.

In line with measures seen elsewhere, the proposed franchise legislation would have minimal impact on entrepreneurs already in compliance. For them, the transition would mainly involve fulfilling the registration process and facing consequences for any breaches of requirements. Conversely, the legislation aims to deter unprincipled entrepreneurs seeking to exploit the franchise model without due consideration. The registration requirement would serve as an initial safeguard, deterring those looking to capitalize on the franchise sector with unproven ventures. These opportunistic individuals, enticing unseasoned individuals with the allure of self-employment, would now face scrutiny and consequences under the legislation.

Focusing on initial regulatory stages benefits both sides of the franchise business. For potential buyers, detailed disclosure becomes crucial in ascertaining the business venture's prospects, understanding obstacles related to market penetration, and appraising fiscal viability. With comprehensive information, buyers can make informed decisions, minimizing investment risks. Sellers benefit from this transparent approach.

Thorough and candid disclosures foster a stronger and more mutually beneficial partnership, founded on enhanced transparency and informed decision-making. This approach significantly reduces the risk of later claims based on misinformation or bad faith.