

# California Enacts New Franchise Broker Law

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On Sept. 24, 2024, California Gov. Gavin Newsom signed Senate Bill 919, the California Franchise Broker Law, into law. Officially titled the “Franchise Investment Law: Franchise Brokers,” the California Franchise Broker Law amends the California Franchise Investment Law to require franchise brokers to comply with annual registration and presale disclosure requirements.

Beginning in 2026, the California Franchise Broker Law will require franchise brokers to register with the California Department of Financial Protection and Innovation (DFPI) before attempting to offer or sell a franchise in California. In this regard, the California Franchise Broker Law is similar to the existing franchise broker registration laws in New York and Washington. However, the California Franchise Broker Law goes further and imposes an additional presale disclosure obligation upon all franchise brokers. Specifically, a franchise broker may not communicate with a prospective franchisee about investing in a franchise opportunity until the franchise broker first provides the prospective franchisee with a copy of the broker’s disclosure document.

Various details regarding California’s new broker registration and disclosure regime remain to be sorted out, and we expect California will issue official guidance over the coming year. Below is a summary of the California Franchise Broker Law as it currently stands.

## To Whom Does the California Franchise Broker Law Apply?

The California Franchise Broker Law applies to franchise brokers. It defines a “franchise broker” as “a person who directly or indirectly engages in the business of the offer or sale of a franchise, regardless of the title used by the person or any organization with which they are affiliated, and receives or is promised a fee, commission or other form of consideration from a franchisor, subfranchisor, franchisee or affiliate of a franchisor, subfranchisor or franchisee.” Common titles for a franchise broker may include franchise seller, broker network, broker organization, franchise sales organization, consultant and coach.

The following are not considered to be a franchise broker:

- Franchisor, subfranchisor or area representative or their officers, directors or employees;
- Employee of an affiliate of a franchisor or subfranchisor;
- A franchisee of the offered franchised brand (unless the franchisee operates a franchised

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broker business).

The California Franchise Broker Law revises the California Franchise Investment Law to restrict who may be involved in a franchise sale. Only a person listed in Item 2 of a franchisor's Franchise Disclosure Document (FDD) that is registered in California, a licensed real estate broker or real estate salesperson, a licensed broker-dealer or agent under the California Corporate Securities Law of 1968, or a person registered as a franchise broker can be involved in a franchise sale in California.

## **Broker Registration Requirements**

Once the California Franchise Broker Law goes into effect, it will be unlawful for a franchise broker to offer or sell any franchise in California unless the franchise broker is currently registered with the DFPI. Registration will require an annual filing. To register, a franchise broker must file copies of the following online with the commissioner of the DFPI:

- A copy of the franchise broker's Uniform Franchise Broker Disclosure Document (Broker Disclosure Document), the form of which is currently still under development;
- Payment of the applicable registration fee, currently \$450 for an initial filing, \$150 for a renewal filing and \$50 for an amendment;
- Copies of any financial securities, insurance policies or other additional documents or exhibits required by the commissioner.

A franchise broker's registration filing is effective upon filing a complete application and paying the applicable registration fee. Registration filings will expire on Dec. 31 of the year in which they were filed.

A registered franchise broker must amend its registration with the DFPI in the event of any "material change" in the information contained in its filed Broker Disclosure Document. The requirement to amend upon a material change does not mean that the franchise broker must constantly update or revise the Broker Disclosure Document throughout the year.

The requirement to amend is based on the same materiality standard applicable to franchisors under the California Franchise Investment Law. Also, the California Franchise Broker Law provides that the commissioner may, at some point in the future, issue a rule that further defines what is to be considered a "material change" for those purposes and the circumstances under which an amended Broker Disclosure Document must be filed.

We expect the DFPI to issue regulations over the coming year expanding the list of specific materials that must be included as part of a broker's annual registration filing, providing the required disclosure document format and clarifying what constitutes a material change that requires an amendment filing.

## **Broker Disclosure Document**

Before communicating with a prospective franchisee about a potential franchise investment, a franchise broker must first provide the prospect with a copy of the broker's completed Broker Disclosure Document. While the precise requirements for a Broker Disclosure Document are yet to be determined, it will include at least the following:

- A franchise broker cover page that contains standardized language regarding franchise brokers, including the types of sellers, the broker's role in the franchise sales process,

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services a broker might provide, different ways a broker might be compensated and examples of questions a prospective franchisee might ask a franchise broker;

- Details about the franchise broker, including legal name, trade name, year and state of formation, principal place of business, owners, directors and officers, contact information, and the franchise broker's broker network or franchise sales organization;
- The franchise broker's professional experience during the past five years, including but not limited to employers, principal positions, each position's location, and the month and year of each position's start and end dates;
- Administrative, civil or criminal actions alleging that the franchise broker, or an owner, officer or director of the franchise broker, violated any franchise, antitrust or securities law or committed fraud, unfair or deceptive practices, or similar violations, whether pending or resolved, within the past five years;
- The industries of the brands the franchise broker represents and how many brands within each industry the franchise broker represents;
- A description of the services performed by the franchise broker;
- How the franchise broker is compensated, including but not limited to how the amount of any consideration the franchise broker receives is calculated;
- Whether a broker network, broker organization or franchise sales organization may receive any additional consideration;
- The brands for which the franchise broker sold a franchise anywhere in the United States or its territories during the last calendar year for which the franchise broker received or is entitled to receive compensation, including but not limited to the total number of units sold for the brand.

We expect the DFPI to issue regulations over the next year specifying the formatting and content requirements for Broker Disclosure Documents, including prescribing mandatory language for the required cover page.

## **Other Requirements**

A registered franchise broker must keep and maintain a complete set of books, records and accounts of each California franchise offer for five calendar years after such offer.

## **When Must a Franchise Broker Begin Complying With the California Franchise Broker Law?**

The broker registration and disclosure requirements are subject to appropriation by the California Legislature. Appropriation means, prior to the law taking effect, the Legislature must authorize the use of public funds for the purpose of carrying out the bill. The California Franchise Broker Law will go into effect on the later of July 1, 2026, or 12 months after appropriation. That is, the California Franchise Broker Law will not go into effect before July 1, 2026.

## **What Are the Risks if a Franchise Broker Fails To Comply With the California Franchise Broker Law?**

A franchise broker who fails to comply with the California Franchise Broker Law may be liable for damages to the franchisee, subfranchisor or franchisor, as well as indemnification to the franchisor. A franchisee who worked with the broker may seek rescission of the franchise for a broker's willful violations. In addition, the commissioner may issue a stop order suspending or revoking a franchise

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broker's registration for violations.

## **Will Other States Follow Suit?**

New York and Washington have long required brokers to register before offering or selling franchises. California, however, is the first state to require a broker to provide presale broker disclosures. Other states may begin to follow suit in response to the North American Securities Administrators Association's (NASAA) proposed Model Broker Registration Act.

In May, NASAA, which includes state franchise regulators, solicited public comments regarding a proposed NASAA Model Broker Registration Act (Franchise Broker Act). If adopted by NASAA, the Franchise Broker Act would be a model for states to use to regulate franchise brokers.

Similar to the California Franchise Broker Law, NASAA's Franchise Broker Act would list various prohibited practices and require franchise brokers to register with a state before offering or selling franchises, provide a presale disclosure statement to prospective franchisees and maintain specified records. The Franchise Broker Act's proposed definition of "franchise broker" is almost identical to California's new definition. NASAA reports it is preparing a draft uniform disclosure statement, which it will post for public comment once finalized.

In addition to the broker registration requirement, the Franchise Broker Act would require a franchisor to file a notice with the applicable state appointing the franchise broker before such broker may offer or sell a franchise on behalf of the franchisor. Other additional requirements of the Franchise Broker Act include:

1. A competency examination fee and exam for franchise brokers;
2. Continuing education requirements for franchise brokers;
3. Broker experience requirements; and
4. Required recordkeeping for 10 years.

For purposes of the competency exam and the continuing education requirements, a franchise broker who is not a natural person is exempt from both.

Although NASAA has not released additional information regarding the competency exam that would be required for franchise brokers, its website offers certain information about the competency exams for the other industries required by NASAA to pass a competency exam, which includes brokerdealer representatives and investment adviser representatives. For each exam, NASAA posts an outline and a study guide of the test materials. Generally, the information covered by these competency exams includes an understanding of the current applicable regulations, economic factors and business information; ethical practices and obligations; communication of prospects and customers; and the remedies available when the applicable regulations are violated.

For recordkeeping, every franchise broker must keep and maintain a complete set of books, records and accounts relating to any offers and sales of franchises, and such records are subject to examination by the applicable official of the state implementing the Franchise Broker Act. This requirement continues for a period of 10 years after the franchise broker has ceased operating as a franchise broker and would include keeping track of not only closed deals/ signed franchise agreements but also records related to conversations and meetings with prospects that never resulted in a closed deal.

The public comment period regarding the Franchise Broker Act ended on June 13, and NASAA is currently reviewing all comments and considering whether to present the act, in its current or a revised form, to its board of directors for potential adoption by NASAA membership. Though NASAA's franchise related recommendations are not binding on any state, many franchisor registration states have traditionally followed them.

We are also aware that there are efforts between NASAA and California to align the California Franchise Broker Law with NASAA's Franchise Broker Act so that there is uniformity among the states that will require franchise brokers to register and disclose candidates. We expect that NASAA may revise the proposed Franchise Broker Act and open another comment period for the revised version. This will remain an issue to watch in 2025.

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National Law Review, Volume XV, Number 59

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