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Business Associations Review of Selected 1970 California Legislation

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Business Associations

Franchise Investment Law

Business and Professions Code §10177 (amended); Corporations Code §§31000-31516 (new); 25019, 25212 (amended).

SB 647; STATS 1970, Ch 1400

Chapter 1400 enacting the Franchise Investment Law brings sales of business franchises under the purview of the Corporations Commissioner.

Section 25019 of the Corporations Code was amended to specifically delete from the definition of "security" any franchise subject to the Franchise Investment Law or exempted by its terms. Section 25212, which provided for licensure and sanction of security broker-dealers, has been amended to subject such broker-dealers to the restrictions to good faith conduct in the sales of franchises as covered in Sections 31210 and 31211. Business and Professions Code Section 10177 is similarly amended to allow licensure and sanction of real estate brokers and salesmen. These two groups of licensed salesmen are the only persons permitted to "effect or attempt to effect a sale of a franchise in this state" other than persons identified in an application filed with the Corporations Commissioner prior to the offering of the franchise sale.

California Corporations Code Sections 31002-31019 defining the terms used in the law establishes new meanings for the words: Franchise (Section 31005) which includes agreements 1) granting rights to engage in the business of distribution of goods or services under a prescribed plan, 2) which is substantially associated with the franchisor's mark, name, or symbol, and 3) for which the franchise is required to pay a franchise fee (*defined in Section 31011*); *fraud* and *deceit* are specifically "not limited to common law fraud or deceit", Section 31012, but are defined further by Sections 31200-31203 as the use of untrue statements or omissions.

Section 31110 provides that on and after April 15, 1971, it will be unlawful to offer or sell a franchise unless registered or exempted by the Law. Chapter 2, Disclosure, specifies in Sections 31111(a)-31111 (v) the material information that must accompany an application for registration with the Commissioner. Included is a financial statement, history of business activities in franchising, background of persons

identified in the application, and copies of the typical contract along with the rights of and requirements imposed upon the franchisee. An open provision is written in by Section 31111(t) to allow the Commissioner to require any further information that is reasonably related to the fulfillment of the disclosure purpose. The application is to be verified pursuant to Section 31112 and accompanied by a registration fee of \$200 (*Section 31500*) and a proposed offering prospectus (*Section 31114*), which must include all of the information filed in the application except for the personal histories required in Section 31111(e).

The Commissioner may by the terms of Section 31115 issue a stop order suspending or revoking registration if he finds a failure to comply with provisions of the Law or orders pursuant thereto; or if there should be an offer constituting a misrepresentation to or fraud upon the purchasers; or if there should be a conviction or judgment entered against persons identified in the application which would create an unreasonable risk to prospective franchisees. Registration becomes effective on the 15th business day after filing if no stop order is issued or at any earlier time the Commissioner determines. Section 31116(b) was inserted to provide the Commissioner more time to act upon applications during the implementation period of January 1, 1971 through May 10, 1971. Applications received during this period will not become effective in the normal 15 days but at specified dates beginning with April 15, 1971.

Registration of a franchise offering is effective for one year (*Section 31120*) and may be renewed at one year intervals, unless the Commissioner specifies a different period, by filing a renewal statement (*Section 31121*) with a renewal fee of \$50. Material changes in information (to be further defined by the Commissioner) must be promptly filed with the Commissioner by amendment to registration (*Section 31123*), which must be approved by the Commissioner before becoming effective, and it must be accompanied by a \$50 amendment fee (*Section 31500*).

Once registered, a franchise may be offered or sold only if within 48 hours prior to execution of any binding agreement or receipt of consideration the prospective franchise is provided with a copy of the prospectus and copies of all proposed agreements relating to the sale (*Section 31119*).

The general provisions of Chapter 3 require each franchisor or sub-franchisor offering franchises for sale in this state to maintain a complete set of records of such sales, though not to be kept necessarily

within this state. Section 31155 requires each entity, other than California corporations, registering under this Law to file an irrevocable consent appointing the Commissioner, or his successor, to be its attorney for receipt of process for an action under this Law. Substituted service procedures and requirements are included in this section.

Section 31156 provides that advertisements of franchise offerings may not be published in this state unless a copy of the advertisement is filed at least 3 business days prior to the first publication. If the Commissioner finds the advertisement to be misleading he may summarily give notice in writing to the advertiser that publication of the advertisement would be unlawful. Section 31157 further provides that the advertiser-franchise offeror may request a hearing to commence within 15 days of his written request. Hearings are to be conducted by the Commissioner in accordance with Sections 11500-11528 of the Government Code.

Included in the Commissioner's powers is the authority to order franchise fees to be placed in escrow or impounded until the franchise is in operation, provided that the franchisor has failed to demonstrate financial ability to meet obligations of contract and that such escrow or impound is necessary to protect prospective franchisees or subfranchisors (*Section 31113*).

Sections 31200-31202 describe fraudulent practices as willfully made untrue statements or omissions of material facts; in a filed application, in a communication for the offer or sale of a franchise, or, in a statement required to be disclosed by an 'exempted' entity under Section 31101.

Section 31100 provides the Commissioner with the power to exempt by rule any transaction he finds not necessary in the public or investor interest. Specifically exempted from Chapter 2, Disclosure, are franchisors with a net worth of \$5 million or with a net worth of \$1 million if the franchise is 80% owned by a public corporation with a net worth of \$5 million, *and* which franchisors have conducted a minimum amount of franchise business in the last five years. These exempted franchisors must, however, disclose information required by Section 31101(c)(1)-(14). Section 31102 exempts franchisees and subfranchisors (when selling entire areas) from registration and disclosure if they are offering or selling for their own account. Section 31103 exempts transactions relating to bank credit card plans since they are regulated by other boards or agencies.

Violations of the provisions of truthful disclosure subjects the per-

son to liability to franchisees or subfranchisors for damages and, if the violations are willful, for rescission. Knowledge of the fact of untruth or omission by the plaintiff is a defense (*Section 31300*). Willful violations further subject a person to criminal action and, upon conviction, may result in a fine of not more than \$10,000, or imprisonment for not more than 10 years, or both (*Section 31410*). The Commissioner, through *Section 31401*, may in his discretion, conduct or have conducted such investigations he deems necessary. Should it appear that a person has engaged or is about to engage in an act unlawful under this Law, *Section 31400* provides the Commissioner with the authority to bring an action in superior court for injunctive relief. If an exempted franchise is offered without complying with the separate disclosure provisions, the Commissioner may issue a cease and desist order to remain in effect until the franchise offer is brought within the requirements of this Law.

Reference:

- 1) 15 N.Y. LAW FORUM 1 (Symposium on Franchising, 1969); Augustine & Hrusoff, *Franchise Regulation*, HAST. L.J. 1347 (1970); Burrus & Savarese, *Exclusive Dealing and Tying Arrangements, Developments in Antitrust During the Past Year*, 38 ANTITRUST L.J. 354 (1968-69).

Accountancy Corporations

Business and Professions Code §§5150-5157 (new).

SB 503; STATS 1970, Ch 1113

Chapter 1113 establishes Business and Professions Code Sections 5150-5157, which now permits accountants to incorporate subject to the provisions of the Moscone-Knox Professional Corporation Act, (*Corporation Code Sections 13400-13410*).

These new Sections enumerate specific procedures for the registration of such corporations with the State Board of Accountancy (*Sections 5151-5156*). The Board is authorized to adopt and enforce rules and regulations necessary to carry out the purposes and objectives of the Act (*Section 5157*).

Corporate Securities

Corporations Code §§23002, 25102, 25104, 25111, 25115, 25503, 25507 (amended).

AB 2346; STATS 1970, Ch 612

Section 23002 is amended to provide that a "qualification of the sale

of securities” by the Commissioner of Corporations has the effect of being conclusive evidence that an unincorporated trust or association is a real estate investment trust for the purposes of limited liability as provided for in Section 23001. Previously Section 23002 provided that the “issuance of a permit” by the Corporations Commissioner had the effect of being conclusive evidence that such a real estate investment trust existed for purposes of limited liability.

Section 25102 adds as a transaction which is exempted from the qualification requirement of issuer transactions under Section 25110: any offer or sale, in a transaction not involving any public offering, of any bona fide general partnership, joint venture or limited partnership interest; or any beneficial interest in a trust which is a “security” within the meaning of Section 25019 (*Section 25019 gives a comprehensive definition of a security*) if, in the case of such beneficial trust interests, immediately after the sale and issuance they are owned by no more than five persons. Previously, this subdivision of Section 23002 exempted any offer or sale of any bona fide general partnership, joint venture or limited partnership interest, in a transaction not involving any public offering.

Section 25104 provides that certain transactions are exempted from the qualifications requirement of nonissuer transactions set forth in Section 25130. One type of transaction which is exempted is an offer or sale in which securities of the same class have been qualified in an issuer transaction within the previous 18 months or in nonissuer transactions within the previous 12 months, provided, however, that no stop order of the Commissioner is in effect. This amendment allows the Commissioner, by rule or order, to withhold this exemption with respect to securities qualified only pursuant to a limited offering qualification.

Section 25115 now provides that an application for qualification of a nonissuer transaction may be signed by the issuer. Previously, every application had to be signed by the person on whose behalf the offering is being made.

Section 25503 provides that any person who violates the qualification requirements of Sections 25110, 25120, or 25130 shall be liable to any immediate purchaser for return of the consideration, plus interest, or for damages in the amount of the difference between the purchase price, and the amount for which the purchaser was able to sell the shares. This amendment adds an additional recovery for violation of Section 25120 only. Any person who violates Section 25120 is liable to any purchaser for the difference between (a) the value of the consideration

received by the seller and (b) the value of the security at the time it was received by the buyer, with interest.

References:

- 1) 1 OPS. ATTY. GEN. 65 (1951); 20 OPS. ATTY. GEN. 192 (1952); 24 OPS. ATTY. GEN. 63, 273 (1954); 26 OPS. ATTY. GEN. 25 (1955); 31 OPS. ATTY. GEN. 219 (1958); 32 OPS. ATTY. GEN. 210 (1958); 33 OPS. ATTY. GEN. 15 (1959); 36 OPS. ATTY. GEN. 15 (1960); 50 OPS. ATTY. GEN. 20, 135 (1967); 51 OPS. ATTY. GEN. 40 (1968).
- 2) 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations* §72 (7th ed. 1960); 2 WITKIN, SUMMARY OF CALIFORNIA LAW, *Real Property* §117A (Supp. 1969); 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations* §§17, 116A, 123A, 137A, 138A, 140A, 160A (Supp. 1969).
- 3) CONTINUING EDUCATION OF THE BAR, REVIEW OF SELECTED 1965 CODE LEGISLATION 14, 108.
- 4) Pearce, *California Corporate Securities Law vs. Proposed Uniform Securities Law*, 9 HAST. L.J. 1 (1957); Comment, *Blue Sky Laws: Corporate Securities Act: Effect of Failure to Comply: Remedies to the Subscriber*, 18 CAL. L. REV. 149 (1929); Comment, *Corporations: Blue Sky Laws: Regulations of the Sale of Personally Owned Securities Under the Corporate Securities Act*, 20 CAL. L. REV. 84 (1931); Note, *Conflict of Laws: Liability for Interstate Sales of Securities Under State Blue Sky Laws*, 31 CAL. L. REV. 95 (1942); Note, *Corporations: Establishment of Voting Trusts Held Not Subject to Issue of Permit Under Corporate Securities Act*, 33 CAL. L. REV. 321 (1945).

Corporate Officers, Names and Addresses

Corporations Code §§3301, 3301.1, 4102, 4103 (amended).

SB 1094; STATS 1970, Ch 671

(Effective January 1, 1971)

Chapter 671 amends Corporations Code Sections 3301 and 3301.1 to clarify provisions facilitating service of process on corporations authorized to do business in California.

In 1969, the State Legislature enacted Section 3301, which established important procedures for obtaining and keeping current the names and addresses of the corporate officers and their designated agents for service of process—if the corporation elected to designate one. If the corporation failed to comply with the procedures designated in Section 3301, its charter would be suspended under Section 3301 after reasonable notice had been given.

The 1970 amendment clarifies the current procedures in two respects. First, the amendment specifies that the suspension will become effective on the date the Franchise Tax Board receives notification from the Corporations Commissioner that the corporation has failed to make its annual filing statement of corporation officers. The second clarification provides that Section 3301 shall not be construed to place any person dealing with the corporation on notice of, or on duty or obligation to in-

quire about the existence or content of the statement required by Section 3301.

This clarification was sponsored by the California Land Title Association in order to protect possible bona fide purchasers who might purchase corporate property from a former owner of the property and be deceived. The commission felt that it would be possible for the situation to arise where an incorporator would file the articles of incorporation for the corporation and then purchase realty for the corporation in his name. If the incorporator subsequently left the corporation, Corporations Code Section 3301, as amended, would require an updating of the names and addresses of the corporate officers. This statute, however, would not affect the owner's name on the title to corporate property that would be registered in the former corporate officer's name.

Sections 4100 to 4318 of the Corporations Code regulate the merger and consolidation of corporations. Section 4102 defines a "constituent corporation" as one which is merged or consolidated with one or more other corporations. To this definition is added the provision that in case of a merger, a constituent corporation includes the surviving corporation (*surviving corporation is defined in Section 4101*).

Section 4103 requires the board of directors of each corporation seeking to merge to approve the merger agreement. The directors are specifically required to approve the manner and basis of conversion of the shares of the constituent corporations into the shares of the surviving corporation. Before this amendment, the section referred only to the "shares of the consolidated or surviving corporation." As amended, the section refers to "shares or other securities of the consolidated or surviving corporation or of a holding corporation of any of the constituent corporations." Thus, the directors are now required to approve the manner of conversion of shares even if converted into securities other than shares. In addition, a holding corporation is specifically brought into the purview of the statute.

References:

- 1) 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations* §§34, 105 (7th ed. 1960), (Supp. 1969).
- 2) ADVISING CALIFORNIA BUSINESS ENTERPRISES 1094, CONTINUING EDUCATION OF THE BAR; CONTINUING EDUCATION OF THE BAR, REVIEW OF SELECTED 1969 CODE LEGISLATION 101.

Statement of Partnership

Corporations Code §15010.5 (amended).

AB 889; STATS 1970, Ch 606

This amendment to Section 15010.5 provides that when a partner

withdraws by reason of an agreement as provided for in Section 15031 from a partnership recorded in any county pursuant to this Section, the recorded partnership statement or an amended statement may state the name of the withdrawing partner, the date of withdrawal and that the partnership was not dissolved by such withdrawal. Such statement shall be a conclusive presumption in favor of a bona fide purchaser for value of any partnership real property located in a county in which such statement or certified copy thereof has been recorded, that the partner has withdrawn. However, there will be no conclusive presumption if there is recorded by one claiming to be a partner or the personal representative of such partner, a statement of partnership, verified and acknowledged by the person executing it that such person claims to be a member of the partnership or that any of the persons named in the previously recorded partnership statement are not members of the partnership.

Previously this Section only applied under circumstances where a partner became deceased and by an agreement under Section 15031 the partnership was not to be dissolved. The conclusive presumption applied only in case of death. Furthermore, the only exception to the application of the presumption was where a person filed a statement claiming to be a partner. The exception of a claim by a personal representative has been added.

References:

- 1) Corporations Code §§ 15006, 15008; Government Code §27322 (recording).
- 2) Generally, regarding conveyance of partnership property by partner for partnership debts see *Dupuy v. Leavenworth* 17 Cal. 262 (1861).
- 3) WITKIN, SUMMARY OF CALIFORNIA LAW, *Partnership* §18 (7th ed. 1960), (Supp. 1969).

Limited Partnerships

Corporations Code §§15502, 15525.5 (amended).
SB 711; STATS 1970, Ch 839

Pursuant to the amendment Section 15502 now permits an attorney to sign, on behalf of a limited partner, the certificate of a limited partnership as required by this Section. Also, pursuant to this amendment, if the signature of a limited partner is not acknowledged, proof of such signature may be made by a subscribing witness.

Prior to this amendment, any limited partner was required to personally sign and have acknowledged the limited partnership agreement certificate.

Another amendment to Section 15502 provides that where a certificate is recorded in accord with this Section the recorded certificate or a copy thereof, if it appears valid in its face, shall create a conclusive presumption in favor of bona fide purchasers or encumbrances for value, that such limited partnership was validly formed.

Prior to this amendment, the Section stated that if a certificate is recorded in accord with this Section there shall be a conclusive presumption as provided in Section 15010.5 (requirement for recording statement of partnership with county recorder).

The amendment to Section 15525.5 provides that if the certificate permits, an amendment to the certificate for the purpose of substituting or adding a member to the partnership may be signed by a general partner and by the member to be substituted or added regardless of the number of limited partners.

Prior to the amendment, the above procedure could only be utilized if there were twenty-five or more limited partners. If there were less than twenty-five any amendment to the certificate could only be made pursuant to Section 15525 which requires the signature of all general and limited partners. The procedure provided for in Section 15525.5 applies only if it is permitted by the partnership certificate.

References:

- 1) 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations* §72 (7th ed. 1960); 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Partnership* §§36, 37, 38 (7th ed. 1960); (Supp. 1969).
- 2) CONTINUING EDUCATION OF THE BAR, REVIEW OF SELECTED 1967 CODE LEGISLATION 98.

Limited Partnerships; loans

Corporations Code §15513 (amended).

SB 1092; STATS 1970, Ch 866

The amendment to Section 15513 specifies that a limited partner in a partnership shall not make a loan upon the security of the partnership property if the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners. In addition no limited partner shall receive as collateral security any partnership property nor receive from a general partner any payment, conveyance, or release from liability if at the time of receipt of a claim against the partnership there are not sufficient assets

to discharge partnership liability to persons not claiming as general or limited partners.

This amendment to Section 15513 is intended to be declaratory of existing law. [See *Van Fleet-Durkee, Inc. v. Oyster*, 112 Cal. App. 2d 739 (1952), *Van Fleet-Durkee, Inc. v. Oyster*, 91 Cal. App. 2d 411 (1949)].

Reference:

- 1) 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Partnership* §36 (7th ed. 1960).

Real Estate Syndicate

Business and Professions Code §10251 (amended).

AB 202; STATS 1970, Ch 28

(Effective March 23, 1970)

This Chapter defines an interest in real property in a “real estate syndicate” held by a husband and wife as an interest held by one person for purposes of identifying members of such “real estate syndicate.”

The Real Estate Syndicate Act of 1969 defined a real estate syndicate as any general or limited partnership, joint venture, unincorporated association or similar organization (but not a corporation) owned beneficially by no more than 100 persons and formed for the sole purpose of, and engaged solely in investment in or gain from an interest in real property, including, but not limited to, a sale, exchange, trade or development. [*Business and Professions Code Section 10251(a)*]

This type of syndicate was transferred from the jurisdiction of the Corporations Commissioner to jurisdiction of the Real Estate Commissioner exempting these securities from the Corporate Securities Law (*Corporations Code Sections 25000-27002*). An “interest in real property” under the act includes “any estate or interest in unimproved land, agricultural land, or land improved with a residential, commercial, industrial or other structure, including profits, rents or other incidental income” [*Business and Professions Code Section 10251 (b)*].

Prior to this amendment, there was substantial confusion concerning whether an interest held by a husband and wife should be considered as beneficially owned by one or two persons. This was important when a real estate syndicate neared maximum membership of 100 beneficial owners and was faced with the possibility of being forced to comply with the Corporate Securities Law.

References:

- 1) Business and Professions Code §§10250-10340 “Real Estate Syndicate Act”.

- 2) CONTINUING EDUCATION OF THE BAR, REVIEW OF SELECTED 1969 CODE LEGISLATION, 8-12.

Property of Unincorporated Associations

Probate Code §27 (amended); Corporations Code §§21200, 21201 (amended).

SB 537; STATS 1970, Ch 965

Prior to 1961 the type of associations, unincorporated societies, and corporations which could take property by testamentary disposition had been restricted by Section 27 of the Probate Code. In 1961 the Section was amended to remove all description as to the type of corporation which could take by will. However, unincorporated associations which could take by will were still restricted to "religious, benevolent or fraternal" societies. With the enactment of Chapter 965 the adjectives "benevolent, religious, and fraternal" have been deleted. Thus, a testamentary disposition can be made to any unincorporated association or society as well as to any corporation.

The amendment to Section 21200 of the Corporations Code eliminates the words "benevolent or fraternal" from the text which limited the type of unincorporated society or association that could hold and transfer legal and equitable title to real property. The courts have been very strict in limiting the unincorporated associations which could hold and transfer legal title to "benevolent or fraternal" associations.

Section 3 of Chapter 965 does not change the manner in which benevolent and fraternal associations can convey real property. It does, however, add to Section 21201 of the Corporation Code provisions for transferring property by "other unincorporated associations for which no specific provision is made by statute." This added provision requires that the conveyance affecting real property be executed by the association's president or comparable officer or any other person designated by a resolution adopted by the association. The association must have recorded a certificate which lists the officers or persons authorized by the association to convey real property of the association before the bona fide purchaser will be protected. The bona fide purchaser is not protected if there is a recording by anyone claiming to be a member of the association which states that the previous recorded statement was recorded without authority or the authorized officers are not so authorized.

The addition to Section 21201 also provides that a bona fide purchaser or encumbrancer for value of the real property of an association

not otherwise authorized by statute to convey property is protected if his transfer was from an authorized officer of the association.

Reference:

- 1) 2 WITKIN, SUMMARY OF CALIFORNIA LAW, *Real Property* §§3, 39 (7th ed. 1960); 3 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations* §51 (7th ed. 1960), (Supp. 1969); 4 WITKIN, SUMMARY OF CALIFORNIA LAW, *Trusts* §28 (7th ed. 1960); 4 WITKIN, SUMMARY OF CALIFORNIA LAW, *Wills and Probate* §§52, 53 (7th ed. 1960); 4 WITKIN, SUMMARY OF CALIFORNIA LAW, *Wills and Probate* §52 (Supp. 1969).

Industrial Loan Companies; guaranty of thrift accounts

Financial Code §§18200.7, 18405-18405.3, 18655.1, 18950-18996 (new); 18200.3, 18203.5, 18205.5, 18617.1, 18649, 18667, 18818 (amended); 18405, 18664, 18669 (repealed).

SB 1290; STATS 1970, Ch 1306

Chapter 1306 revises the law regulating the formation and operation of industrial loan companies (finance companies).

Prior to this Chapter the Commissioner of Corporations was empowered to authorize the formation of such companies. In passing upon such formation, the Commissioner was required to ascertain to his satisfaction that the degree of experience and knowledge of the proposed officers of a finance company was sufficient to afford a reasonable promise of a successful operation. With this amendment he is now required to ascertain that the financial responsibility, character, and general fitness of the officers are such to command the confidence of the community and to warrant the belief that the business will be operated honestly and fairly.

Section 18203.5 is amended to increase the value of the capital stock required to commence business as an industrial finance company from \$300,000 to \$500,000.

Section 18405.1 is added to provide that repayment schedules on personal loans must require equal or substantially equal periodic payments during the term of the loan. Section 18405.2 provides that loans may be made repayable by one payment however the term of such loan shall not exceed one year.

Section 18405 is added to provide for maximum terms for various sizes of loans made by industrial loan companies, and additional conditions have been placed on loans which extend for more than 5 years.

Section 18655.1 is added to provide an alternative to the present method of determining interest rates. Current law provides rates of

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nct more than 2% per month on the unpaid principal balance up to \$700, and not more than 1% per month on the unpaid principal in excess of \$700. An industrial loan company may now charge a rate not exceeding 1½% on the unpaid principal balance regardless of the amount. This section shall have no force or effect after December 31, 1972.

Section 18964 is added to provide what thrift obligations are to be guaranteed by the Corporation. Section 18950-18996 are added to establish a Guarantee of Thrift Accounts. This addition requires the creation of a Thrift Guarantee Corporation to guarantee full payment of thrift obligations of members up to \$10,000 for each account subject to certain limitations. Membership in the Corporation is to include each industrial loan company which has issued and has outstanding thrift obligations and is authorized to conduct business pursuant to Division 7 of the Financial Code.