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DEPARTMENT : of COMMERCE

STATE OF MINNESOTA

Office Memorandum

DATE : January 9, 1991

TO : Maryanne Hruby
Director
The Legislative Commission to Review Administrative Rules

FROM : PATRICIA L. PETERSON
Director of Registration

PHONE : 6-2284

SUBJECT : Statement of Need and Reasonableness
Proposed Amendments to Franchise Rules

Enclosed please find Statement of Need and Resonableness for the Proposed Amendments to Franchise Rules.

P.L.P.

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

IN THE MATTER OF THE PROPOSED AMENDMENTS TO FRANCHISE RULES

STATEMENT OF

NEED AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statements, Section 80C.18, subdivision 1 provides that:

> Subdivision 1. The Commissioner may promulgate rules to carry out the provisions of sections 80C.01 to 80C.22, including rules and forms governing public offering statements, applications, financial statements and annual reports, and defining any terms, whether or not used in sections 80C.01 to 80C.22, insofar as the definitions are not inconsistent with sections 80C.21 to 80C.22.

Additional rulemaking authority provided in Minnesota Statutes Section 45.023 authorizes the Commissioner to "adopt, amend, suspend, or repeal rules ... whenever necessary or proper in discharging the Commissioner's official responsibilities."

The Commissioner finds the proposed rules to be necessary and consistent with the purposes fairly intended by the policies and provisions of Chapter 45 and 80C.

Rule Part 2860.4400 J.

Minn. Rule Part 2860.4400 J prohibits mandatory arbitration. The rule provides that the franchise agreement may contain an arbitration clause only "if the agreement allows the franchisee to opt out of the requirements of the clause."

Representatives of the franchise industry have argued that the language of Minn. Rule Part 2860.4400 J is an unconstitutional restriction of the rights of parties to look to arbitration for dispute resolution. They argue that Section 2 of the Federal Arbitration Act preempts Minnesota's Arbitration rule.

The Federal Arbitration Act provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving Commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction,

> or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Recent Supreme Court and lower federal court decisions have held that the FAA exists to address the traditional hostility of courts toward arbitration and that Congress through the FAA has preempted the state regulation of arbitration. See Southland Corp. v. Keating, 465 U.S. 1, 104 S.Ct. 852, (1984); Securities Industry Association v. Connolly, 703 F. Supp. 148 (D. Mass, 1988). aff'd, 883 F. 2d 1114 (1st Cir. 1989); Saturn Distribution Corporation v. Williams 905 F. 2d 719 (4th Cir. 1990); Seymour v. Gloria Jean's Coffee Bean Franchising Corp., (D. Minn. March 14, 1990). Although there is no court challenge to the current rule, the Commissioner finds that it is reasonable at this time to defer to this line of cases.

Small Business Considerations

Arbitration is generally cheaper than judicial resolution of disputes and this is clearly an advantage for a small business whether that business is a franchisor or franchisee.

Since the rule does not involve compliance or reporting requirements schedules or deadlines or performance standards,

necessary to discuss Minn. Stat. § 14.115, subdivision 2(a)-(e) is inapplicable to the proposed rule.

The Notice of Intent to Solicit Comment contained a statement that the rule may have an impact on small business.