

TITLE 16
DEPARTMENT OF REGULATORY AGENCIES
CHAPTER 37
RULES UNDER THE FRANCHISE INVESTMENT LAW

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SUBCHAPTER 1

GENERAL PROVISIONS

§16-37-1 Definitions. Unless the context indicates otherwise, as used in these rules:

"Bona fide wholesale transaction" means that in any determination as to whether a marketing plan or system of a manufacturer, licensor, or franchisor is a bona fide wholesale transaction or a series thereof, the director may consider, but not be limited to, the following:

- (1) Whether, in connection with an agreement to process, resell, or otherwise distribute a manufacturer's or licensor's product or service, consideration in purchase transactions thereunder is solely for the payments of goods, services, equipment, inventory, or real

estate and such consideration does not reflect, in part or in whole, payment for the right to continue such purchase transactions or business whether on the same or different terms than those stated in the subject agreement.

- (2) Whether, in connection with an agreement to process, resell, or otherwise distribute a manufacturer's or licensor's product or service, a purchase of goods, services, equipment, inventory, or real estate is required.
- (3) Whether, in connection with an agreement to process, resell, or otherwise distribute a manufacturer's or licensor's product or service, the cost of goods, services, equipment, inventory, or real estate thereunder to the seller thereof is reasonably related to the price of the same to the distributor or licensee, taking into account the respective circumstances in the market of both the seller and buyer thereof.

"Director" means the director of regulatory agencies.

"Franchise fee" may be determined by the director to include, but not be limited to, the following:

- (1) Payment which is made before, upon, or after execution of an agreement to purchase, process, resell, or otherwise distribute a manufacturer's or licensor's goods, services, equipment, inventory, or real estate; and
- (2) Said payment is made in the form of a lump sum, installments, periodic royalties, profits, or cash flow, or is or may be reflected in the price of goods, services, equipment, inventory, or real estate sold by the licensor to the distributor or licensee.

"Material event or material change" may be determined by the director to include, but not be limited to, the following:

- (1) The termination, closing, or failure to renew during any three-month period of:
 - (A) The greater of one per cent or five of all franchises of a franchisor or subfranchisor regardless of location or
 - (B) The lesser of fifteen per cent or two of the franchises of a franchisor or subfranchisor located in this State.
- (2) Any change in control, corporate name, or state of incorporation, or reorganization of the franchisor whether or not the franchisor or its parent, if the franchisor or subfranchisor is a subsidiary, is required to file reports under section 12 of the Securities Exchange Act of 1934.

- (3) The purchase by the franchisor in excess of five per cent of its existing franchises during any three-month period on a continuous basis.
- (4) The commencement of any new product, service, or model line involving, directly or indirectly, additional investment by any franchisee or the discontinuation or modification of the marketing plan or system of any product or service of the franchisor where the total sales from such product or service exceeds twenty per cent of the gross sales of the franchisor on an annual basis.

"Net worth" shall include the excess of assets over liabilities which are recognized by generally accepted accounting principles consistently applied with the exception that:

- (A) Intangible assets in making the above computation shall include only the liquidation value of such intangibles,
- (B) Receivables of a franchisor due from its franchisees shall be stated with an appropriate asset offset or reserve for losses, and
- (C) Lump sum franchise fee receipts, or any portion thereof, shall include an appropriate offset under liabilities for accrued obligations to be performed in part or in whole as consideration for such fees.

"The Act" means Act 18, Session Laws of Hawaii 1974, or chapter 482E, Hawaii Revised Statutes. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-1, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-2)

§16-37-2 Forms. The following forms have been adopted for use (typewritten or photocopied reproductions of the listed forms shall be accepted):

- (1) FR-1 Application for filing of franchise offering circular; and
- (2) FR-2 Consent to service of process. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-2, 7/30/81] (Auth: HRS §§91-2, 482E-8) (Imp: HRS §482E-8)

SUBCHAPTER 2

FILING OF FRANCHISE OFFERING CIRCULAR

§16-37-3 General filing requirements. (a) Subfranchisor offering circular. When a person filing an offering circular is a subfranchisor, the circular shall also

include the same information concerning the subfranchisor as is required from the franchisor.

- (b) Financial statements.
- (1) Financial statements required to be filed in connection with an offering circular shall be prepared in accordance with generally accepted accounting principles. Such financial statements shall be audited and certified by a certified public accountant, except where the particular form or this section permits the use of unaudited statements.
- (2) A balance sheet of the franchisor at the close of the franchisor's last fiscal year preceding the date of filing of the offering circular and a profit and loss statement and analysis of surplus for the fiscal year ended at the date of the balance sheet, together with a balance sheet of the franchisor as of a date within ninety days prior to the date of filing of the offering circular and a statement of profit and loss for the period from the close of the last preceding fiscal year to the date of the balance sheet, both verified by a duly authorized officer of the franchisor, if the franchisor has been in existence for less than one year, a balance sheet of the franchisor as of a date within ninety days prior to the date of filing and a statement of profit and loss for the period from the franchisor's organization to the date of the balance sheet shall be filed together with the offering circular.
- (3) Where a franchisor owns directly or indirectly a majority interest of the outstanding voting securities of any other corporation, the financial statements required to be filed shall normally reflect on a consolidated basis the financial condition of the franchisor and all of such subsidiaries.
- (4) In certain cases the director may waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the director is otherwise satisfied as to the reliability of such statements and as to the ability of the franchisor to perform future commitments. Such waiver shall ordinarily be granted only upon a showing that the franchisor has not had prior audited statements; that the close of the most recent or current fiscal year is so near the time of filing of the offering circular that it would be unreasonably costly or impractical to provide audited statements with the application; and that audited statements will be furnished within a reasonable time after the end of the most recent or current fiscal year. In such cases the director may impose an impoundment and

such other conditions and restrictions as in his discretion may be appropriate. In every case where an unaudited statement is to be filed, the person requesting approval shall submit to the director, in writing, his reasons therefore and obtain the prior written approval of the director.

(5) The use of unaudited financial statements as provided herein shall not relieve the applicant or any person from any liability for false and misleading statements contained in such financial statements.

(c) Amendment of offering circular. Any amendment to the text of the offering circular, or of any item, exhibit, or other documents previously filed as a part of the offering circular shall be indicated by underscoring new material and bracketing material to be deleted. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-3, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-3)

§16-37-4 Offering circular. (a) The purpose of the offering circular is to inform prospective franchisees and subfranchisors. Accordingly, the information set forth in the circular shall be presented in a clear, concise fashion that will be readily understandable.

(1) All information contained in the offering circular shall be set forth under appropriate captions or headings reasonably indicative of the principal subject matter contained therein. Except as to financial statements and other tabular data, information set forth in the offering circular shall be divided into reasonably short paragraphs or sections.

(2) Each offering circular shall contain a reasonably detailed table of contents showing the subject matter of the various sections or subdivisions of the offering circular and the page number on which each section or subdivision begins.

(b) Required information in offering circular. Each offering circular shall contain the information required by the Act together with such additional information as the director may prescribe.

(c) Format of offering circular. The format of the offering circular shall be presented in the following manner, with the cover page containing:

(1) The title in boldface type: **FRANCHISE OFFERING CIRCULAR.**

(2) The name, type of business organization, principal business address, and telephone number of the franchisor.

(3) If different from (2) above, the name, principal business address and telephone number of the subfranchisor or sales organization offering the franchise in this State.

- (4) A sample of the primary business trademark, logotype, trade name, or commercial label or symbol used by the franchisor for marketing its products or services and under which the franchisee will conduct its business. (Place in upper left-hand corner of the cover page.)
- (5) A brief description of the franchise to be offered.
- (6) A summary of item C(4) below, to wit: franchisee's initial franchise fee or other payment and franchisee's initial investment, respectively. (See §16-37-4(c)(4))
- (7) The following statement in boldface type:
THESE FRANCHISES WILL BE/HAVE BEEN FILED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF HAWAII. FILING DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE DIRECTOR OF REGULATORY AGENCIES OR A FINDING BY THE DIRECTOR OF REGULATORY AGENCIES THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.
THE FRANCHISE INVESTMENT LAW MAKES IT UNLAWFUL TO OFFER OR SELL ANY FRANCHISE IN THIS STATE WITHOUT FIRST PROVIDING TO THE PROSPECTIVE FRANCHISEE, OR SUBFRANCHISOR, AT LEAST SEVEN DAYS PRIOR TO THE EXECUTION BY THE PROSPECTIVE FRANCHISEE OF ANY BINDING FRANCHISE OR OTHER AGREEMENT, OR AT LEAST SEVEN DAYS PRIOR TO THE PAYMENT OF ANY CONSIDERATION BY THE FRANCHISEE, OR SUBFRANCHISOR, WHICHEVER OCCURS FIRST, A COPY OF THE OFFERING CIRCULAR, TOGETHER WITH A COPY OF ALL PROPOSED AGREEMENTS RELATING TO THE SALE OF THE FRANCHISE.
THIS OFFERING CIRCULAR CONTAINS A SUMMARY ONLY OF CERTAIN MATERIAL PROVISIONS OF THE FRANCHISE AGREEMENT. THE CONTRACT OR AGREEMENT SHOULD BE REFERRED TO FOR A STATEMENT OF ALL RIGHTS, CONDITIONS, RESTRICTIONS AND OBLIGATIONS OF BOTH THE FRANCHISOR AND THE FRANCHISEE.
- (8) The name and address of the franchisor's registered agent in this State authorized to receive service of process.
- (9) The name and address of the subfranchisor's or sales organization's registered agent in this State authorized to receive service of process.

- (10) A table of contents based on the requirements of the offering circular.
- (d) Body of offering circular. The offering circular shall contain the following information:
 - (1) The franchisor. Set forth in summary form:
 - (A) The name of the franchisor, the name under which the franchisor is doing or intends to do business, and the name of any parent or affiliated company that will engage in business transactions with franchisees,
 - (B) The franchisor's principal business address and the name and address of its agent in the State of Hawaii authorized to receive service of process,
 - (C) The business form of the franchisor, whether corporate, partnership, or otherwise.A statement of when, where, and how long the franchisor:
 - (A) Has conducted a business of the type to be operated by the franchisee;
 - (B) Has granted franchises for such business; and
 - (C) Has granted franchises in other lines of business.
 - (2) Identity and business experience of persons affiliated with franchisors. List by name and office held, the officers, directors, trustees, and/or general partners as the case may be, and the general managers, principal executives and/or other persons who shall be charged with the business activities and operations of the franchisor. With respect to each person listed, set forth the principal occupations during the past five years.
 - (3) Prior record and litigation. State whether the franchisor or any person identified in (2) above within ten years preceding filing:
 - (A) Has been found guilty of a misdemeanor or a felony or held liable in a civil action by final judgment where the criminal or civil action involved fraud, embezzlement, fraudulent conversion, or misappropriation of property; or
 - (B) Is subject to any currently effective order of the Securities and Exchange Commission or the securities administrator of any state denying registration to or revoking or suspending the registration of such person as a securities broker or dealer or investment advisor or is subject to any currently effective order of any national securities exchange (as defined in the Securities and Exchange Act of 1934) suspending or expelling such person from membership of such association or exchange; or

- (C) Is subject to any currently effective order or ruling of the Federal Trade Commission or is subject to any currently effective order relating to business activity as a result of an action brought by any public agency or department. Such statement shall set forth the court, the date of conviction or judgment, any penalty imposed, or damages assessed, or the date, nature, and issuer of such order.
- (4) Fees and charges payable. Describe in detail the franchise fee charged, the proposed application of the proceeds of such fee by the franchisor and the formula by which the amount of the fee is to be determined if the fee is not the same in all cases. Describe any payments or fees other than franchise fees that the franchisee or subfranchisor is required to pay to the franchisor, including royalties and payments or fees which the franchisor collects in whole or in part on behalf of a third party or parties. This section should also include a statement indicating whether and under what conditions all or part of the initial franchise fee may be returned to the franchisee and a statement of the estimated total investment to be made by the franchisee for:
 - (A) The initial franchise fee and other fees, whether payable in one sum or in installments;
 - (B) Fixed assets other than real property and leases for real property, whether or not financed by contract or installment purchase, leasing or otherwise;
 - (C) Working capital, deposits and prepaid expenses;
 - (D) Real property, whether or not financed by contract or installment purchase or otherwise, and leases for real property; and
 - (E) All other goods and services which the franchisee will be required to purchase or lease.
- (5) Terms of franchise, renewal rights. Describe fully the term of the franchise and the conditions under which the franchise agreement may be renewed or extended.
- (6) Termination of franchise. Describe fully the conditions under which the franchise agreement may be terminated, modified, or renewal refused.
- (7) Assignment. Describe the terms under which the franchise agreement may be sold or transferred by the franchisee or repurchased at the option of the franchisor.
- (8) Obligations of franchisee or subfranchisor to purchase from designated sources. Describe fully the obligations of the franchisee

or subfranchisor, whether arising by the terms of the franchise agreement or by other device or practice to purchase from the franchisor or a designee, services, supplies, products, fixtures, or other goods relating to the establishment or operation of the franchise business, together with a description thereof. Also a statement of the means by which the franchisor derives income from such purchases.

- (9) Limitations on goods and services which franchisee may offer to his customers. A statement as to whether, by the terms of the franchise agreement or other device or practice, the franchisee is limited in the goods or services offered by him to his customers.
- (10) Terms of purchase. Describe the terms and conditions of any financing arrangements offered directly or indirectly by the franchisor or an agent or affiliate.
Describe any past or present practice or of any intent of the franchisor to sell, assign, or discount to a third party any note, contract, or other obligation of the franchisee or subfranchisor in whole or in part.
- (11) Arrangements with public figures. Describe all compensation or other benefit given or promised to a public figure arising, in whole or in part, from
 - (A) the use of the public figure in the name or symbol of the franchise or
 - (B) the endorsement or recommendation of the franchise by the public figure in advertisements.
- (12) Present franchises and those proposed to be sold. Describe in summary form the number of franchises presently operating, the number of such franchises operating in Hawaii, and the number of franchises proposed to be sold and the number of franchises proposed to be sold in Hawaii during the one year following the date of the offering circular. Also include the names and addresses of all franchisees operating in Hawaii.
- (13) Exclusive area or territory. State whether franchisees or subfranchisors receive an exclusive area or territory. Attach a statement explaining the terms and effects of any covenant not to compete which is or will be included in the franchise or other agreement to be executed by the franchisee or subfranchisor.
- (14) Performance by franchisor. Describe succinctly the obligations required to be performed by the franchisor prior to the opening of the franchised business. Indicate whether such obligations must be completed within a specified time period and the right of

franchisees, if any, to any refund of fees paid if such obligations are not complete within the prescribed time.

- (15) Financial statements.
- (16) Estimated or projected franchisee sales or earnings. A copy of any statement of estimated or projected franchisee sales or earnings prepared for presentation to prospective franchisees or other persons together with a statement immediately following such statement setting forth the feasibility studies, experience or data upon which the estimations or projections are based and explaining clearly the manner and extent to which such studies, experience or data relates to the actual operations of businesses conducted by the franchisor or its franchisees.
- (17) Earnings of past and present franchisees. Summarize the earnings of past and present franchisees, including record of failures, resales to the franchisor, sales of the franchise to others, and transfers. A statement of the number of franchise businesses in each of the following categories which within the three-year period preceding the date of the offering circular have:
 - (A) Been canceled or terminated by either the franchisor or franchisee;
 - (B) Not been renewed by either the franchisor or franchisee;
 - (C) Been reacquired through purchase by the franchisor;
 - (D) Been otherwise reacquired by the franchisor; and
 - (E) Been transferred or sold by the franchisee to persons other than a corporation or other business entity controlled by the transferring or selling franchisee.
- (18) Obligations of franchisor. Describe the training program, supervision and assistance the franchisor has and will provide the franchisee or subfranchisor.
- (19) Registration of franchises or filing of offering circulars in other states. List the following:
 - (A) The states in which a registration is effective or where an offering circular has been filed.
 - (B) The states in which a proposed registration or filing is or will be shortly on file.
 - (C) The states, if any, which have refused, by order or otherwise, to register these franchises.
 - (D) The states, if any, which have revoked or suspended the right to offer these franchises.
 - (E) The states, if any, in which a proposed registration of these franchises has been withdrawn.

- (20) Financial statement prepared for presentation to prospective franchisees. If any financial statement, other than the statement required under paragraph (15) above, has been prepared for presentation to prospective franchisees or other persons, attach a copy together with a statement setting forth the basis for such statement.
- (21) Contracts. Attach a copy of all franchise and other contracts or agreements proposed for use or in use in this State, including, without limitation, all lease agreements, option agreements, and purchase agreements.
- (22) Acknowledgment of receipt by prospective franchisee. The last page of each offering circular shall contain a detachable document acknowledging receipt of the offering circular by the prospective franchisee.
- (23) Other information. Additional information required to be disclosed or which the franchisor desires to present shall continue under the appropriate captions or headings. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-4, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-3)

§16-37-5 Impoundments. (a) The director may order the impoundment of franchise fees if the director finds that such requirement is appropriate to protect the prospective franchisee.

(b) Operation of impoundment. When an impoundment is imposed in connection with the filing of an offering circular, one hundred per cent of franchisee fees and all other funds paid by the franchisees or subfranchisors for any purpose shall within forty-eight hours of the receipt of such funds, be placed with the depository until the director takes further action pursuant to subsection (e) of this section. All checks shall be made payable to the depository.

(c) Purchase receipts. When an impoundment is imposed, the franchisor shall deliver to each franchisee or subfranchisor, a purchase receipt, in a form approved by the director. Such purchase receipts shall be consecutively numbered and prepared in triplicate and the original given to the franchisee or subfranchisor, the first copy to the depository together with the payment received and the second copy to the franchisor.

(d) Depository. Funds subject to an impoundment shall be placed in a separate trust account with a bank or a fiduciary company authorized to do business in this State and acceptable to the director. A written consent of the depository to act in such capacity shall be filed with the director.

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(e) Release of impoundments. The director shall authorize the depository to release to the franchisor such amounts of the impounded funds applicable to a specified franchisee (or subfranchisor) upon a showing that the franchisor has fulfilled its obligations under the franchise agreement, or that for other reasons the impoundment is no longer required for protection of franchisees.

An application for an order of the director authorizing the release of impoundments to the franchisor shall be verified and shall contain the following:

- (1) A statement of the franchisor that all required proceeds from the sale of franchises have been placed with the depository in accordance with the terms and conditions of the impoundment.
- (2) A statement of the depository signed by an appropriate officer setting forth the aggregate amount of impounded funds placed with the depository.
- (3) The names of each franchisee (or subfranchisor) and the amount held in the impoundment for the account of each franchisee (or subfranchisor).
- (4) A statement by the franchisee that the franchisor has performed its obligations under the franchise contract.
- (5) Such other information as the director may require in a particular case. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-5, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-8)

§16-37-6 Fees. Fees in the following amounts must accompany each application for filing of the offering circular or amendment thereof:

- (1) Application - \$50.
- (2) Amendment - \$50. [Eff. 1/1/75; am 3/30/79; am and ren §16-37-6, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-11)

SUBCHAPTER 3

RECORD KEEPING

§16-37-7 Record requirements. Every franchisor or subfranchisor shall make and keep current the following books and records relating to its business:

- (1) Record of original entry containing the sale of franchise, to whom sold, the aggregate price, the amount paid down, and the installment payments, if any.
- (2) Every franchisor or subfranchisor shall preserve for a period of not less than six years from the closing of any franchise account, all records, books, and memorandums that relate to the franchise. [Eff. 1/1/75; am and ren 3.1, 3/30/79; am and ren §16-37-7, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-5)

§16-37-8 Report requirements. Where applicable, every franchisor or subfranchisor shall annually, on or before ninety days after the end of its fiscal year, file a report with the director showing:

- (1) Number of franchises sold during the fiscal year.
- (2) Dollar amount of the proceeds derived therefrom. [Eff. 1/1/75; am and ren 3.2, 3/30/79; am and ren §16-37-8, 7/30/81] (Auth: HRS §482E-8) (Imp: HRS §482E-5)

DEPARTMENT OF REGULATORY AGENCIES

Chapter 37, Rules Under the Franchise Investment Law, on the Summary Page dated May 28, 1981, was adopted on May 28, 1981, following public hearing held on May 28, 1981, after public notice was given in the Honolulu Star-Bulletin on May 8, 1981.

These rules shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ MARY G. F. BITTERMAN
MARY G. F. BITTERMAN
Director of Regulatory Agencies

APPROVED AS TO FORM:

/s/ RANDALL Y. IWASE
Deputy Attorney General

/s/ GEORGE R. ARIYOSHI
GEORGE R. ARIYOSHI
Governor
State of Hawaii

Dated: 7-18-81

July 20, 1981
Filed

NOTE: Act 204, SLH 1982, changed the department name from Regulatory Agencies to Commerce and Consumer Affairs, effective June 10, 1982.

Any reference in title to Department of Regulatory Agencies shall be to Department of Commerce and Consumer Affairs.

This material can be made available for individuals with special needs. Please call the Division Secretary, Business Registration Division, DCCA, at 586-2744, to submit your request.