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MARSHALL & HARLAN
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DAVID GURNICK, ESQ.

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FEDERAL TRADE COMMISSION
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SECRETARY

VIA FED-EX
Office of the Secretary
Federal Trade Commission
Room H-159 (Annex W)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Franchise Rule Staff Report, R511003
Definitions of "Franchise" and "Required Payment"/Minimum Payment Exemption

Ladies/Gentlemen:

Introduction

This letter is in response to the Federal Trade Commission's request for comments on the August 2004 Staff Report entitled "Disclosure Requirements and Prohibitions Concerning Franchising" (the "Staff Report") and the accompanying Proposed Revised Trade Regulation Rule (16 CFR Part 436) (the "Proposed Revised Rule"). This letter provides recommendations on the definitions of "franchise" and "required payment," and on the minimum payment exemption.

The Commission Should Adopt the Proposed Revised Rule's Definitions of "Franchise" and "Required Payment."

The definitions of "franchise" and "required payment" in the October 1999 Notice of Proposed Rulemaking (the "NPR") were inconsistent with the Commission's long-held interpretations of those terms. As a result, the rule stated in the NPR would have extended the Commission's Franchise Rule to distribution arrangements that the Franchise Rule was never intended to cover.

The key problems with the definitions of "franchise" and "required payment" have been corrected in the Proposed Revised Rule.[1] With these corrections, the general scope of the Franchise Rule's coverage will remain consistent with the Commission's historical policy, and with state franchise laws.[2]

Consequently, the Commission should adopt the Proposed Revised Rule's definitions of "franchise" and "required payment."

<u>The "Minimum Payment" Threshold Should Be Increased</u>

The $500 minimum payment exemption has remain unchanged since 1979. Several NPR commenters recommended that the Commission raise that threshold.[3] I urge the Commission to consider this issue further and raise the threshold.

Under the Proposed Revised Rule, the minimum payment threshold and other threshold dollar amounts may be adjusted periodically in the future to reflect inflation. The adjustments will be based on the Consumer Price Index.[4] The Staff Report recognizes that without such a mechanism, the threshold dollar amounts would become outdated and would no longer perform their intended functions.[5] This provision in the Proposed Revised Rule reflects a recognition that threshold dollar amounts need to change over time.

When the minimum payment exemption was established in 1979, the Commission found that an investment of less than $500 did not represent a significant risk. Accordingly, the Commission declined to regulate distribution arrangements in which the required payments during the first six months of operation total less than $500.[6] The principle behind those determinations remains as applicable today as it was a quarter century ago when the Franchise Rule was adopted.

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[1] *See* Sections 436.1(h) and (s) of the Proposed Revised Rule.
[2] The NPR's definitions of "franchise" and "required payment" are discussed more fully in my comments dated December 20, 1999 (Comment 21A) and January 28, 2000 (Rebuttal Comment 36).
[3] Staff Report at 227.
[4] *See* Section 436(b) of the Proposed Revised Rule.
[5] Staff Report at 250-251.
[6] *See* "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures; Promulgation of Final Interpretive Guides," 44 Federal Register 49966 (August 24, 1979) at 49968.

In deciding whether to update the $500 amount, the Commission should consider the value of a $500 investment in 1979. What amount of money would be an approximate equivalent today of $500 in 1979 dollars? While it may be difficult to make a precise assessment of the right amount, there cannot be any doubt that after a quarter century, the $500 threshold is no longer appropriate.

A useful tool for this evaluation is the Consumer Price Index, which is a key measure of inflation in the United States. One of the purposes and functions of this index is to provide the public and government entities with data to permit pricing adjustments from time to time. As noted above, the Staff Report proposes that the Commission use this index to adjust Franchise Rule dollar thresholds going forward.

According to the Consumer Price Index, the buying power of $500 in 1979 dollars equates to <u>$1,300</u> today.[7] Stated differently, maintaining the $500 threshold would mean the FTC imposing the Franchise Rule on transactions that involve investments equivalent to $193 in 1979 dollars.

An unfortunate consequence of the low threshold is that it subjects more transactions to regulation than the Commission ever intended. The low threshold imposes unnecessary compliance costs on transactions that involve only small required payments. For example, a program that has an initial investment of only $550 (equivalent to $212 in 1979 dollars) is subject to the Franchise Rule. The putative "franchisor" in that situation is forced to incur all of the costs of compliance, even though, considering inflation, the transaction is well below the threshold that the Commission considered worthy of regulating in 1979.

The FTC did not intend the Franchise Rule to cover transactions involving investments of $193 in 1979. Rather, the FTC intended it to cover transactions involving investments of $500 or more. In today's terms the minimum payment threshold should be increased to $1,300. If the FTC wishes to achieve a compromise, then $1,000 would provide a bright line threshold that would reflect some consideration to practicality and the effects of inflation over 25 years.

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[7] *See* www.bls.gov/cpi/home.htm#data

The Staff Report suggests on pages 228 and 229 that separating business opportunities from the Franchise Rule justifies retaining a low threshold. However, generally speaking, any given payment amount would be equally significant for a franchise as for a business opportunity. Nothing in the record of this rulemaking justifies a different conclusion.

The Staff Report also points out, on page 228, that almost all franchise systems involve substantial franchise fees or other substantial required payments. Such evidence in fact supports establishing a realistic, contemporary dollar amount for the minimum payment exemption. The Staff Report's findings indicate that a threshold of $1,300 would essentially have no impact on the types of programs that the Franchise Rule is intended to cover. A threshold at this level would be the equivalent of $500 in 1979. A compromise threshold of $1,000 would be the equivalent of $385 in 1979 dollars.

The dramatic difference in the value of money over a quarter century compels the conclusion that the $500 threshold should be adjusted in the new rule. Just as the Proposed Revised Rule recognizes that threshold levels should be adjusted going forward, the Commission should now recognize that, after 25 years, the $500 threshold is too low. The Commission should raise the threshold, to at least $1,000.

Conclusion

Thank you for your consideration of my comments and views. These views and comments do not purport to represent an opinion or views of Lewitt, Hackman, Shapiro, Marshall & Harlan.

Yours truly,

David Gurnick

David Gurnick

DG:mb