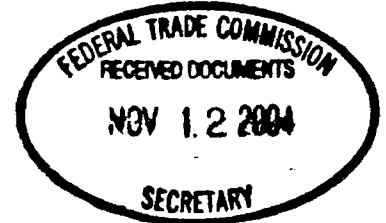




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November 11, 2004

Federal Trade Commission
Office of the Secretary
Room 159
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Franchise Rule Staff Report

To Whom It May Concern:

This comment is submitted in response to the Franchise Rule Staff Report issued by the Federal Trade Commission on August 25, 2004 on the Proposed Revised Trade Regulation Rule (the "Franchise Rule")."

We represent purchasing cooperatives of independent retailers. We also represent franchisors. As such, we understand the very real differences between the business model and operations of cooperatives and franchises as well as the potential consequences of the for application of franchise regulation to cooperatives. Cooperatives and franchises are fundamentally different. The Commission acknowledged the same when the Commission first promulgated the Rule. The Staff Report indicates the Commissions view on this matter remains unchanged. For the reasons described below, cooperatives should not be treated as franchises subject to the franchise disclosure rules and regulation applicable to franchises.

The Commission has historically agreed that cooperatives¹ were different from franchises and specifically exempted cooperatives from the Franchise Rule. Changing the Franchise Rule to eliminate the exemption for cooperatives ignores these differences and may significantly negatively impact the many cooperatives that exist today.

¹See 16 CFR 436.2(1) for the definition of a cooperative for purposes of the Franchise Rule.

Cooperatives are a key competitive tool for survival of independent businesses. “Big box” retailers continue to dominate the marketplace, making it harder and harder for the small, independent business to survive and compete in the marketplace. To survive and compete, many independent businesses are joining cooperatives. The National Cooperative Business Association estimates there are at least 50,000 independent businesses that are members of purchasing cooperatives. It is our experience that many members join cooperatives specifically because they are not franchises. Many independent retailers are concerned that as a member of a franchise, their business will be controlled by the franchisor, something many owners do not want to be the case. As a member of a cooperative, the independent business owner is more in control of its own business operations. This is an important consideration for many businesses. The proposed change in the Franchise Rule eliminating the exemption for cooperatives would make cooperatives less attractive to retailers which in turn may make it more difficult for independent retailers to survive in the business environment today.

We agree with the Commission’s historical position that cooperatives serving independent retailers are not franchises and should not be governed by the rules applicable to franchises. Unlike the franchisor-franchisee relationship, cooperatives are *owned* by their members. Each member of a purchasing cooperative owns one share of stock in the cooperative and enjoys one vote on fundamental business decisions. All members enjoy the same voting rights regardless of the size of the member or the amount of business conducted by such member. Each member operates its business independently of the cooperative and of other members, subject only to compliance with the rules of the cooperative. Through their ability to influence the operations of the cooperative, members in essence own the purchasing/shared services provided through the cooperative. As a member in a cooperative, each member participates in the operations of the cooperative and has an equal say with all other members in the election of representative board members. The representative board members duties include the hiring and firing of officers, the determination of the strategic direction of the cooperative, and establishing the policies and procedures for member participation in the cooperative. In addition, owners of the cooperative are all engaged in business in the same industry and as such are intimately familiar with the industry before becoming a member in the cooperative. That is very different from many franchises in which the potential franchisee may be unfamiliar with the industry and what is necessary to run a successful business operation. Moreover, due to the significant differences in the organizational structure and relationships between that of the cooperative/member and that of the franchisor/franchisee, franchise regulation is appropriate for the franchisor/franchisee relationship, in order to protect the franchisee, but is not necessary in the cooperative setting. The exclusions provided for in 16 CFR 436.2 recognize that cooperatives and franchises are different business structures with different disclosure requirements.

We urge the Commission to retain the cooperative exclusion in the Franchise Rule. Continuing clarity for legal and regulatory purposes greatly outweigh the benefits of reducing the Franchise Rule by 150 words.

We do not understand the proposed elimination of the cooperative exemption particularly when the Staff Report explains that the removal of the exclusions is not intended to signal a shift in Commission policy, but merely to “streamline” the rule. The Report suggests that identifying the

exclusions in Compliance Guides rather than the Franchise Rule is sufficient for demonstrating the Commission's intent that the existing four exempted relationships continue to be excluded from the definition of franchise. Therefore, the only justification for eliminating the current exemptions appears to be a stated objective of streamlining the Franchise Rule. Yet eliminating the exclusions deletes a mere 150 words from the Franchise Rule that currently includes some 7,000 words.

We respectfully suggest that sacrificing years of regulatory and legal clarity to save 150 words is inappropriate and will increase burdens on both FTC staff who will face increasing requests for informal advisory opinions clarifying the term "franchise", as noted above, and on cooperatives who will be required, on a case by case basis, to seek such advisory opinions. Forcing cooperatives to seek advisory opinions appears to be the preferred direction being advocated by the Staff Report. In footnote 807, the Staff Report explains that FTC staff can address future questions concerning the definition of the term "franchise" on a case by case basis through informal advisory opinions. Why this is a preferred position is a mystery. Informal advisory opinions provide no guidance to the industry as a whole, as they are applicable only to the party seeking the advice and then not even binding on them. Cooperatives should have the right to clearly understand the application of the rules as to them and not be put in the position of creating or operating a business structure without clear legal guidance. Such uncertainty can be avoided by retaining the express exclusions in the Franchise Rule itself. Without these explicit exclusions, there will be an unnecessary increase in cost and administration on both the FTC and cooperative businesses as cooperatives become forced to seek advisory opinions (for a position that is clear today) and additional legal counsel as to the applicability of the Franchise Rule to their individual situations.

If the exclusions are eliminated, the likelihood of confusion as to whether a cooperative is a franchise will escalate. The Commission has understood in the past that cooperatives (along with the other excluded relationships) could be perceived as falling within the definition of a franchise (see the Notice of Proposed Rule Making of 1999; hereinafter the "1999 NPR").

Notwithstanding the differences, this position was taken in the 1999 NPR because many cooperatives have characteristics similar to franchises and some may even meet the technical definition of a franchise. However, as noted above, the actual structure and operation of a franchise relationship is very different from that of a cooperative and those differences affect the need for disclosure statements and regulatory governance. It is a reality that cooperatives are *not* very well understood by the public at large, by the legal profession, by business professionals or, in some cases, by regulators. Though some 120 million Americans belong to cooperatives and even more do business with them, surveys show that many do not understand the specific structure of cooperatives, how cooperatives operate and how they differ from other businesses. Frankly there is very little literature relating to cooperatives so that guidance even within the cooperative business structure is scant. Eliminating the exclusions will only contribute to this lack of understanding and lead to more attempts to make legitimate cooperatives subject to extra regulatory governance.

The reality is that the Commission's original conclusion still stands: some cooperatives could easily be perceived as falling within the definition of a franchise and in fact may fall within the

definition. Without clear regulatory exclusion of cooperatives from the definition of “franchise” in franchise disclosure regulations, the rules will create ambiguity over the Franchise Rule’s scope, creating significant but unnecessary confusion among the legal profession, regulators and cooperatives themselves.

To create such ambiguity in order to save 150 words is not a good choice.

Staff Report Recognizes the Usefulness of Exclusions

There does not appear to be an issue as to the usefulness of the exclusions. On Page 252 of the Staff Report the usefulness of the exclusions is recognized. The Staff Report references public comments about the value of the exclusions in the Franchise Rule and in response to them, the Staff Report reverses the Commission’s initial contention in the 1999 NPR that the exclusions “no longer serve a useful purpose”—the original justification for proposing the elimination of the exclusions. Specifically, the Staff Report now concludes that the “exclusions may still serve a useful purpose, explaining to practitioners the distinctions between business arrangements that may appear to be franchises.” As noted in the Staff Report, businesses have relied on the explicit definition of franchises and the clear exclusion of cooperatives.

Despite the Report’s recognition that the exclusions continue to serve a useful purpose, it recommends their elimination from the Franchise Rule without further explanation. At the same time, recognizing the value in continuing to define these exclusions, the Staff Report says that the explanation that these exclusions continue to apply will be provided in the Compliance Guides accompanying the revised Franchise Rule.

We respectfully disagree with this recommendation. Though we greatly appreciate the Commission’s intent to retain its policy that cooperatives are not franchises, it is insufficient to clarify that intent in the Compliance Guides alone.

Moving the exemptions to the Compliance Guides provides insufficient legal clarity. Legal advisors look first to regulation to provide their clients with legal certainty. Few will rely on language in the Compliance Guides alone in advising their clients. We believe this change will easily be misconstrued by many that do not look at the Compliance Guides. This will lead to confusion and uncertainty on an issue and concept that the Commission says it does not want to change. To those not familiar with this issue in the legal and business community, the cooperative exclusion may not be considered (or may be overlooked) once it is relegated to the Compliance Guides. It has been noted in the record that the existing express exclusion also provides guidance to state regulators. What conclusions are state regulators to draw about the exclusion once it has been “downgraded” to Compliance Guide status?

An important benefit of being included in the Franchise Rule is that before a change can be made to a rule, appropriate public notice and comment processes are required by the Administrative Procedures Act. Therefore, no major change can be made without warning and/or comment should the Commission’s interpretation of the Franchise Rule’s exclusion change at a future date.

Although it is the *current* policy of the Commission that the cooperative business relationship identified in the exclusions are not treated as franchises, that policy could change at a future date. A change in this policy would represent a significant broadening of the Franchise Rule's scope and thus should be subject to public notice and comment as provided for in the Administrative Procedures Act. If the exclusions are not explicitly provided for in the Franchise Rule itself and included only in the Compliance Guides, the Commission could change this policy without important and valuable public comment. Such a change which would have far reaching impact on independent retailers and the cooperatives to which they belong, without the benefit of notice and public input.

To ensure the public has an opportunity to comment on any future change in the Commission's interpretation of the term franchise vis-à-vis cooperatives, the exclusions should be retained in the Franchise Rule itself.

Eliminating Exclusions Runs Counter to the Goal of Narrowing the Franchise Rule's Scope

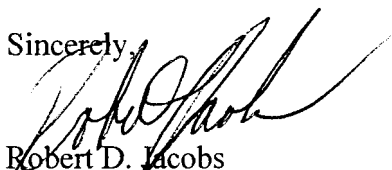
The goal of streamlining does not appear to be the overriding objective of the effort to revise the Franchise Rule. Instead, the goal is to narrow the scope of the rule (p. 12) to capture only "franchise sales" and exclude "other business opportunities." Given that, it is nonsensical to eliminate the exclusions that clarify the scope of the Franchise Rule, particularly since the Franchise Rule adds new exemptions in the Franchise Rule itself. Moreover, eliminating the exclusions appears to dramatically broaden the scope of the Franchise Rule at the same time the Commission seeks to narrow it.

The disadvantages of reducing clarity by eliminating these exclusions far outweigh any benefits to either the public or the regulated community through the minimal streamlining provided.

For all of the reasons identified above, Riezman Berger, P.C. respectfully urges the Commission to retain the current explicit exclusion of cooperatives within the Franchise Rule.

We thank you for the opportunity to comment on the Staff Report.

Sincerely,



Robert D. Jacobs
Riezman Berger, P.C.