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WIGGIN AND DANA

Counsellors at Law

November 10, 2004

Office of the Secretary
Federal Trade Commission
Room H-159 (Annex W)
600 Pennsylvania Avenue, N.W.
Washington, DC 20580

Re: Franchise Rule Staff Report

Dear Sirs/Madams:

We wish to commend the Commission and all those involved in the years long review of the Franchise Rule, culminating so far in ***Disclosure Requirements and Prohibitions Concerning Franchising - Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule (16 CFR Part 436)*** released on August 25, 2004 (the "Staff Report").

We typically represent franchisors in connection with the establishment and operation of their franchise systems, including preparation and updating of their disclosure documents and counsel regarding federal and state disclosure compliance issues. We respect the research and thought that has gone into the Staff Report, and at this time we would like to offer only what we consider to be technical comments on certain of the requirements contained in the Staff Report.

1. Section 436.5(c) Item 3: Litigation

We have two questions concerning the new requirement for disclosure of franchisor-initiated actions in Section 436.5(c)(1)(ii).

a. The discussion of the new disclosure requirement for franchisor-initiated actions in section VI.E.2.d. of the Staff Report concludes that there is value to the prospective franchisees in knowing information about the actions initiated by the franchisor against franchisees. We recommend clarification of the effect on the listing of franchisor-initiated cases when an action started by the franchisor becomes subject to disclosure under Section 436.5(c)(1)(i)(A) or Section 436.5(c)(1)(iii)(B), as a pending or settled civil action, because the franchisee filed a counterclaim alleging a violation of franchise law or unfair or deceptive practices by the franchisor. We believe that as currently proposed, the disclosure requirements would overlap, and the franchisor-initiated action would have to be reported twice, first to provide the normal full summary form for a pending or settled action and again to be able to provide the franchisee a complete list in one place of franchisor-initiated actions.

We recommend that any franchisor-initiated action that is subject to a counterclaim that requires disclosure should only have to be reported once and in the normal full summary form as a pending or settled action. A second listing of the action, even by way of cross-reference, in the franchisor-initiated litigation section of Item 3, would only mislead franchisees and give an impression of more litigation than is the case. We recommend that Section 436.5(c)(1)(ii) be revised to clarify that franchisor-initiated actions do not have to be listed twice, by adding the phrase "other than actions required to be disclosed in paragraph 436.5(c)(1)(i)(A) or paragraph 436.5(c)(1)(iii)(B) of this section".

b. The description of the abbreviated form of disclosure for franchisor-initiated actions in section VI.E.2.d. of the Staff Report, to include only a category heading to indicate the nature of the action (for example, royalty collection suits), and then a listing of actions only by case name, court, and file number), does not seem to match the literal requirements of Section 436.5(c)(3). Section 436.5(c)(3) provides that the category heading will serve as the summary of the nature of the claim for franchisor-initiated litigation, but then goes on to state additional information is needed regarding the status of the action and any judgment or settlement. There is also no definition or other use of the term "franchisor-initiated litigation" to connect the term to Section 436.5(c)(1)(ii).

We recommend moving the sentence related to franchisor-initiated litigation to the very end of Section 436.5(c)(3), adding a reference to Section 436.5(c)(1)(ii) and making it clear that the need to provide the additional information does not apply to franchisor-initiated actions. The sentence would read as follows:

> Provided, however, for franchisor-initiated litigation disclosed under paragraph 436.5(c)(1)(ii) of this section, franchisors may list individual suits under one common heading, which will serve as the summary (for example, royalty collection suits), and will not have to state the additional information described in (i) to (iv) above.

2. Section 436.5(f) Item 6: Other Fees

The expansion of the disclosure requirement to include any fees that the franchisee is required to pay directly to a third party, without any qualifying language such as fees that are required under the franchise agreement, is very broad. Proposed Item 6 attempts to require a listing of operating expenses, with the additional listing of possible future non-recurring fees (for example, future remodeling construction costs), that the franchisor or its counsel can imagine. Item 6 would be used as a complement to Item 7 to provide estimates for the total costs to operate the business in the same way that Item 7 requires a listing of all costs to establish the business. We recommend clarification, either in the Franchise Rule or the Compliance Guides, as to the true scope of the fees required to be listed in Item 6, and further

recommend that a narrow reading of these fees be adopted. For example, should Item 6 include disclosure of employee wages, uniform dry cleaning expenses, accountant fees to prepare tax returns (not just any financial statements the franchisor may require) and attorney fees to prepare corporate annual meeting minutes or annual reports for the Secretary of State? Should potential business broker fees to find a buyer and the franchisee's attorney's fees to negotiate and document the sale of the franchisee's business be disclosed/estimated? If the franchisor's transfer fees are included under Item 6, why wouldn't these potential third party fees necessary to accomplish the same transaction also be included?

3. Section 436.5(t)(4) Item 20: Outlets and Franchisee Information

We believe the lead-in language to this new requirement to add the recent ownership history of a unit offered for sale by the franchisor to address concerns about "churning" is ambiguous. The language reads: "If a franchisor is selling an existing franchised outlet". A franchisor wouldn't ordinarily be offering the outlet if it was currently franchised. If the franchisor took back an outlet through purchase or following abandonment by the franchisee or other reason for termination, and operated the outlet for a period of time, the intent of the provision is not that the outlet would then become a company unit and free of the disclosure requirements of Section 436.5(t)(4). We hesitate to expand the disclosure requirement to cover all outlets that the franchisor offers for sale that had been franchised within the past x years (the proper number of years is discussed below), but we wonder if this is what the Staff Report and the Illinois Attorney General, the original promoter of the requirement, really mean. See section VI.V.2.a. of the Staff Report. We are also concerned over what it means for a franchisor to be "selling" an outlet. We would not want a franchisor's involvement in a franchisee's transfer sufficient to trigger a disclosure requirement on the franchisor under Section 436.1(t) of the proposed revised Franchise Rule [definition of sale of a franchise] to trigger the disclosure requirement under Item 20.

We note that the Staff Report in section VI.V.2.a. reports that the Illinois Attorney General recommended providing a three year ownership history of the offered unit, and the Staff Report adopted the same three year time period in its discussion on this point. However, the proposed Franchise Rule Section 436.5(t)(4) requires the history be provided for a five year time frame. We recommend correcting the five year time period to the three year time period.

Finally, we are concerned about the disclosure mechanics for the ownership history for the specific outlet. Section 436.5(t)(4) provides that the information may be provided in an addendum to the disclosure document. This raises two questions. The first is the problem of the possible need to register the addendum with any state. The second is the timing for making the disclosure. The prospect will often be applying to the franchisor generally, and not with a particular resale outlet in

mind. Would a prospect have to receive a new disclosure document with the appropriate outlet specific addenda and wait an additional fourteen days each time one or more existing outlets were called to the prospect's attention? If a prospect was already disclosed and talking to the franchisor about possible locations, would it be a violation to discuss the existing outlet if the prospect did not receive the disclosure with the outlet's specific addendum? We recommend revising the delivery requirement for the outlet ownership history to make the document outside of the disclosure document itself similar to a franchisor's ability to deliver outlet specific financial performance representations for outlets being offered for sale under Section 436.5(s)(1), Item 19. Delivery of the ownership history information would be mandatory, not voluntary like the financial performance representations, and would have to be given before the prospect signs the franchise agreement or makes payment. We do not recommend imposing any additional cooling off period to track.

4. Section 436.5(t)(8) Item 20: Outlets and Franchisee Information

We recommend that the 90 day time period for a trademark-specific franchisee organization to renew its request to a franchisor to be included in the franchisor's disclosure document for the next fiscal year be reduced to 60 days. A great number of franchisors are meeting the current 90 day annual update requirement under the current Franchise Rule. Even though the Staff Report recommends increasing the annual update requirement to produce the new disclosure document from 90 days to 120 days, under Section 436.7(a) of the proposed revised Franchise Rule, franchisors should not be prohibited from issuing their annual updates in accordance with the current 90 day target date. Franchisors should be able to use their updated disclosures as soon as practically possible. Requiring franchisors to wait until 90 days after the close of the fiscal year to finalize their disclosure documents would prevent them from proceeding when they are ready. A number of franchisors have their disclosure documents printed. They require lead time to be able to have their disclosure documents ready. Making these franchisors wait until the end of 90 days to then send their documents to the printer does not delay their distribution by only a day, but by weeks. On the other hand, the association is not harmed by shortening the time period for giving notice of renewal. All that is required from them is a simple one line letter delivered to the franchisor. The strategic decision whether to be included in the disclosure document for another year or not can certainly be made within a 60 day time frame.

5. Section 436.5(w)(2) Item 23: Receipts

We would like to call to your attention that the name, principal business address, and telephone number of each franchise seller is to be included in the Receipt. We believe this may be an unintentional carryover from the Uniform Franchise Offering Circular directions and should be deleted consistent with the deletion of franchise

broker biographical information from Item 2. The discussion of the reasons for deleting franchise broker information at section VI.D.2.b. would seem to apply to deleting the listing of franchise sellers in the Receipt. Adding potentially hundreds of names with contact information to a Receipt would not serve any purpose except perhaps to enable the prospect to search through the list to confirm that the individual or individuals the prospect has dealt with were somehow authorized. Eliminating the requirement to list franchise sellers in Item 2 (with biographies) does not allow the Receipt to cross-reference Item 2 for the required information, resulting literally in possible multiple page receipts or the retention of some of the information the proposed change in Item 2 sought to eliminate. We also point out that the definition of franchise seller at Section 436.1(i) is broader than the definition of franchise broker under state laws. A franchise seller includes the franchisor and the franchisor's own employees, who would now need to be listed in the Receipt.

6. Section 436.9(f) Additional Prohibitions

We recommend two changes to the language of Section 436.9(f) that makes it an unfair or deceptive act or practice for a franchisor to fail to furnish existing disclosures to a prospective purchaser of an existing franchised outlet, upon reasonable request. This requirement is briefly discussed at section IV.P.2 of the Staff Report.

We find it ambiguous who may make the request, the existing franchisee or the prospective purchaser, or either. We recommend that the language be revised to state "upon reasonable request of the existing franchisee". The franchisor does not have a relationship with the prospective purchaser, especially early on when the prospective purchaser and the existing franchisee first start talking about the potential transfer. The franchisor cannot easily verify that the prospective purchaser is in fact negotiating for the purchase of the outlet without approaching the franchisee anyway. Anyone would be in a position to ask franchisors for disclosure documents by asserting that they are considering purchasing an existing franchised outlet. We recommend that the existing franchisee be the best judge of whether the prospective purchaser is a serious candidate and should be provided a disclosure document.

We find a second ambiguity in the phrase "existing disclosures". The disclosure documents have to be more than physically existing, they have to be currently effective (if registration is required in the state) and in use by the franchisor. A franchisor should not be forced to register a disclosure document in a state merely because one exists that could be registered, either with or without modification. A franchisor should also have the ability to declare an existing disclosure document no longer effective because it does not reflect material changes. There is often some awkward gap time between occurrence of a material change and the franchisor's

announcement of the change. During this gap period, the franchisor should be able to refuse to issue a disclosure document it knows has material deficiencies without risking liability, despite the quarterly, and not immediate updating requirement, contained in Section 436.7. An franchisor preparing to file for bankruptcy, for example, should be able to refuse a request to issue a disclosure document to a prospective purchaser. We recommend the introductory language be revised to read "Fail to furnish currently effective disclosures for the state to a prospective purchaser".

7. We are concerned about the statement in section IV. of the Staff Report in note 59 that in order for the disclosure document to be clear, conspicuous and legible, the accompanying Compliance Guides will require that all disclosures be made in at least 12 point upper and lower case type. We note that the Staff Report considers that this is consistent with the current Franchise Rule which dictates 12 point type for certain statements, such as the disclaimer that must be made in connection with any earnings claim. The current FTC cover page also requires 12 point type. We suggest that the fact that the current Franchise Rule specifically requires certain statements to be made in 12 point type means that the other disclosures can be made in a smaller font size.

Many franchise systems use a smaller font size for their disclosures. We recommend that the Franchise Rule does not require 12 point type. We believe the ability to use a smaller font size is particularly important with respect to the charts of information required in the disclosure document and the lists of information, especially the existing units list, that are often computer generated that could contain hundreds or thousands of locations. Requiring 12 point type for the charts and these lists will make formatting difficult and will greatly increase the pages needed. Each of the three Item 20 tables that requires a listing of every state for three years of information will go on for several pages for a national franchisor. We think this elongated presentation will decrease the value of the information to the prospective franchisee. For example, a table with 154 lines (column heading plus 3 lines per state plus 3 lines for yearly totals), before inserting any information, using 12 point type, will cover three and one-half pages in standard portrait format. (We recommend that the proposed format to show yearly information in rows rather than in columns under the applicable headings as is done currently under the Uniform Franchise Offering Circular format) will also unnecessarily increase the size of the charts, making them less beneficial to the prospective franchisee.) The other tables that require a lot of text will also be longer because less text will fit across the width of the columns. Switching to landscape format, as some franchisors do now, to widen the columns, would not help much, would increase the number of pages used for the table, and would require that the prospect turn the disclosure document (or his or her head or the computer monitor) sideways.

If the 12 point font requirement is adopted, we would recommend relief in the area of the tables and listings of information.

8. We would also like to call to your attention the following typos:

a. Section 436.5(r)(3) Item 18: Public Figures ("the public figure**r** contributed in services")

b. Section 436.5(t)(3) Item 20: Outlets and Franchisee Information (Table 5 – Column 3 and Column 4 Headings) (Column 3 refers to outlets in the **Next** Fiscal Year and Column 4 refers to outlets in the **Current** Fiscal Year; both columns should be referring to the same fiscal year and should use the same term)

c. Section 436.8(a)(6) Exemptions – ("responsibility for the offer and sale of the franchisor's franchisee**s**")

Thank you for this opportunity to address our comments on the Staff Report to the Commission.

Sincerely,

Robert S. Burstein