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<u>Comment on the FTC Staff Report on the Franchise Rule August 2004</u>

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These comments are to the FTC Staff Report ("Report") on the FTC Franchise Rule ("Rule") released on August 25, 2004. These comments reflect the opinion only of the author, and not of the law firm or of any client or other organization.

The proposed revisions to the Rule will generally modernize and improve the Rule. There are a few areas in which I recommend improvements.

1. Item 3 Litigation. The litigation disclosure for larger franchisors under the current UFOC guidelines has grown to be unwieldy. For larger franchisors, Item 3 (often moved to an exhibit) approaches the length of that of all of the other disclosures combined. The current practice of larger franchisors is to seldom disclose any litigation other than franchise litigation, taking the position that it is not "material" or practical. This situation renders Item 3 of great cost, but of little use for prospective franchisees of most large franchisors. The two additional disclosures proposed in the Report will make this situation worse.

The problem is not so much in the Report proposals, but in the overlapping requirements of Item 3. In section (1) (i) A is the requirement of disclosure of all pending actions of certain types, regardless of materiality. These should be limited to franchise disputes. Other non-franchise suits are disclosed under the next subsection if they are material. And, by definition, such suits are not relevant to a prospective franchisee if they are not material. For example, most such suits presumably are material and would be disclosed if they involve small franchisors, but large publicly-held franchisors normally defend numerous frivolous and nuisance value suits. The disclosure of such non-material non-franchise suits is impractical, often ignored, and is a distraction to more important disclosures.

Likewise, the terms "securities, antitrust, trade regulation, or trade practices" should be removed from the sections of Item 3 relating to concluded actions and pending orders, for the same reason. The words "been a defendant in a material action" should also be removed from the section relating to concluded actions. If the franchisor were a defendant and paid money, that suit would be included in the definition of "Held liable." If not "held liable", the concluded action is presumably not material to a prospective franchisee.

2. Item 6 Other Fees. The Report proposes disclosure of payments required to be made to third parties. The current UFOC guidelines take a more reasoned approach of only disclosing payments it imposes or collects directly or indirectly from third parties. The franchisor

presumably knows or could discover such payments. The franchisor could not know or "list all required payments" to the hundreds of vendors and accounts that any small business must pay. It is not relevant who the franchisee's pencil or paper clip vendor is, how much is paid, or even that this is a category of ongoing expense. The price of initial pencil and paper clip supplies are already estimated in Item 7, and that is all that a franchisor should be required to do.

If a franchisor actually attempts to estimate all ongoing payments in Item 6, it will caught in a dilemma of having violated Item 19, earnings claims. If a franchisor does not estimate all ongoing payments in Item 6, it will have violated the Rule, angered regulators, or have made a meaningless disclosure that such payments are unknown.

3. Item 23 Receipt. The Report proposes adding a requirement that the name, address, and phone number of each "franchise seller' be added to the receipt. "Franchise seller" includes brokers, subfranchisors, employees, and agents. In the case of use of a national brokerage firm, for example, the receipt could become as long as the rest of the disclosure document. Such requirements should be moved back to disclosure Items 1 or 2. In the receipt, the disclosure makes the use of a receipt unwieldy or impractical.

4. Timing for Making Disclosures, Proposed Section 436.2 (a). The Report proposes that a franchisor deliver the document "on reasonable request." This negates any benefit gained from eliminating the "first personal meeting requirement." The reasonable request standard is ambiguous, and is not found in any state law. Franchisors have many valid reasons for not giving out disclosure documents, for example, because the document is: out of date, being revised, not registered in the prospect's state, is not available because of cost or technical issues; or because the requesting party: is not a qualified prospect, is from a geographic region in which franchises are not being offered, is a competitor, cannot be adequately identified, etc. Franchisors will have many potentially tainted sales, and increase their compliance costs greatly, with no corresponding benefit to the franchisee. Franchisees will regardless of this proposal only get the offering circular when it is appropriate and available, and always at least 14 days before key events. If the intention is to give the disclosure document to a prospective franchisee sooner, the only practical way to do so is to add to the number of days in the 14-day waiting period.

5. Current Exclusions and Exemptions. The Report proposes to eliminate the certain current exclusions and exemptions that should be retained. As to the exemption for cooperatives, from a policy perspective, coops differ from franchises because the members of a coop own the entity (the coop) that licenses the trademarks. Some states have recognized this difference by exemption coops or franchisee transactions when the franchisee owns or works for the franchisor. As to cooperatives, this exemption is used by numerous national coops, including for example, Best Western Hotels, and several hardware industry coops. In states without similar exemptions, coops often run afoul of the definition of franchises. The Report has not proposed any policy reason for the change, but only erroneously concluded that the change is unnecessary.

As to the single trademark license exemption, there are many companies that use such an exemption. The Report is incorrect that this has not been useful. The Rule could restrict this exemption to a one-time license for the entire U.S.

As to the exclusion of commissioned agents, the current FTC Interpretive Guidelines state that because a commissioned agent pays no franchise fee, there is no coverage of the FTC Rule. While this may not be necessary, there has been litigation under state franchise laws as to whether commissions are "hidden franchise fees." Keeping this exclusion will avoid unnecessary litigation.

* Respectfully submitted,

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