

Gentlemen:

I have a few comments on the latest Staff Report on the Franchising Rule.

1) You claim that there is no reason for you to regulate post-sale activities because there are few complaints in that area. (Staff Report, p.11). Given the FTC's oft-stated position that it will not address such complaints, why would you expect aggrieved franchisees to bring their complaints to the FTC?

In addition, you state that in the six-year period from 1993 to 1999, 124 post-sale complaints were received (id.) which you believe is a very small number given that there are 2,500 franchisors in the U.S.. (Id.)

Per your own numbers, complaints in the post-sale area came in at a rate of almost 21 a year. From 1979 to 2004, the FTC only brought 200 suits for pre-sale violations under the FTC Rule (p.10, n.8). I would venture a guess that well over half of these were "biz op" complaints. Even taking a conservative percentage of 50% franchise/50% biz op, that means that the FTC has filed only 100 suits in the past 25 years for pre-sale violations by true franchisors. That is 4 cases a year (and that is giving the FTC the benefit of the doubt).

If it is truly the FTC's position that it should not be involved in an area where there are 2,500 franchisors and few opportunities for enforcement actions, then I suggest that the Staff Report's logic leads to the conclusion that the FTC should not be regulating pre-sale disclosures either. If 2,500 franchisors are required to spend huge amounts of time and money filing UFOCs so that (at the most) 3 or 4 complaints per year might be pursued, then the FTC's regulation of pre-sale disclosures is, likewise, "unwarranted."

It is apparent from the Staff Report that franchisors like having the FTC Rule because it is seldom if ever enforced and it has no private right of action. It should be of great concern to the FTC, an alleged "watchdog" for prospective franchisees, that it is being used as a shield by franchisors who want to avoid tougher regulation by the states (p.6, n.19) while franchisee advocates believe that the FTC is doing so little that they would not mind seeing the FTC Rule abolished. (P.10, n.27).

In this regard, it was disturbing to see an FTC Staff member appear at the ABA Annual Forum on Franchising to conduct a panel discussion along with two franchisor advocates and no franchisee advocates, particularly when that Staff member constantly referred to franchisors as "the franchise community," and refused to respond to a comment from a franchisee advocate in the audience. The "franchise community," I would think, should at least *include* franchisees and their advocates. This sort of appearance does nothing to convince franchisees and their advocates that the FTC is a watchdog for the rights of franchisees or potential franchisees. It provides further support for the respective positions taken on pages 6 and 10 of the Staff Report.

2) I fail to understand why the FTC continues to deprive prospective franchisees of mandatory earnings claim information. The number one pre-sale problem we have in franchising is that franchisors give franchisees numbers on a cocktail napkin or in some other secretive

manner. Often these claims are made by people who have no real firm fix on the true numbers and no reason to tell the truth (i.e., people who are paid based upon the number of franchises they sell). The franchisees, having nothing else to go on, rely on these numbers, often to their great detriment.

Rather than mandate some form of earnings claim to clear up this practice, the Staff Report accepts the arguments made by franchisors that 1) they cannot possibly come up with a format for such claims; 2) they are powerless to get financial information from their franchisees, who also might get mad at them; 3) the information given by franchisees is false; and 4) if the franchisor gave an earnings claim, it might get sued. (P.161)

To call these arguments "weak" is kind. It is amazing that franchisors ever get any sort of financing for their operations when they have no idea how much their franchisees take in or whether the franchisees are profitable. I guess that these financial institutions simply take the franchisor's word for everything. Another amazing contradiction is found on pages 160 and 161. On page 161, existing franchisees are cast by franchisors as providers of false and unreliable information (see first paragraph, numbered item 3). But on page 160, prospective franchisees are almost certain to get accurate information because they "are free to discuss earnings and other financial performance issues with former and current franchisees!" So, the bottom line is that the FTC rejects mandatory earnings claim information because it believes that 1) a prospective franchisee can get accurate information from a franchisee that has *no* obligation to tell the prospective franchisee anything at all, but 2) the same existing franchisee would be likely to provide incomplete and inaccurate information to its franchisor (a franchisor that could terminate the franchisee immediately for providing false information)!

The FTC seems to accept the proposition that a prospective franchisee should not get earnings information because making a franchisee give such information "will have a negative impact on the franchisor-franchisee relationship." All or nearly all franchisees pay royalties. All or nearly all franchisees have to submit a sheet with their royalties stating how much revenue they made. All or nearly all franchisees have an obligation in their contract to submit quarterly or annual performance data. The franchisees have no incentive to inflate the revenue information (the more they make, the higher their royalties) or the profit information (they cannot obtain any concessions from the franchisor if they are doing well, only if they are in financial distress). Many franchisees pay their royalties through electronic funds transfer because they are forced to do so by their franchise agreement. Against this reality, exactly how was the FTC convinced that franchisors may endanger their relationship with franchisees by asking for financial information?

The FTC Rule is supposed to protect prospective franchisees from being sold "a bill of goods." It is not supposed to act as a sales tool for franchisors. Franchisees have no reason to report to their franchisor that they are doing better than they actually are doing. Using franchisee-reported revenue and profit numbers, it is unlikely that a franchisor will ever provide inflated revenue or profit figures to prospective franchisees. If prospective franchisees buy based upon numbers that are understated, they will certainly be happy when they learn that they are doing much better than expected. I am sure that some franchisors would prefer to direct prospects to those few franchisees who are doing extremely well and who will give an impression of easy success. Requiring system-wide earnings disclosures would help cure this unfortunate practice.

3) Having already given away half of the store by continuing to allow franchisors to refuse to provide earnings information, the Staff Report pounds the final nail in the coffin of many franchisees by allowing the franchisor to disclaim even its own written documents and the statements made by the people who are the franchisee's only connection to the franchisor—the salesman (and it usually is a man).

Calling a salesman a "rogue salesperson" is yet another example of the FTC's seemingly intentional ignorance of how franchising actually works. When a prospect calls a franchisor, he gets assigned a salesperson. That salesperson is often the franchisee's only connection to the franchisor. The prospect often has no substantive communication with anyone else. The prospect has no idea that the salesman is a "rogue" or is "unauthorized" or is saying things that the prospect has no right to rely upon. The prospect is the equivalent of someone seeking gold. The salesman is the guide who leads the prospect down a mine shaft with the promise of finding gold. After being led a mile underground, the prospect is then turned over to the lawyers for the mine who tell him to sign a 40-page document which says on page 40 that the prospect agrees that he is not relying upon anything the guide told him. Then why is the prospect there at all? It is easy for the FTC Staff to say that the franchisee should walk away, but he knows what he has been told, and he is still being told that the guide is an honest man and the contract is just to protect the mining company.

For the FTC to take the franchisor's side in such a dispute is unconscionable, but the FTC makes a far worse mistake in the Staff Report. The Staff Report states that if a prospect gets written sales material from a franchisor that contains misrepresentation, the franchisor can disclaim its own written material in the franchise agreement! This is inconsistent with any consumer protection law of which I am aware. Can GM and Ford start advertising 20-year bumper-to-bumper warranties on TV while handing out 3 year limited warranties at the dealership? I doubt it. Bait and switch schemes are universally condemned by the attorneys general of every single state. Yet the Staff Report endorses the worst kind of bait and switch—making specific representations to someone in writing to get them to sign something and then disclaiming the representation in the fraudulently-induced document.

So, under the practice implicitly endorsed by the Staff Report, a franchisor may provide a prospective franchisee with a written document signed by the President of the franchisor which states "All of our franchisees gross \$2,000,000 a year and take home \$200,000 a year. You will do the same." Having seen this great opportunity and keeping a copy of the President's document, the franchisee signs a franchise agreement that somewhere states that the franchisee agrees that it is relying upon its own investigation and no representations from the franchisor. The Staff Report apparently takes the position that the purposes of the FTC Rule are best served by punishing the negligent franchisee and not the fraudulent franchisor. I could not disagree more. The FTC Rule is supposed to protect prospective franchisees and assure that they get accurate and honest pre-sale disclosures. Allowing clauses designed to strip away the civil remedies of franchisees rewards fraudulent franchisors, even those who commit their fraud in writing for all to see. I cannot fathom how the FTC Staff feels this is the proper result.

That concludes my comments.

Jeff Haff