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# BRIGGS AND MORGAN

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November 11, 2004

## VIA E-MAIL

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

**Re: Franchise Rule Staff Report, R511003**

Dear Sir/Madam:

I respectfully submit the following comments on the Staff Report. These comments are based upon my personal experience of having (indirectly) counseled thousands of franchisees in many different franchise systems and industries through representation for many years of many large franchisee association, as well as having worked individually with scores of individual franchisees and prospective franchisees.

The Staff Report is deficient in three key areas:

1. Exemptions: The proposal to exempt transactions involving an initial investment of more than \$1,000,000, or a franchisee with five years experience and a personal net worth of \$5 million, dip far, far too low. Garden variety fast food and "fast casual" franchises can easily involve investments of over a million dollars (apart from real estate). The criteria for the "large franchisee" would sweep in thousands of small business entrepreneurs who own three or four units or independent businesses, or perhaps unrelated family wealth. Personal net worth has no correlation whatsoever with the need for information to make an informed business investment decision in respect to an unfamiliar franchise, or even an incremental franchise in a familiar system where time has brought changes in the contract, the technology, the facilities, or the positioning and competitive circumstances of the franchise. And even if a prospective franchisee has a sizeable net worth and can afford to hire professional advisors, how can the advisors do their jobs without UFOC information to evaluate?

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The idea that disclosure becomes unnecessary when the investment exceeds an arbitrary threshold, because scale is a proxy for sophistication or bargaining power, is an oxymoron. The Staff's rationale (at p. 238, that sophisticated investors "... will demand and obtain material information ...") is purely speculative and unsupported by experience or logic. Argumentation to the contrary supplied by a handful of powerful, large franchisors is purely anecdotal and subjective information; it is not evidence.

If the Staff were to solicit views of the franchisees of even the large hotel systems, a different impression would be created. These very same franchisors in reality often are extremely difficult to pry information from, and often, with the support of their attorneys, extremely difficult to engage in meaningful negotiation.

2. UFOC Item 19: It is incomprehensible that the Staff Report concludes not to require disclosure of what is plainly the most material information imaginable to any prospective investor in a franchise: the financial "track record" of performance (where one exists) of other franchised or non-franchised businesses of the same type being offered by the franchisor.

If a prospective investor could have only one bit of data on a franchise, it would be this: what financial results have others achieved with this program?

Compared to the prolix, and in some cases comically trivial, UFOC disclosure information that the Staff Report would continue to mandate, the omission of financial results, where they exist, is baffling.

One can understand why many franchisors, and their trade association, might oppose financial performance disclosure: it would reveal either the unproven character of a given franchise program, or even compel disclosure of mediocre or unsuccessful results. Most franchisors would prefer to keep such data well-hidden, and their trade association certainly opposes anything that might undermine the myth of "franchising = success." Indeed, the position of the Staff Report in effect condones the intentional omission of material information, and of material information that is often necessary in order to render the balance of a UFOC not misleading. This is hardly what America's small business investors and owners need from the Federal Trade Commission.

A mandate of disclosure of this information is *not* difficult or costly. A subcommittee of the NASAA Franchise Regulation Committee has already prepared a simple set of disclosure requirements (previously supplied to the FTC Staff) that could easily be adapted to the Staff Report's changes to the UFOC format.

The Staff Report suggests instead relying on "... a free market approach", but only for *this* critical information. If a "free market approach" makes sense, why only here? The rationale

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adduced (at pg. 160 of the Staff Report) logically is equally applicable to *every other* UFOC Item and indeed to presale disclosure altogether.

The justifications for the Report's conclusion (at pg. 162) are plainly wrong, or inconsistent:

- "... unintended effect of forcing honest franchisors to disclose financial information that they believe is unreasonable, incomplete or inaccurate ..."; yet, Item 7 mandatory cost information is no different.
- "... financial performance disclosure is not cost free ..."; this is true of *all* presale disclosure. The NASAA draft disclosure protocol would have imposed on franchisors no measurable new costs beyond what they already incur to prepare their UFOCs as it is. The overreaction of a few large franchisors was posturing, not serious analysis.

The other justifications in the Staff Report (*e.g.*, "... existing franchisees might be subject to liability ...") are pure speculation.

3. Multibrand Offerings. The Staff Report retreats from promising clarification of disclosure obligations in offerings involving the combination of two or more otherwise unrelated business format franchisees. This is disappointing. Multibrand offerings are extremely complicated, costly and risky. See Andrew C. Selden and R. Scott Toop, *Multiplicity: The Challenges of Co-Branding*, ABA 26<sup>th</sup> ANNUAL FORM ON FRANCHISING, LB2 (2003). This Rule revision offers a rare and valuable opportunity for the Commission to offer specific guidance to franchisors, and assistance to prospective franchisees, in how to construct presale disclosure in these programs.

Respectfully submitted,

  
Andrew C. Selden

ACS/ph