American Association of Franchisees & Dealers
The Center for Total Quality Franchising®

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Comment of the American Association of Franchisees & Dealers

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From the perspective of franchisee advocates, the FTC Staff Report's proposed inclusion of a requirement for franchisors to disclose the existence and contact information for independent associations of the systems franchisees is the silver lining in the proposed revision of the FTC's Franchise Rule. The FTC further deserves praise for requiring a franchisor to disclose any group of franchisees who meet a minimum threshold of legitimacy.[1]

While the FTC's purpose is to provide an effective tool for market driven disclosure of issues, good and bad, that may exist within a franchise system, the technical requirement that a franchisee group be *incorporated* to gain 'standing' for disclosure is too confining, and will deny access to deserving groups that have formed through some other business entity, as an unincorporated association, trust, cooperative, or even a partnership or LLC.

Specifically, it should be noted that the American Association of Franchisees and Dealers, formed in 1992 *as a trust* has been approved by the Internal Revenue Service as a 501(c)(6) not for profit trade association. The AAFD is governed by a Board of Trustees and a Board of Directors, a written trust indenture, bylaws, and a voting franchisee Trade Association Council. Certainly, the AAFD deserves recognition as a viable entity even though it is not *a corporation!*

It should also be noted that the AFFD is organized by the development and support of independent trademark specific franchisee associations that form as chapters of the AAFD. In this sense the AAFD serves as a "mid-wife" and organizational vehicle for groups of franchisees that wish to form an association. To achieve active chapter status within the AAFD, a group of franchisees must have the lesser of 50 members or 50% of the

[1] Parenthetically, we wish a similar test would be applied to franchisors before they are allowed to sell franchises.

franchisees within a franchise system. Over the past 12 years, the AAFD has helped form, launch and manage dozens of franchisee associations dedicated to improving their franchise systems, and in protecting the rights of franchise owners. *None of the AAFD's 'internal chapters' are incorporated, but each chapter that meets our criteria is sanctioned by the AAFD, and is a part of a national association with more than 8000 members since inception.*

The AAFD agrees with the FTC that the disclosure of existing franchisee associations can be an excellent tool to moderate the franchise 'product' offered by franchisors, and to provide a dramatically improved market utility to FTC disclosure documents.[2] Unduly limiting the 'qualified groups' to those who have been technically incorporated may well defeat the purpose. We urge that the FTC allow other methods of legitimacy, including recognition of active (vouched for) chapters of the AAFD, the AFA, and the IFA, and including groups that have chosen to formalize their foundation by some alternative business entity. Additionally, we suggest that the FTC consider requiring disclosure of the non-existence of a franchisee association.

The American Association of Franchisees and Dealers is one of the 'franchisee advocacy groups' that has been critical of the FTC franchise rule for its lack of teeth to protect franchise owners from what we perceive to be unfair business practices. Franchisors do not need to meet any minimum standards to sell franchises, do not need to respect any minimum suitability standards for prospective investors, are not subject to pre-disclosure review or post disclosure audit, and investors have no ability to seek private redress for rule violations. And yet franchise investors trust and rely on industry claims that franchising is 'heavily regulated like the securities industry.'

Of equal concern is a litany of lawsuits enforcing adhesive franchise agreements on the rationale the franchisees were provided 'federally mandated presale disclosure' and had the right to pass on signing the agreement. Where else in our legal framework of consumer protection laws does the principle of *caveat emptor* prevail?

The FTC staff report has recognized a need to address abuses in franchise relationships, but has determined that it lacks jurisdiction and authority to address relationship issues under the Federal Fair Trade Practices Act and in the Franchise Rule. The Commission has urged that the marketplace bolstered by more effective presale disclosure is the best tool it has in its arsenal to protect investors.

Several years ago, when the FTC first opined that it had no 'jurisdiction' to be involved in the 'relationship issues' between franchisors and franchisees, the AAFD withdrew its involvement in the Rule review process, and focused its resources in the development of market drivers that would follow the FTC's suggestion. The AAFD's *Fair Franchising Standards* Committee is made up of forward thinking franchisors, franchisees and franchisor and franchisee attorneys who come together twice a year to 'negotiate' fair and balanced standards for franchise agreements and relationships. The development of the AAFD's *Fair Franchising Standards,* and the recognition of franchisors that respect our standards by awarding the AAFD's *Fair Franchising Seal,* are intended to drive franchise investors to a better product.

The AAFD as an organization is dedicated to promoting negotiated franchise relationships, and to recognizing franchise systems that have negotiated relationships. The AAFD also believes that it is impractical, even unwise, for a franchisor to 'negotiate' the terms of each individual franchise agreement, but that group negotiations can effectively serve the interests of a franchisor and its constituent franchisees. The AAFD is dedicated to the premise that negotiated franchise agreements between equal bargaining partners will produce

[2] We note that such associations rarely exist for new or unseasoned franchisors.

franchise systems that respect the legitimate interests of both the franchisor and franchisees—we call the resulting relationship *Total Quality Franchising!*

The AAFD sets forth its "credentials" for the purpose of being formally recognized by the FTC as an entity that should be uniformly disclosed to prospective franchise owners. Indeed, we suggest that the FTC might establish a registry of franchisee associations who satisfy the FTC's revised criteria for legitimacy. The AAFD currently maintains and publishes such a registry at our website, www.AAFD.org, and we can vouch for the practicality of such an enterprise.

The AAFD also offers its offices, as well as the resources of our *Standards Committee,* to participate in a dialogue to establish minimum standards for the disclosure of franchisee associations, so that such disclosure satisfies the legitimate concerns of franchisors and franchisees regarding the fairness of FTC disclosure.