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

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Federal Trade Commission
Office of Secretary
600 Pennsylvania Ave., NW
Washington, DC 20580

Re: Franchise Rule, 16 CFE part 436, Comment, Matter No. R511003

I am Chairman and a founder of the American Association of Franchisees and Dealers, a national not for profit trade association that was founded in 1992 to fill what was a virtually complete void in the representation of franchisee interests at the time of the promulgation of the FTC Rule on Franchising. Since our founding, the AAFD has grown to represent scores of trademark specific franchisee associations, and thousands of franchise owners who have been impacted by the effects of the FTC Rule.

I am also the author of the book entitled The Franchise Fraud: How to Protect Yourself Before and After You Invest, first published in 1994. The premise of my book was that the franchising community, aided by the unintended impact of the FTC Rule, *was falsely representing that franchising is a safe and secure path to business ownership that is heavily regulated by both Federal and state legislation to protect the interests of franchisees.* Unfortunately, while the fine deputies at the FTC have exhibited a sincere desire to provide guidance and protection to prospective franchisees, I remain convinced that the FTC and other sincere government agencies have themselves become 'victims' of *The Franchise Fraud*, **and without adjustment to the rule, including implementation of other aspects of the US Federal Trade Act, the aspirational intent of the Rule will continue to be subverted to cause harm to the very citizens the Rule is intended to protect.**

Some Context. The FTC Rule, and its predicate statute, the California Franchise Investment Law, were both based upon the manner in which the securities industry has been regulated at both the state and federal level. Under our securities laws, certain conduct was made *unlawful and criminal and civil penalties and remedies were made available to address violations and abuses.* In a compromise with the securities industry, sellers of securities were afforded a *safe harbor* from liability in the form of delivering an offering circular or prospectus that discloses the material aspects *and risks* of an offered security to *shield the sell from liability for otherwise prohibited acts.* ***It is important to note that the intended purpose of the offering circular (rarely even read by investors) was more to shield sellers than to protect investors.***

Similarly, the FTC Rule on Franchising requires all companies selling franchise opportunities to provide prospective investors a Franchise Disclosure Document (FDD) and a franchisor is shielded from liability to a substantial extent if the franchisor makes required disclosures, and whether or not the impacted franchisee has actually read the document. Further, most franchisors require a prospective franchisee to acknowledge receipt and understanding of the FDD as a condition

prerequisite to completing the sale of the franchise. ***Presumably, the FDD is intended to protect franchisors from the authority of the FTC to regulate and punish unfair business practices that are proscribed under Article 5 of the US Federal Trade Act,*** much as the CFIL Disclosure Document was intended to protect California franchisors from liability under the CFIL.

With this context, we make the following comments:

1. **Without enforcing Article 5 authority under the FTC Act, the FTC Rule has perpetuated the unintended consequence of falsely representing that the purpose of the Rule is to Protect Investors.**

Overarching all of the discussions at the recent FTC workshop review of the Franchise Rule was the explicit and repeated affirmations that the purpose of the Rule is to protect investors. ***While this may be the goal of the FTC, the FDD is designed to protect franchisors far more than franchisees and serves as a safe harbor shield against liability.*** The truth of the purpose of the FDD needs to be made clear to prospective investors.

Equally, unless the FTC asserts its authority to apply Article 5 of the Act to the franchising industry, and applies significant resources to that effort, the aspirational intent of the FTC to protect franchisees is actually being subverted and turned against the very 'victims' that the government professes to protect! All of our remaining comments need to be appreciated in the context of this overarching truth.

Over the past 40 years the FTC has professed that its only role in franchising is encompassed by pre-sale disclosure, and the FTC has refrained from addressing serious abuses. Moreover, the FTC has largely adopted the prescription offered by the franchising industry that simply *disclosing a potential for abuse or unfair behavior is all that is needed to protect investors.* We submit that in the universe of consumer and investor protection, the only industry that still adopts a regulatory standard of "Let the Buyer Beware – *Caveat Emptor*" is franchising!

2. **The Standard of Financial Performance Representations should include all material financial impacts and not be limited to the performance results of franchisees.**

Financial performance representations is a very difficult subject to handle because there are so many variables—and the reality that financial performance (let's call them earnings claims) are universally being made regardless of the technical representations made in the FDD. We need a broader discussion of this entire subject, with more participants. But we should remember one very important factor that is frequently left out of our discussions – **in the context of securities regulations a seller of securities is blocked from public markets if it does not meet minimum standards of viability, AND sellers and brokers of securities have a legal obligation to determine the suitability of the investment as well as the suitability of the prospective investor. Neither of these important requirements apply in franchising. A start-up franchisor can sell a franchise to a completely unsuitable investor without meeting any minimum standards.** The importance of this observation needs to be a part of the discussion leading to reforms to the FTC Rule as it applies to financial performance representations.

3. **The ability of a franchisor to require and enforce liability waivers significantly exacerbates the goal of protecting franchisees from unfair business practices.**

Our overarching comment is of particular importance with respect to a discussion of liability waivers. It is extremely important to recognize that one goal of the Franchise Rule is to provide a *safe harbor* to honest franchisors who are intent appropriately shielding from unfounded allegations of fraud and wrongdoing. Negotiated contractual waivers of liability freely given are engrained in our contract laws. The problem comes from the notion that waivers have been negotiated between parties of similar bargaining power. This is often not true with a franchise agreement that is offered on a *take it or leave it* basis. This is also an area that screams for more dialogue, but we would suggest that the validity of such waivers be based upon a finding of balanced negotiating strength with a somewhat relaxed standard short of that necessary to find an agreement to be a void as a contract of adhesion.

4. **The current application and enforcement of the FTC Rule, without enforcement of Article 5 of the FTC Act, has the impact of validating often unscrupulous conduct.**

As we observed the recent workshop regarding the current application of the FTC Rule, there were two repeated themes – 1) franchisees divulging examples of abusive behaviors that are allowed and even protected by the current enforcement of

the Franchise Rule, 2) Franchisor counsel making sincere offers to disclose the behavior as the 'solution' to the problem. We cannot stress enough that the Rule provides a shield form liability, and we really need to identify and prohibit specific behaviors.

5. **The evidence offered that the Rule is 'doing the job' gives a false representation of reality that there aren't significant issues in franchising.**

More than one panelist offered evidence of a limited number of franchising lawsuits as an indication that there really is not a problem that needs to be addressed by serious regulation. It was offered that over the last number of years there have been very few lawsuits by franchisees—it also could have been offered that most of these lawsuits are resolved in favor of franchisors! The data presented mischaracterizes reality.

That there are few lawsuits does not indicate a lack of a problem. We submit that the data suggests a lack of an effective right of action and a lack of a remedy:

a. Most franchise agreement compel arbitration and bar lawsuits from being filed.
b. Most franchise agreements bar franchisees from joining their claims with other franchisees, and the resources needed by franchisees to pursue a claim deny any meaningful access to justice.
c. And generally, franchise agreements are so skewed in favor of franchisors that there are frequently no contractual remedies available.

6. **The AAFD is the leading advocate for franchisees in the United States, and we would be very interested in being a participant in future workshops where the voices of our thousands of members can be hears.**

Sincerely,

Robert L. Purvin, Jr,
Chair, Board of Trustees