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RUN THROUGH THE WRINGER: HOW CLEANING INDUSTRY FRANCHISORS EXPLOIT FRANCHISEES' HOPE FOR AN AMERICAN DREAM

JOHN R. DUNNE*

I. INTRODUCTION

Stratus Building Solutions worked its way to the top by offering their franchisees an environmentally friendly cleaning service, pursuing accounts with large commercial office buildings.¹ It was the fastest-growing franchise in 2011 and 2012.² Recently, franchisees are accusing Stratus of operating a fraudulent pyramid scheme—calling Stratus' successes into question.³ Their franchisees filed a nationwide class action lawsuit against Stratus in 2012.⁴

Guadalupe Clemente, a representative plaintiff in the class action, owned one of the unit franchises that she claims was part of Stratus's pyramid scheme.⁵ Her petition asserts that Stratus has developed a system of using Master Franchisees to exploit unit

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1. *Stratus Building Solutions*, ENTREPRENEUR.COM, <http://www.entrepreneur.com/franchises/stratusbuildingsolutions/329456-0.html> [hereinafter *Entrepreneur.com*] (last visited Mar. 21, 2014).

2. *Id.*

3. Shane D. Gosdis, *Stratus Building Solutions Under Attack from Franchisees*, FRANCHISE LAW BLOG (Feb. 15, 2012), <http://franchiselawblog.net/?p=254>.

4. Class Action Pet. For Declaratory J. at 20, *Rivera v. Simpatico, Inc.*, No. 12SL-CC00339 (June 8, 2012), available at <http://www.unhappyfranchisee.com/wp-content/uploads/2012/07/Rivera-v-Simpatico-Amended-Petition-Declaratory-Judgment-final.docx> [hereinafter *Rivera Class Action Petition*]. The plaintiffs to this action allege that Stratus fraudulently used master franchisees to induce unit franchisees to enter into franchise agreements without disclosing a number of the documents and information required by the Federal Trade Commission. *Id.* ¶ 160.

5. *Id.* ¶ 74. "Guadalupe Clemente is a citizen and resident of the State of Arizona who owned and operated a franchise of PHSCCH SBS, LLC, doing business as Stratus Building Solutions of Metro Phoenix." *Id.* ¶ 2.

franchisees.⁶ Ms. Clemente learned about the janitorial franchise opportunity from Stratus Building Solutions' advertisement in *Segundo Mano*, a Spanish-language magazine.⁷ Because Ms. Clemente spoke minimal English, Stratus provided her with a Spanish-speaking salesperson.⁸ Based on Stratus's claim that she would generate \$3,000 in monthly revenue, Ms. Clemente decided to purchase a Stratus unit franchise.⁹ On April 4, 2011, Ms. Clemente paid her initial franchise fee and signed a Franchise Agreement with PHSCCH SBS, LLC—Stratus' Master Franchisee for the Phoenix, Arizona territory.¹⁰ Ms. Clemente states that she was offered her first Stratus account on April 28, 2011, but the location was too far away and did not provide a large enough profit to accept the account.¹¹ After refusing the account, Ms. Clemente executed a form given to her by Stratus entitled "Non Acceptance of Account."¹² Ms. Clemente alleged that Stratus did not offer her another account for five months.¹³ Once Ms. Clemente received this new account, she learned it was one taken away from another franchisee named Martha, a woman with whom Ms. Clemente did her franchise training. After learning of the poached account, Ms. Clemente demanded a refund from Stratus, stating that she did

6. *Id.* ¶ 129. Many of the similarly situated Unit Franchisees were minorities or immigrants. *See, e.g., Id.* ¶¶ 66, 116.

7. *Id.* ¶ 130. Stratus used other methods of targeting the immigrant and minority population in Phoenix by advertising on a Phoenix Spanish radio station, La Nueva 105.9 FM. *Id.* ¶¶ 127–28; *see also* Complaint at 4, *Mendoza v. Goldeneye Holdings, Inc. dba Stratus Building Solutions of Orange, (Cal. Super. Ct. Jan 11, 2012) (No. 30-2012-00536505-CU-FR-CJC)*, available at <http://www.unhappyfranchisee.com/wp-content/uploads/2012/05/Goldeneye-v-Stratus.pdf> (alleging that Stratus targets non-English speaking individuals by advertising in Spanish speaking publications). *Id.* Further, this complaint alleges that Stratus uses a Spanish speaking sales representative that pitches the franchise opportunity in Spanish. *Id.* However, when a franchisee decides they would like to purchase a franchise, the franchise agreement they must sign is written in English. *Id.*

8. *Rivera Class Action Petition, supra* note 4, ¶ 129.

9. *Id.* ¶ 130. Stratus provided potential franchise plans to prospective franchisees, which showed the correlation of the projected revenue as compared to the different amounts invested in the initial franchise fee. *Id.* ¶ 67.

10. *Id.* ¶ 133. PHSCCH SBS, LLC is the Master Franchisee for the Phoenix territory, doing business as Stratus Building Solutions of Metro Phoenix. *Id.* ¶ 6.

11. *Id.* ¶ 135. One of the alleged fraudulent tactics used by Stratus and their Master Franchisees was to offer Unit Franchisees accounts that required traveling a great distance in order to entice the Unit Franchisees to not accept the account. *Id.* ¶ 122. The action of a Unit Franchisee not accepting an account relieved the Master Franchisee of its obligations to provide a certain level of revenue as set forth in the Franchise Agreement. *Id.* ¶ 120.

12. *Id.* ¶ 136.

13. *Id.* ¶ 137. Ms. Clemente's lawyer asserts that the offering of this second account could possibly reveal the fraudulent activity of "churning" accounts by Stratus and the Master Franchisee. *Id.* ¶ 88.

not want to participate in Stratus's system.¹⁴ Stratus simply replied that it had fulfilled its obligations under the contract by offering her an account, and because she rejected the account, she would not receive a refund.¹⁵

This lawsuit against Stratus is not the first class action against a cleaning business franchisor that alleges a fraudulent pyramid scheme.¹⁶ While many franchisors in the cleaning business use a similar business model, their franchisees are finally starting to challenge it.¹⁷ The franchisees accuse these cleaning and janitorial franchisors of consistently using the same tactics to take advantage of franchisees in positions similar to Ms. Clemente.¹⁸

14. *Id.* ¶¶ 141–43.

15. *Id.* ¶ 144.

16. Julie Bennett, *Taking off the Gloves: Commercial Cleaning Franchisees Sue*, FRANCHISE TIMES, (Aug. 2009), available at <http://www.franchisetimes.com/August-2009/Taking-off-the-Gloves>; see also *Awuah v. Coverall N. Am., Inc.*, 707 F. Supp. 2d 80, 81 (D. Mass. 2010) (providing an example of a class action lawsuit in the cleaning industry). The plaintiffs in this case were franchisees of the defendant Coverall North America, a company providing cleaning franchises. *Id.* The plaintiffs alleged that Coverall committed unfair or deceptive trade practices. *Id.*; see also *Juarez v. Jani-King of California, Inc.*, 273 F.R.D. 571, 574 (N.D. Cal. 2011) (showing a class action case brought by franchisees against the franchisor of cleaning and janitorial services alleging several violations). These allegations include violations of California's Labor Code, violations of California's Unfair Competition Law, as well as breach of the covenant of good faith and fair dealing. *Id.* *Depianti v. Jan-Pro Franchising Int'l Inc.*, 2012 WL 3835090, at *1 (D. Mass. Aug. 31, 2012). This case involves a national class action brought by franchisees against Jan-Pro Franchising International, a company providing franchises for cleaning services. *Id.* The plaintiffs allege that the franchisor deceived the purchasers of these franchises with respect to the amount of income they will earn. *Id.* In an Amended Complaint, the plaintiffs also allege unfair and deceptive business practices and misrepresentation against the defendant. *Id.*

17. Bennett, *supra* note 16. The founders of Jani-King developed a business model in 1974, which has repeatedly been copied by companies in the cleaning industry. *Id.* These companies promote the business model as a low-cost business opportunity, and use master franchisors to expand to other markets quickly. *Id.* These master franchisors then sell unit franchises, mainly to minorities and immigrants, for thousands of dollars. *Id.*

18. *Id.* These tactics include targeting immigrants and minorities, misrepresenting the franchise offerings, requiring extensive travel to the franchisees, and "churning" accounts when franchisees are unable to accept the accounts. *Id.* The attorneys representing the franchisors disagree and deny these allegations:

Jacqueline Vlaming, Coverall's general counsel, said, "Every franchise owner who runs it like a business can make money. Ninety-nine percent of the people who buy a Coverall franchise are committed to it." Ron Rosenwasser, of Friedman, Rosenwasser & Goldbaum, of Boca Raton, who represents Jan-Pro, said, "We have thousands of franchisees who work hard and develop their franchise; other fail because they do not work the territory or are distracted by personal problems." And Don Burleson, executive vice president of Jani-King, said, "We have over

In order to protect potential franchisees who desire to own their own cleaning business, Congress and the Federal Trade Commission (FTC) must create a new regulatory scheme that specifically governs the cleaning and janitorial industry. Part II of this Comment provides a brief history of franchise fraud, the franchise industry, and the evolution of franchise laws enacted to protect franchise investors. This part uses Stratus Building Solutions as a case study, illustrating how franchisors in the cleaning industry use a unique business model to become highly successful. Part III analyzes current state and federal regulations to determine their adequacy to protect franchisees in the cleaning industry. This section discusses the business model challenged by unit franchisees, and used by cleaning businesses to grow rapidly nationwide.¹⁹ Although special federal and state franchise laws apply to certain industries, there are no federal or state laws that specifically govern franchises in the commercial cleaning industry.²⁰ To resolve many of the cleaning industry franchising problems, Part IV proposes an industry-specific franchise regulation on franchisors in the cleaning and janitorial industry.

II. BACKGROUND

Since the 1960s, franchising has played a very important role when distributing goods and services in the United States.²¹ The concept of franchising provided businesses with a great opportunity to grow and expand, but it also provided an opportunity for deception and illegal activities.²²

A. *The Birth of Franchise Fraud and the Evolution of Franchise Regulation*

The rise of the modern franchise system in the 1960s has led to associated problems with franchise fraud.²³ The popular success of franchisors and franchisees provided an opportunity for

12,000 franchisees worldwide who have been operating for decades and have many success stories.

Id.

19. See *infra* Part III.B (discussing challenges to the franchisor's business model).

20. Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate Over Franchise Relationship Laws* 7-8 (2011), http://extranet.isnie.org/uploads/isnie2012/emerson_benoliel.pdf.

21. W. MICHAEL GARNER, *FRANCHISE & DISTRIBUTION LAW & PRACTICE* § 1:01 at 1 (1993) (explaining the rapid growth of franchising and the potential of future growth in the industry).

22. CCH EDITORIAL STAFF, *FTC DISCLOSURE RULES FOR FRANCHISING AND BUSINESS OPPORTUNITIES* 11 (Jan. 23, 2007).

23. *Id.* (explaining how the popularity, expansion, and success of businesses like McDonald's, Pizza Hut, and Holiday Inn proved that franchising could provide huge economic awards for franchisors and franchisees).

criminals to take advantage of those who wanted to invest in the franchise arena.²⁴ The widespread amount of franchise fraud throughout the 1960s led to the enactment of state and federal franchise-specific laws in the 1970s.²⁵ Several bills were proposed to Congress in the late 1960s; however, none of these bills passed, and franchise regulation shifted to the states.²⁶ California passed the first franchise specific law in 1971.²⁷ Fourteen other states soon followed suit.²⁸ Then, on December 21, 1978, after years of

24. *Id.* "Tens of thousands of people around the country lost millions of dollars to criminal franchise enterprises. . . ." *Id.* The U.S. Department of Commerce conducted a report from 1973-1975 and concluded that franchise sales of goods and services should reach \$176.9 billion by the end of 1975. William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 29 (2008), [http://www.faegrebd.com/webfiles/FLJ%2028-1%20Killion%20\(4\).pdf](http://www.faegrebd.com/webfiles/FLJ%2028-1%20Killion%20(4).pdf). Another report was conducted in 2005 by PricewaterhouseCoopers that concluded that franchise businesses generated an annual economic output of \$2.3 trillion, or 11.4 percent, of the total private U.S. sector output. *Id.*

25. CCH EDITORIAL STAFF, *supra* note 22, at 11-12; Larry A. Mackey & William C. Kurylak, *Interfaces of the FTC Trade Regulation Rule and State Franchise Laws*, 1980 ARIZ. ST. L.J. 527, 527 (1980) (explaining that these laws required franchisors to disclose certain documents in order to reduce one of the major causes of franchise failure - a lack of knowledge about the proposed business relationship). The seller must also provide the buyer sufficient time to study the disclosure document before accepting any payments. *Id.*

26. Killion, *supra* note 24, at 27. Michigan Senator Philip Hart, was the main supporter of federal legislation on franchising. *Id.* Senator Hart, Senator James Eastland of Mississippi, and Senator John Williams of Delaware all introduced bills to regulate franchises. *Id.*; see also Franchise Competitive Act, S. 2321, 90th Cong., 1st Sess. (1967) (introducing Senator Hart's bill, which sought to regulate franchise relationship termination); Franchise Distribution Act of 1967, S. 2507, 90th Cong., 1st Sess. (1967) (introducing Senator Eastland's bill, which sought to reduce "the great disparity in economic power now heavily in favor of the franchisor."); Franchise Competitive Act, S. 1967, 91st Cong., 1st Sess. (1969) (introducing Senator Hart's revised bill, which included further regulations on the franchise relationship); Franchise Competitive Price Act, S. 3844, 91st Cong., 2d Sess. (1970) (introducing Senator Williams' bill addressing concepts of presale disclosure).

27. California Franchise Investment Law, CAL. CORP. CODE §§ 31000-31516 (Deering 2014).

28. Hawaii Franchise Investment Law, HAW. REV. STAT. §§ 482e-1-12 (West 2014); Illinois Franchise Disclosure Act, 815 ILL. COMP. STATS. §§ 705/1-44 (West 2014); IND. CODE §§ 23-2.5-1-51 (2014); Maryland Franchise Registration and Disclosure Law, MD. CODE ANN., BUS. REG., tit. 14, §§ 14-201-223 (West 2014); Michigan Franchise Investment Law, MICH. COMP. LAWS §§ 445.1501-1546 (2014); MINN. STATS. §§ 80C.01-.30 (2014); N.Y. GEN. BUS. LAW §§ 680-695 (McKinney 2014); North Dakota Franchise Investment Law, N.D. CENT. CODE ANN. §§ 51-19-01-17 (West 2014); Oregon Franchise Transactions Law, OR. REV. STAT. §§ 650.005-.480 (2014); Rhode Island Franchise and Distributorship Investment Regulations Act, R.I. GEN. LAWS §§ 19-28.1-1-34 (2014); South Dakota Franchises for Brand-Name Goods and Services Law, S.D. CODIFIED LAWS §§ 37-5b-1-53 (2014); Virginia Retail Franchising Act, VA. CODE ANN. §§ 13.1-557-574 (2014); Washington

investigating fraud in the franchise arena, the Federal Trade Commission adopted the FTC Franchise Rule.²⁹ But each of these laws defines “franchise” differently.

B. Defining a Franchise

The word “franchise” has many different definitions, which vary by state statutes and regulations, and the FTC regulation.³⁰ The state definitions usually have the same or similar meaning to the FTC’s definition, which is set forth in a three-prong test.³¹ The three-prong test provides that “the franchisor must: (1) promise to provide a trademark or other commercial symbol; (2) promise to

Franchise Investment Protection Act, WASH. REV. CODE §§ 19.100.010–.940 (2014); Wisconsin Franchise Investment Law, WIS. STAT. §§ 553.01–.78 (2014).

29. 16 C.F.R. § 436 (2014); CCH EDITORIAL STAFF, *supra* note 22, at 12. The investigation, put on by the Commission, confirmed that franchisors were making many material misrepresentations as well as performing unfair or deceptive practices. *Id.* Some of these misrepresentations pertained to the costs to purchase and operate the franchise, the probable success of the franchise, and the seller’s financial viability. *Id.* The Commission decided that regulation in the franchise industry is important to protect consumers from the economic harm resulting from these practices. *Id.* The Rule took effect on October 21, 1979. *Id.*

30. RUPERT M. BARKOFF & ANDREW C. SELDEN, FUNDAMENTALS OF FRANCHISING xvii (3rd ed. 2008). A “franchise” can be thought of as a commercial transaction or relationship that contains four elements. *Id.* Those four elements are the “grant,” the “trademark,” the “community of interest or marketing plan,” and the “franchise fee.” *Id.* Franchise lawyers must be vigilant and research all laws that could potentially apply to the business when the business transactions have multi-state implications. Douglas D. Smith, Ryan D. Smith & Bradley D. Smith, *Government Regulation of Franchises* § 67.4, available at <http://www.franchisesmith.com/site/1040fran/Franchise-Government-Regulation-of-Franchises.pdf> (last visited March 21, 2014).

Others have described franchising as “a method of structuring a productive relationship between two parties in which both contribute to the production or distribution of the product or service.” Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 931 (1990).

31. Smith, Smith & Smith, *supra* note 30, at §§ 67.2–.3 (quoting the FTC’s three-prong test). The test is:

Any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

- (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;
- (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and
- (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

Id.

exercise significant control or provide significant assistance in the operation of the business; and (3) require a minimum payment of at least \$500 during the first six months of operations.”³² Because the definition of a franchise differs throughout the country, courts could classify a business venture as a franchise if it meets the relevant requirements, even when the parties call the relationship something else.³³

Several state and federal laws regulate franchises in the United States.³⁴ The primary governing federal law is the FTC’s Franchise Rule.³⁵ In an effort to protect potential franchisees, the Franchise Rule requires franchisors to disclose certain information necessary for a franchisee to make an educated business decision when considering purchasing a franchise.³⁶ In 2008, the FTC revised the Franchise Rule and created a revised disclosure document known as the “Franchise Disclosure Document” or FDD.³⁷ The revision helped to harmonize the Federal Rule with state franchise-disclosure laws.³⁸ The current FDD sets forth twenty-three disclosure requirements for franchisors.³⁹ This

32. Fed. Trade Comm’n, THE FRANCHISE RULE COMPLIANCE GUIDE 1 (May 2008), <http://business.ftc.gov/documents/bus70-franchise-rule-compliance-guide.pdf>.

33. Smith, Smith & Smith, *supra* note 30, § 67.3; *see also, e.g.*, Cooper Distributing Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 275 (3d Cir. 1995) (holding a home appliance distributor was a “franchise” under the New Jersey Franchise Practices Act, even though the distributor did not intend to hold itself out as a franchisor).

34. 16 C.F.R. §§ 436.1–.11 (2014); Arkansas Franchise Practices Act, ARK. CODE ANN. §§ 4-72-201–210 (2014); California Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20000–20043 (Deering 2014); CONN. GEN. STAT. § 42-133e (2014); Delaware Franchise Security Law, DEL. CODE ANN. tit. 6, §§ 2551–2257 (2014); Franchise Investment Law, HAW. REV. STAT. §§ 482E-1–12 (2014); Franchise Disclosure Act of 1987, 815 ILL. COMP. STAT. 705/1–44 (2014); IND. CODE §§ 23-2-2.5-1–51 (2014); IOWA CODE §§ 523H.1–.17 (2014); Franchise Investment Law, MICH. COMP. LAWS §§ 445.1501–.1546 (2014); MINN. STAT. ANN. §§ 80C.01–.30 (West 2014); Franchise Practices Act, NEB. REV. STAT. §§ 87-401–410 (2014); Franchise Practices Act, N.J. STAT. ANN. §§ 56:10-1–15 (2014); TENN. CODE ANN. § 47-25-1501–1511 (2014); Wisconsin Fair Dealership Law, WIS. STAT. ANN. §§ 135.01–.07 (West 2014).

35. 16 C.F.R. §§ 436.1–.11 (2014). The basic requirement of the FTC Franchise Rule is to compel franchisors to provide written disclosure forms containing information about the franchisor, the business, and the franchise relationship to potential franchisees. *Id.* §§ 436.2–.7. The franchisor must allow all potential franchisees at least fourteen days to read and review these documents before deciding whether to purchase a franchise. *See id.* § 436.2 (requiring franchisors to tender disclosure documents to potential franchisees at least 14 days before the franchisees sign a binding agreement with the franchisor).

36. *Id.* §§ 436.2–.7.

37. CCH EDITORIAL STAFF, *supra* note 22, at 10.

38. *Id.* at 15. Another goal of the revision was to provide a more uniform nationwide disclosure platform to “help facilitate ‘comparison shopping’ among franchise systems by prospective franchisees.” *Id.*

39. *Id.* at 15–26. A list of titles of the disclosure requirements is as follows:

information allows franchisees to make a better-informed decision when contemplating a franchise investment.⁴⁰ A potential franchisee should also understand the different structures used in franchising.⁴¹ The prevailing franchisor business model uses the master franchising structure.⁴²

C. Understanding the Concept of Master Franchising

Stratus and other franchisors in the cleaning and janitorial industry use a franchising business model structure known as master franchising.⁴³ Master franchising involves at least three parties: a franchisor,⁴⁴ a master franchisee,⁴⁵ and at least one unit franchisee.⁴⁶ The franchisor grants a territory to the master

Item 1: The Franchisor and Any Parents, Predecessors, and Affiliates, Item 2: Business Experience, Item 3: Litigation; Item 4: Bankruptcy, Item 5: Initial Fees, Item 6: Other Fees, Item 7: Estimated Initial Investment, Item 8: Restrictions on Sources of Products and Services, Item 9: Franchisee's Obligations, Item 10: Financing. Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training, Item 12: Territory, Item 13: Trademarks, Item 14: Patents, Copyrights, and Proprietary Information, Item 15L Obligation to Participate in the Actual Operation of the Franchise Business, Item 16: Restrictions on What the Franchisee May Sell, Item 17: Renewal, Termination, Transfer, and Dispute Resolution, Item 18: Public Figures, Item 19: Financial Performance Representations, Item 20: Outlets and Franchisee Information, Item 21: Financial Statements, Item 22: Contracts, and Item 23: Receipts.

Id.; see generally FRANCHISE RULE COMPLIANCE GUIDE, *supra* note 32 (discussing these items and their application).

40. BARKOFF & SELDEN, *supra* note 30, at 96.

41. CARL E. ZWISLER, MASTER FRANCHISING: SELECTING, NEGOTIATING, AND OPERATING A MASTER FRANCHISE 11-14 (March 1999) (explaining the different franchising structures which include unit franchising, area development franchising, and master franchising).

42. *Id.* at 9-10.

43. *Id.* Master franchising is the most popular method that franchisors use to expand their business on a national level. *Id.*

44. The franchisor successfully develops the business operating system and trademark that other individuals are willing to pay fees to replicate. *Id.* at 10-12. The franchisor enters into a master franchise agreement with the master franchisee that provides the master franchisee with a territory, establishes a development schedule, and defines the rights to share in fees paid by the unit franchisees. *Id.* at 13-14.

45. The franchisor provides territory to a master and encourages it to recruit and service third-party unit franchisees within its given territory. *Id.* at 14. The master franchisees act as the franchisor to the unit franchisees in their territory. *Id.*

46. Unit franchisees execute franchise agreements with the master franchisee in their territory. *Id.* at 12. Unit franchisees pay the master franchisee many fees that the franchisor could designate as initial fees, service fees, license fees, continuing franchise fees, etc. *Id.* 13-14; see also Andrew Kostecka, *Franchising in the Economy 1984-1986*, at 5-23 (Washington, D.C.: U.S. Department of Commerce, U.S. Government Printing Office, 1986) (explaining that master franchises are most commonly found in fast-food restaurants, convenience stores, and cleaning businesses, among other

franchisee; the master franchisee then has the right to grant franchises to third party unit franchisees.⁴⁷ Both the master franchisee and the unit franchisees follow the franchisor's business system and use the franchisor's trademark.⁴⁸ The basic structure of master franchising forms a hierarchical pyramid: the franchisor is at the apex, followed by the master franchisee, and multiple unit franchisees at the base.⁴⁹ This structure looks very similar to a pyramid or Ponzi scheme.⁵⁰ There are many factors that a franchisor should contemplate when deciding whether to use a master franchising structure,⁵¹ including the franchisor's desire to expand quickly, the customs and nature of the target market, as well as the cost of acquiring property in that market.⁵² Stratus Business Solutions has nearly perfected using the master franchising structure in its business model. This structure has allowed Stratus to appear as a top franchise opportunity in the cleaning and janitorial industry.⁵³

D. The Founding of Stratus Business Solutions

The story of how Stratus climbed its way to the top of the list of franchise opportunities begins at the founding of the company. Stratus, in its original name "Simpatico," began as a master franchisee of Jan-Pro Franchising International, Inc. ("Jan-Pro").⁵⁴ The territory designated by Jan-Pro for Simpatico to sell franchises included the St. Louis, Missouri Metropolitan area.⁵⁵

In April 2004, Simpatico detached itself from Jan-Pro and reformed as Stratus Building Solutions.⁵⁶ Simpatico used the same business model as well as the same Franchise Agreements as Jan-

businesses that provide a product or service).

47. ZWISLER, *supra* note 41, at 10, 14–15. For the most part, the master franchisee becomes the franchisor of the territory that it is granted. *Id.* at 10.

48. *Id.*

49. *Id.* Master franchise agreements encourage the master franchisee to recruit and service unit franchisees. *Id.* at 14.

50. Pyramid and Ponzi schemes are very similar. U.S. SEC. AND EXEC. PONI Schemes – Frequently Asked Questions, <http://www.sec.gov/answers/ponzi.htm#PonziWhatIs> (last visited Mar. 21, 2014). Both are fraudulent investing plans presented to investors disguised as a valid business opportunity. *Id.* Although they are easy to identify, investors still fall for this trap with the hopes to make quick money with little effort. *Id.* The operators of these schemes promise individuals certain returns on their investments that they simply cannot provide to each investor. *Id.*

51. ZWISLER, *supra* note 41, at 19–20.

52. *Id.* at 20–21. Some additional factors include local regulations that might apply to the unit franchisor, the likelihood of the business to produce profit margins that will allow the unit franchisee to profit and stay in business, and the familiarity the franchisor has with the size of the target market. *Id.*

53. Entrepreneur.com, *supra* note 1.

54. Rivera Class Action Pet., *supra* note 4, ¶ 54.

55. *Id.* ¶ 5.

56. *Id.* ¶ 56.

Pro.⁵⁷ On October 19, 2006, "Stratus Franchising, LLC, filed its Articles of Organization with the Missouri Secretary of State," intending to sell master franchises throughout the United States.⁵⁸

Stratus used the master franchising system to have other entities employ and monitor unit franchises across the country.⁵⁹ It charged "a large franchise fee to the master franchisee,"⁶⁰ and restricted the master from disclosing its franchisees' failures in other parts of the country.⁶¹ The master franchise agreement shows how Stratus retained control over the actions of the master franchisee.⁶² By using a master franchising structure with thin profit margins, all the pressure is on the master franchisee "to sell as many unit franchises as possible in order to survive."⁶³

The ultimate result of Stratus' business model forces the master franchisee to "churn" accounts in order to have a chance of

57. *Id.* ¶¶ 61–62.

58. *Id.* ¶¶ 82–86.

59. *Id.* ¶ 87.

60. *Id.*

61. *Id.* With respect to the last reason Stratus used a master franchising method, the franchise disclosure documents are issued by the master franchisee in charge of the respective region. *Id.* Plaintiffs allege that the main reason Stratus used master franchisees was to provide "the illusion of an independent entity between Stratus and the Unit Franchisee," intended to give itself the benefits of a franchisor without incurring the risks. *Id.* ¶ 88.

62. *Id.* ¶ 89. The master franchise agreements state that:

(a) Stratus maintains the right to bypass the Master and enforce any provision of the Franchise Agreement between the Master and the Unite Franchisee; and

(b) Stratus maintains the right to take over the customer accounts sold by the Master without notice to the Master and without compensation to the Master; and

(c) The so-called, independent Master has no ownership interests in the accounts it sells. In the event that the Master Franchise is terminated, the customer accounts revert to Stratus without compensation to the Master; and

(d) All documents provided by the Master to the sub-franchisee, must be approved by Stratus. In fact, Stratus provides the Unite Franchise Agreement to the Master to be used which is identical to the agreements used by Simpatico; and

(e) The Masters are required to do business under the name Stratus Building Solutions and their Unite Franchisees are required to represent themselves to the customers as Stratus Building Solutions; and

(f) Stratus requires that all Franchise Agreements between the Master and the sub-franchisee contain a provision that Stratus be identified as a third-party beneficiary of the contract. Stratus inserts itself into the Agreement between the Master and the sub-franchise in order to alert all parties that it has ultimate control of the relationship.

Id. ¶ 90. "Stratus requires the Master Franchisees to appoint Stratus as attorney-in-fact of the Master Franchisees." *Id.* ¶ 91.

63. *Id.* ¶ 93. Stratus aggressively marketed the opportunity to become a master franchisee, and sold many master franchises to individuals who had little to no experience in the janitorial industry. *Id.* ¶¶ 96–98.

operating a successful business.⁶⁴ Uninformed franchisees, including immigrants and minorities, are more likely to default on the franchise agreements and provide master franchisees with opportunities to churn accounts because they do not fully understand the agreements.⁶⁵

III. ANALYSIS

This section analyzes current state and federal regulations to determine their adequacy in protecting cleaning industry franchisees. This section also analyzes the master-franchise business model, such as the one Stratus and other cleaning companies use, and how franchisees challenge its legitimacy.

A. *Franchisees of the Cleaning Industry are Not Adequately Protected*

In the last half of the twentieth century, franchising developed into businesses' most dynamic geographical expansion strategy.⁶⁶ For the past few years, cleaning franchises remain highly ranked on the top franchise opportunities list as the country's fastest-growing franchises.⁶⁷ These statistics are highly regarded by individuals considering a franchise purchase.

1. *The Franchisor's Stance on Additional Regulation: Enough is Enough!*

Franchisor-advocates assert there are already sufficient laws protecting franchisees against abuse by the franchisor.⁶⁸ Franchisor-advocates stress that franchisees are sophisticated business people; the franchisor provides all the necessary

64. *Id.* ¶ 95. Stratus misled the master franchisees by not providing full disclosure of this outcome. *Id.* ¶ 97. Stratus is accused of misleading franchisees to believe that they are purchasing a franchise that is part of a system of over 5,000 franchises; however, Stratus attempts to put the risk of problems with the unit franchises solely on the master franchisee, who is in charge of a much smaller system of franchises. *Id.* ¶¶ 113–14; see CCH EDITORIAL STAFF, *supra* note 22, at 39 (stating the amended FTC Franchise Rule holds the franchisor, "or, as applicable, a subfranchisor," directly liable for failure to abide by the Rule).

65. See *infra* Part III.A.2.

66. ZWISLER, *supra* note 41, at 9. Franchising strategies are projected to account for nearly half of all retail sales in America. *Id.*; Jefferson I. Rust, *Regulating Franchise Encroachment: An Analysis of Current and Proposed Legislative Solutions*, 19 OKLA. CITY U. L. REV. 491 (1994) (stating that, in the past forty years, franchising has played an important role in the United States distribution of goods and services).

67. Bennett, *supra* note 16; see also *Entrepreneur.com*, *supra* note 1 (showing the websites list of top franchise opportunities).

68. Killion, *supra* note 24, at 23, 29, 31; see James A. Brickley, et al., *The Economic Effects of Franchise Termination Laws*, 34 J.L. & ECON. 101, 130 (1991) (stating that franchise termination laws reduce the amount of franchising and increase the cost of franchising).

information to make an educated decision.⁶⁹ Franchisor attorney and past Editor-in-Chief of *The Franchise Law Journal*, William Killion, has said that franchisees have all the necessary information that legislators and regulators have found they needed to make an educated business decision.⁷⁰ Killion further explains that, "Franchise legislation and regulations have achieved their goal."⁷¹ Advocates of franchisors support their position by referring to the Franchise Disclosure Document (FDD), required by the FTC.⁷² The FDD arguably warns potential franchisees against abuses by the franchisor by including certain relevant information that a franchisee should review to detect the possible risks of investing in that franchise.⁷³ Some of these required disclosures include information on pending or prior lawsuits involving the franchisor, specific provisions of the franchise agreement that deals with termination and arbitration in a specified tabular format; and names, addresses, and phone numbers of current franchisees.⁷⁴ Franchisor-advocates argue that, at the very least, all franchisees have the ability to consult with a franchise attorney before signing a contract to purchase a franchise.⁷⁵ Because franchisor-advocates assume that franchisees are sophisticated individuals with all the necessary information to make an informed decision, and can hire a franchise attorney to assist them, they believe there is no reason for further franchise

69. Emerson & Benoliel, *supra* note 20, at 9, 10; see also Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. 695, 766 (arguing that franchisees should be treated differently than consumers or employees because they are more sophisticated and well-informed people); Thomas J. Chinonis, *Implied Covenant of Good Faith: A Two-Way Street in Franchising*, 11 DEPAUL BUS. L.J. 229, 243 (1998) (explaining that the growing popularity of franchising allows franchisees to have a better idea of what to look for and expect in the franchise relationship); 16 C.F.R. 436.

70. Killion, *supra* note 24, at 29, 31. Killion adamantly believes that courts should not bail franchisees out for simply making bad business decisions—assuming that franchisees are informed and not subject to franchisors' superior bargaining positions. *Id.* at 31.

71. *Id.* at 29. Killion bases his belief on the theory that "informed investors can determine for themselves whether a particular deal is in their best interest." *Id.*

72. Emerson & Benoliel, *supra* note 20, at 11.

73. *Id.*

74. *Id.*; see generally CCH EDITORIAL STAFF, *supra* note 22, at 16–26 (listing all items included in the FDD); BARKOFF & SELDEN, *supra* note 30, at 103–16 (providing a description of each item listed in the FDD); Killion, *supra* note 24, at 29 (arguing that this information easily allows franchisees to shop alternative franchise opportunities).

75. Larry E. Ribstein, *Choosing Law by Contract*, 18 J. CORP. L. 245, 257 (1993) (arguing that if franchisees cannot read the franchise contract carefully, they can hire an attorney to do so); see also Drahozal, *supra* note 67, at 766–67 (insisting that franchisees are educated people, can shop around for the best franchise opportunities, and should know to hire an attorney to review their contracts).

regulation.⁷⁶

2. Franchisee's Stance on Existing Regulation: The Franchisors' Assumptions Do Not Apply to the Average Franchisee

As mentioned above, franchisor-advocates base their arguments on the assumption that franchisees are sophisticated individuals who have all the necessary information available to them, and that they can hire a franchise attorney if needed.⁷⁷ These assumptions are questionable.⁷⁸ Many new franchisees, including immigrants and minorities, lack prior business ownership experience, have trouble understanding and comprehending all of the information available to them, and do not consult with an attorney before entering into a franchise contract.⁷⁹ In fact, "the majority of franchisors say that they prefer to enroll a franchisee with no experience in their line of business."⁸⁰

Franchisees are attracted to the opportunity of owning their own businesses and being their own bosses.⁸¹ Individuals with no prior business ownership experience are especially attracted to the franchise business format because it provides them with an opportunity to invest in a proven business model, and receive training and site selection assistance.⁸² Therefore, franchisees can reduce their risk of failure by relying on the franchisors' methods

76. Emerson & Benoiel, *supra* note 20, at 13; Killion, *supra* note 24, at 31.

77. Emerson & Benoiel, *supra* note 20, at 13; Killion, *supra* note 24, at 30–31.

78. Emerson & Benoiel, *supra* note 20, at 14.

79. *Id.* at 14–33; see Hadfield, *supra* note 30, at 961–63 (explaining that franchisees are generally inexperienced businesspersons who rely on the franchisor to limit mistakes that cause businesses to fail); Elizabeth C. Spencer, *Consequences of the Interaction of Standard Form and Relational Contracting in Franchising*, 29 FRANCHISE L.J. 31, 32 (2009) (stating that the franchisee may not have the resources to obtain an attorney with extensive experience in franchising); Kimberley A. Morrison, *An Empirical Test of a Model of Franchise Job Satisfaction*, 34 J. SMALL BUS. MGMT. 27 (1996) (referring to a her study, based on a data collected from 307 U.S. franchisees which showed that most franchisees did not consult with lawyer before signing a franchise contract); BARKOFF & SELDEN, *supra* note 30, at 291 (indicating that most franchisees do not consult with an attorney before purchasing a franchise).

80. Hadfield, *supra* note 30, at 962; cf. MARTIN MENDELSON, *THE GUIDE TO FRANCHISING* 80, 81 (7th ed. 2004) (explaining that franchisees with no experience are easier to control and are less likely to use confidential information to compete against the franchisor in the future).

81. Hadfield, *supra* note 30, at 959 (describing some franchisors advertising tactics).

82. RICHARD J. JUDD & ROBERT T. JUSTIS, *FRANCHISING: AN ENTREPRENEUR'S GUIDE* 33 (4th ed. 2007); MENDELSON, *supra* note 80, at 48; Rust, *supra* note 66, at 492–93. Being able to use franchising to promote an existing trademarked product or service allows franchisees to start a new business without having to create their own products or service. *Id.*

because a franchisor has already overcome many of the independent business owner's mistakes.⁸³

Many franchisors provide franchisees with a training program.⁸⁴ The training will include many functions of operating the franchise, which can include financial, marketing, and management training.⁸⁵ A study conducted to observe the motivational incentives for franchisees to enter the franchising industry indicated initial training as a primary motivating factor in deciding to purchase a franchise.⁸⁶ Many business franchises also provide continuous training on an ongoing basis to novice franchisees during the franchise relationship.⁸⁷

Another attractive element of the franchise model is that the franchisor will usually assist the franchisee in selecting an appropriate site to heighten the probability of success of the new franchise unit.⁸⁸ These are relevant reasons why individuals who lack prior business ownership experience, and are not sophisticated in the aspects of business, are attracted to franchising. For these same reasons, franchising seems especially attractive to immigrants and minorities who desire their piece of the American dream.⁸⁹

83. MENDELSON, *supra* note 80, at 47, 48; *see also* Hadfield, *supra* note 30, at 959 (explaining that both franchisees and franchisors view the business opportunity as a low-risk alternative to individually starting a small business).

84. JUDD & JUSTIS, *supra* note 82, at 21 (indicating that over 98% of franchisors offer some sort of initial training).

85. *Id.* at 525–26; MENDELSON, *supra* note 80, at 94–95; Robert T. Justis & Peng S. Chan, *Training for Franchise Management*, 29 J. SMALL BUS. MGMT. 87, 89 (1991); *see* Rust, *supra* note 66, at 493 (explaining another benefit to the franchisee by receiving training as well as assistance from the franchisor on managing day to day operations).

86. Scott Weaven & Lorelle Frazer, *Investment incentives for Single and Multiple Unit Franchisees*, 9 QUALITATIVE MARKET RESEARCH: AN INTERNATIONAL JOURNAL 225, 227–37 (2006). Franchisees with limited prior business experience in certain areas identified the franchising method as an easier method to enter self-employment in those areas. *Id.*

87. JUDD & JUSTIS, *supra* note 82, at 527. The continuous training could include activities such as meetings with field representative that would provide consultation and management and operational suggestions to the franchisee, as well as information on marketing updates, industry trends, and new product and services developments. *Id.*

88. MENDELSON, *supra* note 80, at 96; *see also* JUDD & JUSTIS, *supra* note 82, at 219 (showing that some franchisors will provide franchisees with a list of factors to investigate while selecting the site). *Id.* These factors include local demographic characteristics, economic strength and potential, development and construction costs, and locations of primary competitors. *Id.*

89. Hugh Chapman, *Immigrants Find the American Dream with Commercial Cleaning Franchise*, SERVICES MAG. (Jan. 12, 2011), <http://www.servicemag.org/industry/management/item/24-immigrants-find-the-american-dream-with-commercial-cleaning-franchise> (explaining the story of two immigrants, Hector Lomas and Tanja Arnautovic, who achieved the "American dream" through owning a commercial cleaning franchise). They

Contrary to the franchisor-advocates' belief, many inexperienced franchisees tend to sign franchise contracts without conducting the necessary research to understand the accessible information and make a well-informed decision.⁹⁰ Many prospective franchisees will face cognitive obstacles when considering the relevant information before purchasing a franchise because they lack prior business ownership experience.⁹¹ Emerson and Benoliel, in their article, *Are Franchisees Well-Informed? Revisiting The Debate Over Franchise Relationship Laws*, lay out three cognitive obstacles that inexperienced franchisees face while considering the purchase of a franchise.⁹² These cognitive obstacles are: the unawareness problem; screening difficulty; and comprehension limitations.⁹³

The unawareness problem for inexperienced franchisees emerges when the franchisee first decides to look into the franchising opportunity.⁹⁴ Many novice franchisees might not know all the risks—business and legal—that are involved in owning a franchise unit.⁹⁵ This research requires major cognitive efforts of the franchisee to determine what unknown risks will apply to their particular franchise opportunity.⁹⁶

After researching to determine the information that franchisees need to analyze in order to make a knowledgeable investment decision, franchisees will experience difficulty distinguishing between the relevant and irrelevant information that they have gathered.⁹⁷ This is the second cognitive obstacle

both found franchise training programs to be appealing. *Id.* Hector states that new immigrants in America are attracted to the commercial cleaning industry because it requires a skill that does not involve interaction with the public, gives them time to improve their English speaking, and is “virtually recession-proof.” *Id.* Tanja states that the low start-up cost provides a low risk for immigrants and minorities. *Id.*; see also Richard Gibson, *Chain Reaction: For many immigrants, owning a franchise is the path to the American Dream*, WALL ST. J. (Oct. 13, 2008), <http://online.wsj.com/article/SB122347728915015415.html> (stating that many immigrants turn to franchising to fulfill the American dream).

90. Emerson & Benoliel, *supra* note 20, at 23 (stating that franchisees ignore franchise disclosure documents, fail to conduct a comparison analysis between contracts and disclosure documents, and sign franchise agreements without consulting a franchise attorney).

91. *Id.* at 24.

92. *Id.*

93. *Id.*

94. *Id.* Franchisees may not know where to initially look for the most accurate and relevant information for making the decision to own a franchise. *Id.*

95. *Id.* at 24–25.

96. *Id.* It is a challenging, if not impossible, task for a franchisee to be able to account for risks that they may not know are relevant to their decision making process. *Id.*

97. *Id.* This is because inexperienced franchisees usually have never engaged in processes of this sort. *Id.*

that franchisees must overcome: the screening difficulty.⁹⁸ After the franchisee has completed the preliminary research, the screening process becomes even more difficult as the franchisee begins the process of deciding which individual franchise opportunity to pursue.⁹⁹

Once the franchisee has decided which franchise opportunity to pursue, this leads to the pre-contractual stage, where novice franchisees will encounter comprehension obstacles.¹⁰⁰ It will contact the franchisor and soon receive that franchise's FDDs, which includes massive amounts of information tailored to that particular franchise.¹⁰¹ The franchisee must then analyze that information to determine if the franchise is a profitable investment opportunity.¹⁰² Because many inexperienced franchisees lack basic business ownership knowledge, comprehending and evaluating all the available business and legal data that they receive, including the FDDs, will prove to be a daunting task.¹⁰³

Novice franchisees that encounter these cognitive obstacles often ignore important information they need to make a well-informed decision.¹⁰⁴ Contrary to franchisor-advocates' belief, these cognitive obstacles tend to lead inexperienced franchisees to ignore information set out in FDDs.¹⁰⁵ Therefore, the franchisor-advocates' reasoning that current regulations are sufficient is flawed because many new franchisees lack prior business

98. *Id.* at 25. This can be a very time intensive process. *See id.* at 25–27 (describing the steps a franchisee should take to conduct a proper screening). Franchisees should conduct extensive research to grasp the complex issues that accompany the franchising opportunity. *Id.* Some helpful sources for franchisees include franchise directories, franchise business publications, trade shows, and other sources available on the internet. *Id.*

99. *See id.* at 26–27 (detailing the steps a franchisee must take to determine which particular franchise opportunity to pursue).

100. *Id.* at 27.

101. ATL. PUBL'G GRP., INC., THE FRANCHISE INVESTOR'S HANDBOOK: A COMPLETE GUIDE TO ALL ASPECTS OF BUYING, SELLING, OR INVESTING IN A FRANCHISE 34–35 (2006).

102. This additional analysis could include interviewing existing franchisees and reviewing complex financial statement. Emerson & Benoliel, *supra* note 20, at 26–27.

103. *Id.* at 27; *see also* Andrew A. Caffey, *Franchise Research Basics: How to Compare Similar Opportunities*, ALL BUSINESS, <http://www.allbusiness.com/franchises/buying-a-franchise/13420130-1.html#axzz2AQs9sh9i> (last visited Mar. 21, 2014) (stating that when prospective franchisees read FDDs, "they are often seized with a condition called MEGO—"My Eyes Glaze Over").

104. *See* John Kim, Frank R. Kardes & Paul M. Herr, *Consumer Expertise and the Vividness Effect: Implications For Judgment and Inference*, 18 ADVANCES CONSUMER RES. 90, 90 (1991) (explaining that novices overlook and underutilize important information because they lack the cognitive resources necessary to process a large set of information).

105. Emerson & Benoliel, *supra* note 20, at 28–29.

ownership experience, have trouble understanding and comprehending all of the information available to them, and do not consult with an attorney before entering into a franchise contract. While current regulations require franchisors to disclose large amounts of information in the FDDs to allow franchisees to make a well-informed investment decision, many franchisees do not get the assistance necessary to help them fully understand the information given to them.¹⁰⁶ Accordingly, the regulations are not serving their purpose.

B. The Profitable Business Model: Is It "Clean" or "Dirty"?

A similar attribute in many of the class action lawsuits against franchisors in the cleaning and janitorial industry is that they challenge the franchisor's business model and promotional strategies.¹⁰⁷ Many franchise companies in the United States, including Stratus, still use Jani-King's business model, which its founders developed in 1974.¹⁰⁸ The business model uses master franchisees to delegate the obligations of selling unit franchises in a particular region.¹⁰⁹ Many of the individuals that purchase these unit franchises are minorities and immigrants.¹¹⁰ Companies have used this business model for decades and every franchise sold increases the market's competitive nature.¹¹¹ The highly competitive market causes cleaning companies to make excessively low bids on accounts and give them to unit franchisees, which have a low probability of building a profitable business.¹¹²

106. See *supra* text accompanying notes 103–05 (describing franchisee' inability to full comprehend the information contained in the FDDs).

107. See discussion *supra* note 16 (identifying the issues involved in class action lawsuits against cleaning and janitorial franchisors).

108. Bennett, *supra* note 16; see also *Rivera Class Action Petition*, *supra* note 4, ¶¶ 54–62 (explaining that Stratus, as an independent entity, used the same business model as Jan-Pro).

109. Bennett, *supra* note 16.

110. *Id.* The "individuals—mostly minorities and immigrants—" purchasing the unit franchises usually pay franchise fees of up to five thousand dollars, in addition to finders' fees determined by the amount of monthly business. *Id.* As an example, a franchisee paid \$10,750 for a Coverall franchise package that provided \$1,500 worth of business each month. *Id.* The regional franchisor provided training, obtained and distributed cleaning contracts, sold the required supplies and insurance coverage and—for individuals whose native language was not English—handled the billing and collections. *Id.*

111. See *id.* (stating that in order to win contracts, companies must bid so low that a franchisee cannot make a living through their work).

112. See *id.* (describing examples of franchisees that made minimal profit from their contracts). Gerardo Vazquez purchased a Jan-Pro franchise from the San Bernardino, California office and was told that the franchise would generate \$1,600 worth of business per month. *Id.* Vazquez then stated, "But the office would underbid each contract, and no matter how hard I worked, I never made more that \$4 to \$5 an hour." *Id.* (quoted in original); see also Donald P. Horwitz & Walter M. Volpi, *Regulating the Franchise Relationship*, 54 ST. JOHN'S L. REV. 217, 266 (1980) (stating that a productive relationship

There are numerous lawsuits claiming misrepresentation and breach of contract by cleaning company franchises that use the master-franchise business model.¹¹³ At the same time, top cleaning company franchisors claim to have thousands of happy and successful unit franchisees.¹¹⁴ But when *Franchise Times* attempted to contact unit franchisees from Coverall, Jani-King, and Jan-Pro, it found only a limited number of people who were still happily working for the respective franchise.¹¹⁵ *Franchise Times* attempted to contact fifty-six unit franchisees of these franchisors, and found that only five said they were still active franchisees.¹¹⁶ The executive vice president of Jani-King, Don Burleson, indicated the company has been doing the same thing for a long time, and therefore, he does not “believe there is any merit in these lawsuits.”¹¹⁷

Franchisees of Stratus Building Solutions have also recently attacked the master-franchise business model.¹¹⁸ Dennis Jarrett and Pete Frese, who learned the effectiveness of master franchising while working at some of the largest commercial cleaning companies in United States, founded Stratus in 2004.¹¹⁹

between the franchisor and franchisee throughout the life of the franchise is critical to franchises' success); Robert T. Joseph, *Do Franchisors Owe A Duty Of Competence?* 46 BUS. LAW. 471, 471 (1991) (describing the franchisor-franchisee relationship—analogueous to a team—necessary for successful franchising).

113. Bennett, *supra* note 16. Coverall settled over 25 similar cases from 1998 to 2008 without admitting guilt, however it paid franchisees settlements up to \$450,000. *Id.* Jani-King also paid settlements to franchisees in many of their fifty-two lawsuits listed in their Franchise Disclosure Document. *Id.*

114. *See id.* (claiming that “franchisees are happy” and the franchisors have “wonderful relationships” with franchisees). Jan-Pro’s master franchisor in San Bernardino and San Jose said that their franchisees are generally happy and some franchisees have thanked him because their success enabled them to purchase their first homes. *Id.*

115. *Id.* For example, *Franchise Times* called 39 out of the 94 franchisees disclosed in the FDD of a Jan-Pro regional franchisor in California, and only three people that they spoke to were still active franchisees. *Id.* Of those three franchisees, two had been successful and the third indicated that she regretted purchasing the franchise. *Id.* Of the rest of the sample, ten numbers had been disconnected, seven numbers were unanswered, eleven did not return *Franchise Times* messages, four only spoke Spanish, and four indicated that they never made any money and left the franchise. *Id.*

116. *Id.*

117. *Id.*

118. *See* Gosdis, *supra* note 3 (describing the three class action lawsuits filed against Stratus Building Solutions).

119. Status Bldg. Solutions, *About Us*, FRANCHISE CLEANING BUSINESS, http://stratusclean.com/?page_id=188 (last visited Mar. 21, 2014). Dennis Jarrett has served as the Chief Executive Officer of Stratus Building Solutions since it was formed in 2004. *Id.* He served as President of Jan-Pro International, a national janitorial franchise company, before co-founding Stratus. *Id.* Before that, he was the Vice-President of Coverall North America, Inc., which is another janitorial franchising company. *Id.* He has been in the franchising industry for over twenty years. *Id.* Pete Frese, the other co-

Both founders are veterans in the franchising industry.¹²⁰ When approached about these allegations by Linda Wagner, a Fox News Problem Solvers reporter, Jarrett stated the lawsuit is only on behalf of a small number of people who “messed up” their accounts and “want to point the finger of accountability at someone else.”¹²¹ The class action lawsuit is pending.¹²²

Because many of the plaintiffs in these class action lawsuits are uninformed novice franchisees and/or immigrants and minorities,¹²³ the solution to this recurring problem in the cleaning and janitorial industry should focus on that class of individuals. These individuals need legislation that will better prepare them to make a well-informed decision before purchasing a cleaning or janitorial franchise. There have been too many disputes and lawsuits in this growing industry,¹²⁴ and it is time for Congress to step in and help alleviate this problem.

founder of Stratus Building Solutions, has also been in the franchising industry for over twenty years. *Id.* He has served as President and Chief Operating Officer since its formation in 2004. *Id.* Prior to co-founding Stratus, Mr. Frese was also an executive with Jan-Pro International, where one of his responsibilities was overseeing franchise development on a national level. *Id.* Before that, Mr. Frese worked for a different janitorial and cleaning franchising company, Jani-King. *Id.*

120. *Id.*

121. *Stratus Franchise Called “Pyramid Scheme” on FOX News*, UNHAPPYFRANCHISEE.COM (May 10, 2012), <http://www.unhappyfranchisee.com/stratus-franchise-pyramid-scheme>

122. *See Rivera v. Simpatico*, No. 4:12CV362 RWS. (E.D. Mo. May 15, 2012)(granting remand back to state court).

123. *See* Complaint at 1, *Mendoza v. Goldeneye Holdings, Inc.*, (Cal. Super. Ct. Jan 11, 2012) (No. 30-2012-00536505-CU-FR-CJC), *available at* <http://www.unhappyfranchisee.com/wp-content/uploads/2012/05/Goldeneye-v-Stratus.pdf> (listing the plaintiffs’ names). It can be seen that many of the plaintiffs are immigrants or minorities by looking at the names of the individuals in these class action lawsuits. For example, the named plaintiffs in one of the class action lawsuits against Stratus include: Alfred Mendoza, Delfino Morales, Heriberto Navarro, Jessica Dominguez, Cesar G. Nava, Gerardo Rodriguez Gracida, Jose Luis Ramirez Zuniga, Javier Quinto Ortiz, Fernando Quintana, Maria Ines Palacios, Fausto Palacios, Elva Perez Albor, Maria de los Angelales Piedras, Guillermo Rodriguez, Javier Rodriguez Belton, Alejandro Rojas, and many more similar names. *Id.*

124. Jan-Pro’s website states three reasons why this industry is growing:

1. “The commercial cleaning industry is viewed by many financial analysts as recession resistant and highly stable.”
2. “The franchise commercial cleaning industry is valued at nearly \$50 billion and has grown by over 66% in the past ten years.”
3. “According to the U.S. Bureau of Labor Statistics, the fastest growing occupation for the next decade is that of a professional cleaning specialist.”

Jan-Pro Franchising Int’l, Inc., *Market & Industry*, JAN-PRO, <http://www.jan-pro.com/franchising/market-industry.da> (last visited Mar. 21, 2014).

IV. PROPOSAL

Current franchise regulations do not sufficiently protect many franchisees in the commercial cleaning and janitorial industry.¹²⁵ To solve this problem, Congress must enact a federal industry-specific statute to govern franchises in the cleaning and janitorial industry.¹²⁶ The statute would be simple to enact as it would not drastically change the current requirements under the FTC Rule, and would place only two additional requirements upon franchisors in the cleaning and janitorial industry.¹²⁷ These additional requirements include the franchisor furnishing the *Buying a Janitorial Services Franchise*¹²⁸ brochure and providing translated versions of all documents to prospective non-English speaking franchisees.¹²⁹ These two additional requirements will allow franchisees in this industry to inform themselves better before investing,¹³⁰ and franchisors would mitigate many of the franchisee-lawsuits filed against them in recent years.¹³¹

125. See Bennett, *supra* note 16 (bringing to light all of the class action lawsuits filed against franchisor companies in the cleaning and janitorial industry).

126. Congress has done this before in the automobile and petroleum industries. See *Automobile Dealer Suits Against Manufacturers*, 15 U.S.C. §§ 1221–1226 (2012) (creating a cause of action for automobile dealer-franchisees against manufacturer-franchisors); *Petroleum Marketing Practices*, 15 U.S.C. §§ 2801–2841 (2012) (restricting franchisors' ability to terminate a franchise relationship).

127. The Franchisee's Cleaning Act would not change any of the regulations that already govern these franchisors, but would add two additional requirements, making it very easy to draft and put into action.

128. Council of Better Bus. Bureaus, FTC – *Buying a Janitorial Services Franchise: Making a Clean Sweep*, BBB NEWS CENTER (Aug. 1, 2001), <http://www.bbb.org/us/article/ftc—buying-a-janitorial-services-franchise-making-a-clean-sweep-4551> (displaying text of FTC brochure). This brochure informs prospective franchisees of the many risks of investing in a janitorial services franchise that a thorough review of the franchises FDDs would not present. *Id.* For example, the brochure recommends getting all promises written in the contract to protect potential franchisees from integration clauses that may alleviate the franchisor of any oral claims or promises that it may have made to the franchisee. *Id.*

129. Currently, franchisors are only required to provide FDDs written in English. The second additional requirement of the Act would compel the franchisors to provide the FDDs to the franchisee in that particular franchisees native language. This is also a simple task given translation technology readily available in today's marketplace as well as the amount of diverse individuals qualified to draft these documents.

130. The new requirements would inform the franchisees because they would have a better understanding of the franchise opportunity and the risks that accompany it.

131. The requirements would lead to fewer unsuccessful unit franchises, and therefore fewer lawsuits against the franchisor, because of the franchisees' increased awareness.

A. Franchisee's Cleaning Act

The proposed statute, The Franchisee's Cleaning Act, would require franchisors in the cleaning and janitorial industry to provide prospective franchisees with a translated version of the informational brochure, *Buying a Janitorial Services Franchise*. It will also require franchisors to provide a translated version of the FDDs already required by the FTC Rule in the native language of the prospective franchisee, if his or her native language is not English.¹³² Adding these two requirements should effectively inform prospective franchisees of the risks of investing in this type of franchise and better help franchisees to understand the information in the FDDs.

1. Why a Federal Industry-Specific Statute is Appropriate

The FTC is committed to evolving the United States federal regulation of franchising as changes in society, demographics, economics, and technology affect this component of the American economy.¹³³ Additionally, Congress should use its legislative power to benefit the franchise industry and protect American citizens. Enacting a federal and state industry-specific statute has helped solve past franchise industry controversies.¹³⁴ In 1956, Congress enacted The Automobile Dealers' Day in Court Act to help solve a disparity in bargaining power between large automobile manufactures and the individual franchisee-dealers.¹³⁵ This Act has helped resolve many disputes in the automobile franchise industry.¹³⁶

A federal industry-specific statute would also help mitigate disputes in the cleaning and janitorial franchise industry. The industry is continuously growing,¹³⁷ and that growth will likely

132. See *supra* text accompanying notes 126–27 (explaining that the Franchisee's Cleaning Act would not change the current regulations governing franchisors buy add two simple additional requirements).

133. CCH EDITORIAL STAFF, *supra* note 22, at 51.

134. See 15 U.S.C. §§ 1221–1226, 2801–2841 (2012) (illustrating industry-specific franchise laws); Emerson & Benoliel, *supra* note 20, at 6–7 (explaining that several states have enacted industry-specific franchise laws which relate to automobile dealers, alcohol beverages, farm equipment, petroleum, and office products). See also, e.g., CAL. VEH. CODE §§ 3060–3069 (Deering 2014); HAW. REV. STAT. §§ 481G-1 G-8 (2014); KAN. STAT. ANN. §§ 16-1201–1208, 41-410 (2014); N.Y. GEN. BUS. LAW §§ 199-a–n (McKinney 2014) (exemplifying industry-specific franchise laws that are already in place).

135. Rust, *supra* note 66 (explaining that if an automobile manufacturer does not act in good faith under the franchise contract, the Act allows a dealer to bring suit against that manufacturer).

136. John A. Donovan, *Federal Laws Affecting The Right Of A Franchisor To Terminate Or Not Renew A Franchise: Automobile Dealers Day In Court Act*, 49 ANTITRUST L.J. 1353, 1353 (1980) (stating that this act has been the subject of over 100 decisions).

137. JAN-PRO CLEANING SYSTEMS, *supra* note 124. Demand is expected to grow about \$15 billion over the next three years. *Id.* “That growth is predicted

lead to more disputes and lawsuits.¹³⁸ Congress should step in and help diminish the likelihood of these problems reoccurring—before it is too late to save our most vulnerable small-business owners. Enacting the Franchisee's Cleaning Act, and only imposing two additional requirements on the franchisor, provides a solution to many of this industry's problems.

2. *The Informational Brochure, Buying a Janitorial Services Franchise*

Providing an informational brochure to prospective franchisees will help franchisees to realize aspects of the franchise opportunity that may not be apparent on the face of the opportunity. The FTC and the Maryland Attorney General's Office jointly produced the *Buying a Janitorial Services Franchise* brochure in September 2001.¹³⁹ Under the Franchisee's Cleaning Act, franchisors would be required to furnish this brochure to prospective franchisees thirty days¹⁴⁰ before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or its affiliate.¹⁴¹

This provides the prospective franchisee sixteen calendar days to review the brochure and take all necessary measures to be

to come as a result of the rising pace in new business formation and expansion activity as well as new end user markets, which should spur a cyclical rebound in building construction and reduction in office vacancy rates." *Id.* The best growth opportunities will be in healthcare, education and other private facilities. *Id.*

138. As both the commercial cleaning and janitorial franchise industry and immigrant population continue to grow in the United States, the disputes in this industry will grow as well.

139. See *supra* text accompanying note 127 (explaining that the Act would not change the regulations currently in force but add two additional requirements).

140. Thirty calendar days provides the prospective franchisee with sixteen days to review the brochure and take necessary actions to prepare itself to receive the FDDs, which the franchisor must furnish fourteen days before the franchisee can enter into the franchise agreement.

141. The proposed language, "before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or its affiliate" is the same language used in the FTC Rule pertaining to the timing requirement. 16 C.F.R. § 436.2(a) (2014); see CCH EDITORIAL STAFF, *supra* note 22, at 28 (explaining the FTC's 2008 revision of the timing requirement). The original Rule required franchisors to furnish its FDDs "at the earlier of: (i) the "first personal meeting" between a franchisor and such prospective franchisee, or (ii) ten business days prior to the execution by the prospective franchisee of any franchise agreement or the payment by such prospective of any monies or other consideration to the franchisor." 16 C.F.R. §§ 436.1(a), 436.2(g) (2014). The revised Rule decided to no longer use "business days" and instead use "calendar days" because the "business days" requirement caused confusion when taking into account federal holidays that some states do not observe. See CCH EDITORIAL STAFF, *supra* note 22, at 28 (discussing change to the FTC disclosure rule and providing a section by section analysis of Part 436).

fully prepared to receive and review the FDDs, which the franchisor must furnish fourteen days before any signing or payment.¹⁴² The brochure provides an overview of the janitorial franchise industry's risks in a straightforward manner, which all prospective franchisees should be able to understand and comprehend.¹⁴³ The nineteen page brochure contains information on main issues including how janitorial services franchises work; problems the franchisee may face; an overview of the FTC's Franchise Rule; and how the franchisee should protect itself before investing.¹⁴⁴

The brochure is currently available in English and Spanish,¹⁴⁵ and under this statute, the franchisor would be obligated to provide it any other language that might be the potential franchisees primary language.¹⁴⁶ This simple addition would help ensure that prospective franchisees are prepared to review the immense amount of information that is contained in the FDDs.

3. *Breaking the Language Barrier*

"Immigration is the largest factor contributing to population growth in the U.S."¹⁴⁷ Providing a translated version of the FDDs to franchisees in the janitorial and cleaning industry will help mitigate problems that arise with non-English speaking franchisees.¹⁴⁸

The FTC Rule does not currently require franchisors to provide FDDs in a language other than English.¹⁴⁹ The FTC requires FDDs to provide prospective franchisees with all the information they need to weigh the risks and make a well-informed decision before investing in the franchise.¹⁵⁰ This is

142. 16 C.F.R. § 436.2(a) (2014).

143. *Buying a Janitorial Services Franchise*, *supra* note 128.

144. *Id.*

145. A Spanish translation of the brochure is available on Maryland's Attorney General website. *CÓMO COMPRAR UNA FRANQUICIA DE SERVICIOS DE LIMPIEZA*, <http://www.oag.state.md.us/Securities/s-janitor.pdf> (last visited Mar. 21, 2014).

146. This will ensure that franchisees can clearly understand the contents of the brochure, despite the franchisees native language.

147. Fred Elbel, *U.S. Immigration, Population Growth, and the Environment*, <http://www.susps.org/overview/immigration.html> (last visited Mar. 21, 2014) (stating immigration contributes over 2.25 million people to the U.S. population annually).

148. See generally JULIE BENNETT & CHERYL R. BABCOCK, *FRANCHISE TIMES GUIDE TO SELECTING, BUYING & OWNING A FRANCHISE* 266 (Sterling Publ'n Co. Inc., 2008) (stating that "minorities, especially new immigrants, are opening new business at five times the rate of the majority population").

149. 16 C.F.R. §§ 436.1(d), 436.3(e)(2), 436.6(b) (2014). There is no requirement to provide FDDs in another language than English in the current statute.

150. See discussion *supra* Part III.A.1 (discussing franchisors' stance on additional regulations).

problematic in the cleaning and janitorial industry because many of the franchisees investing in these types of franchises are not primarily English-speaking individuals.¹⁵¹ The translated FDDs will make it less difficult for these prospective franchisees to understand the information contained in the FDDs. This will help the franchisee weigh the risks to make a well-informed decision.

B. Enacting the Franchisee's Cleaning Act Benefits Both the Franchisors and the Franchisees

The Franchisee's Cleaning Act will provide a benefit to both the franchisors and franchisees of the cleaning and janitorial industry.¹⁵² It will help the franchisors mitigate the risks of franchisees' future lawsuits.¹⁵³ By providing the franchisees with the *Buying a Janitorial Services Franchise* brochure and translated FDDs, franchisors will better protect themselves against allegations of fraud and coercion.¹⁵⁴ These additional requirements will allow franchisees to better understand and comprehend the risks of investing in cleaning and janitorial franchise opportunities, especially regarding franchisees who speak limited or no English. This will lead to less confusion on the franchisees' part, and therefore, fewer lawsuits against the franchisors. Although this may decrease the number of prospective franchisees who end up deciding to purchase a janitorial or cleaning franchise,¹⁵⁵ it will also "screen out" the franchisees that are likely to be unsuccessful and lead to fewer unhappy franchisees and, therefore, fewer lawsuits.

151. See *supra* text accompanying note 88 (indicating that some franchisors provide a list of factors to potential franchisees when investigating a site); see also *Buying a Janitorial Services Franchise*, *supra* note 128 (recognizing that the FTC and the Maryland Attorney General's Office state that buying janitorial services franchise appeals to immigrants and others who speak limited English).

152. See *supra* text accompanying notes 129–30 (explaining that the second requirement of the Act would mandate franchisors to provide the FDDs to the franchisee in that particular franchisee's native language, so the franchisee can understand the franchise opportunity better).

153. See *supra* text accompanying note 130 (asserting that requiring the franchisor to provide the FDD to the franchisee in his or her native language would better inform the franchisee of the franchise opportunity and risks that accompany it).

154. Many of the lawsuits against franchisors allege that the franchisors coerced the plaintiffs to sign the franchise agreements in English. Complaint at 4, *Mendoza v. Goldeneye Holdings, Inc. dba Stratus Building Solutions of Orange*, (Cal. Super. Ct. Jan 11, 2012), (No. 30-2012-00536505-CU-FR-CJC) available at <http://www.unhappyfranchisee.com/wp-content/uploads/2012/05/Goldeneye-v-Stratus.pdf>.

155. Assuming that if the risks of the franchise opportunity were clearer to prospective franchisees, individuals who would have purchased a franchise before knowing these risks might decide to forego the opportunity.

V. CONCLUSION

It is an apparent problem that the current franchise regulations do not serve their stated purpose of sufficiently informing franchisees in the cleaning and janitorial industry. The Franchisee's Cleaning Act provides a solution to this alarming problem. The Franchise Cleaning Act will better inform franchisees of the risks of the cleaning franchise opportunity and lead to fewer lawsuits against the franchisors. This in turn will reduce cleaning franchisors' exploitation of uninformed franchisees chasing the American dream. The Franchisee's Cleaning Act may serve to save a highly controversial industry in the United States.

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