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The Federal Trade Commission Franchise Disclosure Rule, 13 J. Marshall L. Rev. 637 (1980)

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THE FEDERAL TRADE COMMISSION FRANCHISE DISCLOSURE RULE*

INTRODUCTION

Franchising in the United States is a growing business activity, "probably the only form of business entity that, by its very nature, contributes to the creation of new business units."¹ It was estimated that franchising would account for thirty-one percent of retail sales in 1979.² Total sales by franchised businesses were \$116 billion in 1969;³ by 1979 total sales had grown to almost \$300 billion.⁴

In 1971, the Federal Trade Commission (FTC) began an investigation into practices used in the sale of prospective franchise schemes.⁵ The FTC's investigation was prompted by its determination that "the general nature of the 'franchise relationship' results in a serious informational imbalance between prospective franchisees and their franchisors."⁶ On December

* The authors gratefully acknowledge the assistance of Mr. John R.F. Baer.

1. U.S. DEP'T OF COMMERCE, *FRANCHISING IN THE ECONOMY* 1 (Jan., 1979) [hereinafter cited as *FRANCHISING IN THE ECONOMY*].

Franchising is one of the hottest segments of the U.S. economy. Well-heralded rags to riches stories have come out of this particular way of marketing in which a parent company relies on a network of outlets owned by small business operators to sell its brand of products or services.

CHANGING TIMES 21 (July, 1979).

2. *FRANCHISING IN THE ECONOMY*, *supra* note 1, at 12 chart 3.

3. *Id.* at 35, table 4.

4. *Id.* at 34, table 3.

5. See generally *Hearings on Review of Federal Trade Comm'n Franchise Disclosure Rule before the Senate Comm. on Small Business* (July 17, 1979) [hereinafter cited as *Senate Hearing*] (Opening Statement of Senator Gaylord Nelson, Chairman).

6. Brief of Federal Trade Comm'n at 6, *Shell Oil Co. v. Federal Trade Comm'n*, No. 79-7076 (9th Cir. 1979) [hereinafter cited as *FTC Opposition Motion*] (Opposition to Emergency Motion for a Stay of the Effective Date of the Franchise Disclosure Rule) (citing 43 Fed. Reg. 59,697, 59,699 (1978)) (Petitioners include Shell Oil Co., Atlantic Richfield Co., Union Oil Co. of California, Exxon Corp., Mobil Oil Corp., Phillips Petroleum Co., Standard Oil Co. (Indiana), Chevron U.S.A., Inc., Chevron Chemical Co., Gulf Oil Corp., Getty Refining and Marketing Co., and Kerr-McGee Refining Corp.; Ashland Oil is an intervenor).

"The record demonstrates that many franchisors, (*sic*) find it in their interest to misrepresent or not fully disclose material information needed by the prospective franchisee." *Id.* at 7 (citing 43 Fed. Reg. 59,699 (1978)).

Many investors in franchises have indeed succeeded beyond their wildest dreams. Many more have done well, though not without invest-

21, 1978,⁷ the investigation resulted in promulgation of a final trade regulation rule which was originally scheduled to become effective on July 21, 1979, but was postponed until October 21, 1979. The Rule, "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,"⁸ has the force and effect of law.⁹ Claiming to have discovered "widespread consumer injury due to lack of information and misrepresentations in the sale of franchises,"¹⁰ the FTC took the position that "[t]he evidence of abuses contained in the [rulemaking] record documents the need for protection of prospective franchisees"¹¹ through the use of an appropriate disclosure document prior to the inception of the franchise relationship.

Franchising

The franchise system provides unique advantages to both franchisor and franchisee.¹² It is a means by which the franchisor "can expand into the distribution function, while avoiding the large-scale capital requirements demanded by the more traditional techniques of expansion such as the integrated

ing a hefty amount of time and hard work in addition to dollars. But for another group of investors, the dream has proved to be a nightmare.

Some have seen their businesses collapse because the franchise company was poorly run. Some gambled on a franchised product or service that simply failed to appeal to customers. Others have met financial ruin in deals concocted by swindlers who used the alluring word *franchise* to rope them into rip-off schemes.

CHANGING TIMES 21 (July, 1979).

7. "The Commission first proposed a franchise rule on November 11, 1971. Public hearings were conducted in 1972. On August 22, 1974, a revised proposed rule was published. Comments on the revised proposed rule were accepted until November 20, 1974, on which date the Commission contends the public record was closed." Brief of Schwinn Bicycle Co. at 13, Schwinn Bicycle Co. v. Federal Trade Comm'n, No. 79-7172 (9th Cir. 1979) [hereinafter cited as Schwinn Brief] (Memorandum of Law in Support of Schwinn Bicycle Co.'s Emergency Motion for a Stay of the Effective Date of the Trade Regulation Rule on Franchising Pending Judicial Review) (footnotes omitted).

Along with the Rule (43 Fed. Reg. 59,614-59,621) the Commission also published a Statement of Basis and Purpose (43 Fed. Reg. 59,621-59,733) and Proposed Guides (43 Fed. Reg. 59,733-59,753). On July 25, 1979, the Commission released revised Guides, 44 Fed. Reg. 49,965 (1979).

8. 16 C.F.R. § 436.1 *et seq.* (1979) [hereinafter referred to as the Rule].

9. *Senate Hearing, supra* note 5 (Opening Statement of Senator Gaylord Nelson, Chairman, at 2).

10. Federal Trade Comm'n News Release (Dec. 21, 1978) at 1 [hereinafter cited as FTC News].

11. FTC Opposition Motion, *supra* note 6, at 19.

12. Caine, *Termination of Franchise Agreements: Some Remedies for Franchisees under the Uniform Commercial Code*, 3 CUM.-SAM. L. REV. 347, 348 (1972) [hereinafter cited as Caine].

chain. . . ."¹³ At the same time, the system "provides the opportunity for a [franchisee] with little capital and little or no experience to operate his own business with a reasonable chance of success."¹⁴ It gives a franchisee a competitive advantage over other small business entrepreneurs,¹⁵ because a franchisee may have the use of trade names, marketing expertise, financial assistance, a distinctive business format, standardization of products and services, advertising, and training from the parent organization.¹⁶

Franchising involves distribution of goods or services through selected outlets.¹⁷ The definition of "franchise" which the FTC chose to use in the Rule is a list of characteristics which can make a continuing commercial relationship into a franchise.¹⁸ The FTC's definition covers both product and pack-

13. *Id.* (citing Professor Jerome Shuman, "[f]ranchising is the natural outgrowth of technological evolution").

14. *Id.*

15. FRANCHISING IN THE ECONOMY, *supra* note 1, at 1.

16. *Id.*

17. 44 Fed. Reg. 49,965 (1979).

18. (a) The term "franchise" means any continuing commercial relationship created by any arrangement or arrangements whereby:

(1)(i)(A) a person (hereinafter "franchisee") offers, sells, or distributes to any person other than a "franchisor" . . . goods, commodities, or services which are:

(1) Identified by a trademark, service mark, trade name, advertising or other commercial symbol designating another person (hereinafter "franchisor"); or

(2) Indirectly or directly required or advised to meet the quality standards prescribed by another person (hereinafter "franchisor") where the franchisee operates under a name using the trademark, service mark, trade name, advertising or other commercial symbol designating the franchisor; and

(B)(1) The franchisor exerts or has authority to exert a significant degree of control over the franchisee's method of operation, including, but not limited to, the franchisee's business organization, promotional activities, management, marketing plan or business affairs; or

(2) The franchisor gives significant assistance to the franchisee in the latter's method of operation, including, but not limited to, the franchisee's business organization, management, marketing plan, promotional activities, or business affairs; *Provided, however,* That assistance in the franchisee's promotional activities shall not, in the absence of assistance in other areas of the franchisee's method of operation, constitute significant assistance; or

(ii)(A) A person (hereinafter "franchisee") offers, sells, or distributes to any person other than a "franchisor" . . . goods, commodities, or services which are:

(1) Supplied by another person (hereinafter "franchisor"), or

(2) Supplied by a third person . . . with whom the franchisee is directly or indirectly required to do business by another person (hereinafter "franchisor"); or

(3) Supplied by a third person . . . with whom the franchisee is directly or indirectly advised to do business by another person (herein-

age franchises, as well as business opportunity schemes, in the same regulation.¹⁹ It is unique, and differs from pre-existing state franchising statutes, which emphasize as elements a continuing commercial relationship, granting of the franchisor's property rights to the franchisee, and "retention of control by the franchisor over the franchisee in the conduct of the business."²⁰

The FTC's definition of "franchise" in its consumer bulletin "Franchise Business Risks"²¹ is more succinct and understandable: "A system used by a company . . . which grants to others . . . the right and license to market a product or service and engage in a business developed by it under franchisor's trade names, trademarks, service marks, know-how and method of doing business."²²

Because franchising is a method of distribution, not an industry,²³ the basic difficulty in attempting to regulate franchising is the problem of defining a franchise in such a way that all

after "franchisor") where such third person is affiliated with the franchisor; and

(B) The franchisor:

(1) Secures for the franchisee retail outlets or accounts for said goods, commodities, or services; or

(2) Secures for the franchisee locations or sites for vending machines, rack displays, or any other product sales display used by the franchisee in the offering, sale, or distribution of said goods, commodities, or services; or

(3) Provides to the franchisee the services of a person able to secure the retail outlets, accounts, sites or locations referred to in paragraph (a)(1)(ii)(B)(1) and (2) above; and

(2) The franchisee is required as a condition of obtaining or commencing the franchise operation to make a payment or a commitment to pay to the franchisor, or to a person affiliated with the franchisor.

16 C.F.R. § 436.2.

The first alternative definition [(a)(1)(i)(A) and (B)] covers so-called product and package franchises. The second alternative definition [(a)(1)(ii)(A) and (B)] covers so-called business opportunity schemes. The last element [(a)(2)] applies to both types of franchise.

19. *Id.*

20. Comment, *Franchises: Compelling Full Disclosure in Franchise Agreements*, 5 CUM.-SAM. L. REV. 501, 502 (1975) [hereinafter cited as CUMBERLAND-SAMFORD] (referring to ARK. STAT. ANN. § 70-801(a) (Supp. 1973) & CONN. GEN. STAT. ANN. § 42-133e(b) (West 1973)).

21. FEDERAL TRADE COMM'N, FRANCHISE BUSINESS RISKS, Consumer Bulletin No. 4 [hereinafter cited as BUSINESS RISKS].

22. *Id.*

23. See generally FTC Opposition Motion, *supra* note 6; Letter of Charles W. Walton, Vice President-General Counsel and Secretary of Koehring Co. to FTC (Feb. 13, 1979) [hereinafter cited as Koehring comment] (submitted pursuant to FTC request for comments concerning Proposed Guides); Letter from Irene E. Bialas on behalf of Rexnord, Inc. to FTC (Feb. 16, 1979) [hereinafter cited as Rexnord comment]; FRANCHISING IN THE ECONOMY, *supra* note 1.

genuine franchises are regulated without burdening similar nonfranchise business forms.²⁴ "The franchise relationship has characteristics associated with the legal relationships of agency, employment, and independent contracting. Yet because it fits so badly into any of these traditional classifications, franchising has generally been considered *sui generis*."²⁵

The traditional types of franchising, known as product and trade name franchising, consist of product distribution arrangements in which the franchisee is identified with the manufacturer's supplies. Typical of this type are automobile dealerships and soft drink bottlers. Business format franchising is a newer type of franchising in which a franchisor "establishes a fully integrated relationship that includes not only product, service, and trademark but also a marketing strategy and plan, operating manuals and standards, quality control, and a communications system that provides for information feed-forward and feedback. . . ."²⁶ Examples of this form of business are fast food restaurants, many types of non-food retailing, lodging, personal and business services, and real estate services.²⁷

24. Fern, *The Overbroad Scope of Franchise Regulation: A Definitional Dilemma*, 34 BUS. LAW. 1387, 1388 (Apr., 1979) [hereinafter cited as Fern].

25. 59 MINN. L. REV. 1027, 1029 (1975) (referring to D. Thompson, FRANCHISE OPERATIONS AND ANTITRUST, 6 (1971)).

26. FRANCHISING IN THE ECONOMY, *supra* note 1, at 3.

27.

RANKING OF KINDS OF FRANCHISING BY SALES: 1977

Kinds of Franchised Business	Sales (\$000)	Number of Establishments
TOTAL - ALL FRANCHISING	253,374,669	450,800
Automobile and Truck Dealers	132,041,000	31,680
Gasoline Service Stations	56,538,000	176,450
Fast Food Restaurants (All Types)	18,180,404	51,972
Retailing (Non-Food)	10,329,838	41,760
Soft Drink Bottlers	9,046,000	2,146
Automotive Products and Services	6,515,321	48,718
Hotels and Motels	5,148,863	5,186
Convenience Stores	4,319,743	14,144
Business Aids and Services	3,388,914	32,227
Retailing (Food Other Than Convenience Stores)	3,231,446	13,299
Rental Services (Auto-Truck)	2,105,809	6,888
Construction, Home Improvement, Maintenance and Cleaning Services	1,090,737	13,093
Recreation, Entertainment and Travel	239,644	4,242
Educational Products and Services	233,440	1,878
Laundry and Drycleaning Services	229,237	2,769
Rental Services (Equipment)	192,219	1,421
Campgrounds	108,892	1,057
Miscellaneous	435,162	1,870

FRANCHISING IN THE ECONOMY, *supra* note 1, at 49 (footnotes omitted).

Beginning in the 1950's, franchising, an old idea with limited application, caught on and expanded rapidly in many directions.²⁸ Along with reputable businessmen, this rapid growth has attracted many unprincipled operators who try to take advantage of anyone they can.²⁹ In 1971, California became the first state to enact a franchise disclosure law³⁰ to control entrepreneurs of dubious integrity and promoters of under-capitalized ventures.³¹ In 1978, the California Commissioner³² advocated the need for a stricter disclosure law:³³

[M]any prospective franchisees, enamored with [*sic*] the idea of running their own business(es), may not be capable of recognizing the long range onerous effects of certain contractual terms. Even if a prospect has the ability to recognize such terms, he is usually powerless to modify the agreement. The inferior bargaining position of the prospective franchisee generally leaves no meaningful choice other than to accept the agreement as drafted by the franchisor or forego the investment.³⁴

After the franchise relationship has begun, the franchisee may experience other problems. If he quits a losing business, "he not only loses his investment, but also is barred from the business by the covenant not to compete."³⁵ Furthermore, litigation is often painfully slow, and franchising has grown so quickly that a corresponding body of case law has not yet developed.³⁶

28. *Id.* at 20.

29. BUSINESS RISKS, *supra* note 21.

30. To date, fourteen states have enacted franchise disclosure laws adopting the Uniform Franchise Offering Circular (UFOC). The UFOC is a system of uniform compliance procedures established by the International Franchise Association (IFA)—the trade association of franchisors. The IFA was formed in 1960 to serve as an advocate for the franchise method of doing business. Membership today has grown to encompass nearly 380 franchising companies who are engaged in business in three dozen different industries. *See* note 130 *infra*.

31. "Fraud isn't the only thing to worry about in scouting for a franchise business investment. Money can be lost just as surely in a venture that is not financially sound." CHANGING TIMES, *supra* note 1, at 22.

32. The Commissioner heads the California Department of Corporations, the agency that administers the California Investment Law.

33. "This new form of regulation is derived from state securities ("blue sky") laws and is commonly referred to as the 'fair, just and equitable' test or standard. It would extend significantly the reach of a state's regulatory arm into the substantive provisions of the franchise agreement." FRANCHISING IN THE ECONOMY, *supra* note 1, at 21.

34. *Id.* at 22-23.

35. H. BROWN, FRANCHISING REALITIES AND REMEDIES 158 (1978) [hereinafter cited as H. BROWN].

36. *Id.*

The Rule's Definition of Franchisor

There are three elements in the FTC's definition, all of which must be present to have a "franchise." First, the FTC defines the franchisor as the member of the business relationship who provides goods or services for distribution, which are identified with him by a trademark, service mark, or other commercial symbol,³⁷ or who prescribes quality standards to be met by the franchisee.³⁸

"[T]he distinguishing characteristic of franchising is that the manufacturer's trademark is used to such an extent that there is commonality of identity between the manufacturer and the dealer."³⁹ It has been suggested that this commonality has been used "to deceive the potential customer of the franchisee as to the identity of the person with whom he is dealing."⁴⁰ A more moderate view of the characteristic use of the franchisor's trademark is that it makes the franchisees' businesses appear to be part of an integrated chain.⁴¹

Second, the franchisor must exert a "significant degree of control over"⁴² or give "significant assistance"⁴³ in the franchisee's method of doing business. "Control is a vital ingredient of successful franchising⁴⁴ because the entire franchise system

37. 16 C.F.R. § 436.2(a)(1)(i)(A)(1) (1979).

38. *Id.* § 436.2(a)(1)(i)(A)(2).

39. Koehring comment, *supra* note 23.

40. Rockefeller, *Franchising and Antitrust Laws*, 56 CHI. B. REC. 44, 45 (July-Aug. 1974). The author offers in support of his theory the example of McDonald's:

[O]ne sees signs at McDonald's drive-ins claiming so many billion hamburgers sold. The notion conveyed to the potential customer is that here is a location at which he can buy a hamburger from a thrifty Scotchman who started a single hamburger stand and built it into an empire of 2,500 locations at which billions have been sold, when the truth is that the seller at that location is not named McDonald and is not even named Kroc and never sold that many hamburgers. . . . Thus is [*sic*] seems the principle objective of "franchising," in defining the term, is consumer deception. There is also a secondary purpose in every franchise relationship, as many use the term, and that is to restrain trade and eliminate competition between franchisees.

Id.

41. Comment, *Franchising and the Antitrust Laws: An Overview*, 41 TENN. L. REV. 535 (1974) [hereinafter cited as TENN. L. REV.].

42. 16 C.F.R. § 436.2(a)(1)(i)(B)(1) (1979).

43. *Id.* § 436.2(a)(1)(i)(B)(2).

44. The essence of any franchise system is the establishment of

is dependent upon the goodwill of the franchisor's trademark. If one franchisee is permitted to vary from uniform procedures and quality standards, the public image of the entire system is jeopardized."⁴⁵

With regard to business opportunity ventures,⁴⁶ if he does not provide significant control or assistance, the franchisor may supply the goods or services to the franchisee,⁴⁷ or require him to do business with another supplier.⁴⁸ Furthermore, the franchisor secures for the franchisee retail outlets or accounts,⁴⁹ or locations for sales display.⁵⁰

Finally, the franchisor requires a payment as a condition for granting the franchise operation.⁵¹ The definition of "franchise fee" has been a major issue in disputes over the scope of the Rule.⁵²

The FTC's Rulemaking Authority

In 1914, the Wilson Administration's plan for a trade commission was introduced in Congress.⁵³ The Covington bill debates included arguments that the new commission should be given only adjudicatory powers, and that it should have a combination of adjudicatory and substantive rulemaking powers.⁵⁴ Because the enacting law and legislative history were not clear, it was not known whether this language gave the Federal Trade

quasi-independent businessmen subject to various controls respecting their business operations, the nature of which depends in part on the philosophy of the franchisor and on the nature of the products and services franchised. However, some form of control over the franchisee is an essential ingredient of the franchise system.

15 Business Organizations, Glickman, FRANCHISING, § 201 n. 5 (quoting Report of Ad Hoc Committee on Franchising submitted to the FTC by its staff on June 2, 1969 and announced by the FTC on Dec. 10, 1969, in turn quoting FTC Memorandum to SBA 4 (Mar. 10, 1966)).

45. TENN. L. REV., *supra* note 41, at 536 n. 5 (referring to Garlick, *Pure Franchising, Control and the Antitrust Laws: Friends or Foes?* 48 J. URB. L. 835, 839-42 (1971)).

46. *See* notes 18-19 and accompanying text *supra*.

47. 16 C.F.R. § 436.2(a)(1)(ii)(A)(1) (1979).

48. *Id.* § 436.2(a)(1)(ii)(A)(2).

49. *Id.* § 436.2(a)(1)(ii)(B)(1).

50. *Id.* § 436.2(a)(1)(ii)(B)(2).

51. *Id.* § 436.2(a)(2).

52. *See* notes 125-38 and accompanying text *infra*.

53. National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672, 698 app. (D.C. Cir. 1973).

54. *Id.* at 700.

Commission⁵⁵ the power to make industry-wide regulatory rules.⁵⁶

This uncertainty was addressed and finally resolved in 1973 by Judge Skelly Wright of the District of Columbia Circuit Court of Appeals in *National Petroleum Refiners Association v. Federal Trade Commission*.⁵⁷ The FTC Act as finally adopted on September 26, 1914 declares "unfair or deceptive acts or practices" to be unlawful.⁵⁸ At issue in *National Petroleum* was whether the FTC could declare a practice unfair or deceptive through rulemaking as well as through case-by-case adjudication.⁵⁹ The court of appeals held that the FTC has authority to promulgate trade regulation rules which have the effect of substantive law.⁶⁰ The court noted the "judicial trend favoring rulemaking over adjudication for development of new agency policy"⁶¹ to support its opinion. The court felt that "contemporary considerations of practicality and fairness"⁶² support recognition of the Commission's authority to impose bright line standards of behavior.⁶³ Judge Wright was "confident that if Congress believes that its creature, the Commission, thus exercises too much power, it will repeal the grant."⁶⁴

Far from repealing the grant of authority, Congress ratified it⁶⁵ in the Magnuson-Moss Warranty—Federal Trade Commis-

55. Federal Trade Commission, Promotion of Export Trade and Prevention of Unfair Methods of Competition, 15 U.S.C. § 41 *et seq.* (1976).

56. "Our conclusion as to the scope of § 6(g) [the FTC rulemaking section] is not disturbed by the fact that the agency itself did not assert the power to promulgate substantive rules until 1962 and indeed indicated intermittently before that time that it lacked such power." *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 693 (D.C. Cir. 1973).

The Commission first announced it would enforce the provisions of the deceptive practices section of the FTC Act (§ 5), with the assistance of substantive rules, in 1962 when it amended its Rules of Practice to provide for issuance of Trade Regulation Rules. 27 Fed. Reg. 4636, 4796 (1962).

57. 482 F.2d 672 (D.C. Cir. 1973) (at issue was the Commission's power to promulgate a substantive rule declaring that failure to post octane ratings on service station pumps was a deceptive practice).

58. 15 U.S.C. § 45(a)(1) (1964).

59. *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d at 686.

60. *Id.* at 698.

61. *Id.* at 683.

62. *Id.*

63. *Id.*

64. *Id.* at 697.

65. Senator Magnuson pointed out, "For years the argument has been going on about the Federal Trade Commission not having the authority it should have. We tried to fashion a bill. I, myself, had some doubts about the rulemaking authority, but I think the bill covers it very well." 117 CONG. REC. S. 17,858 (1971).

sion Improvement Act of 1975.⁶⁶ Magnuson-Moss permits the FTC to prescribe "interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices in or affecting commerce"⁶⁷ and "rules which define with specificity acts or practices which are unfair or deceptive. . . ."⁶⁸

Magnuson-Moss states that in prescribing a rule the Commission should follow section 553 of the Administrative Procedure Act (APA),⁶⁹ which states the procedures for informal rulemaking by a federal agency.⁷⁰ In addition to the APA requirements, Magnuson-Moss mandates some trial-type features, such as oral submissions, rebuttal testimony, and cross-examination.⁷¹

Finally, Magnuson-Moss is a proscription of rulemaking under any other authority.⁷² However, the amendments made by Magnuson-Moss are not to apply to any rule promulgated prior to Magnuson-Moss's enactment. Any proposed rule which

66. Pub. L. No. 93-637, 88 Stat. 2183 [hereinafter referred to as Magnuson-Moss].

67. Pub. L. No. 93-637, 88 Stat. 2183 Title II § 202(a) (amending 15 U.S.C. § 18 (a)(1)(A)).

68. *Id.* § 202(a)(1) (amending 15 U.S.C. § 57a, § 18(a)-(1)(B)).

69. 5 U.S.C. § 553 provides in part:

(b) General notice of proposed rule making shall be published in the Federal Register. . . .

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.

70. Pub. L. No. 93-637, 88 Stat. 2183 Title II § 202(a) (amending 15 U.S.C. § 57a, § 18(b)).

71. When prescribing a rule under subsection (a)(1)(B) of this section, the Commission shall proceed in accordance with section 553 of title 5, United States Code . . . and shall also (1) publish a notice of proposed rulemaking stating with particularity the reason for the proposed rule; (2) allow interested persons to submit written data, views, and arguments, and make all such submissions publicly available; (3) provide an opportunity for an informal hearing in accordance with subsection (c); and (4) promulgate, if appropriate, a final rule based on the matter in the rulemaking record. . . . together with a statement of basis and purpose.

Pub. L. No. 93-637, 88 Stat. 2183 Title § 202(a) (amending 15 U.S.C. § 57a, § 18(b)).

72. (2) The Commission shall have no authority under this Act, other than its authority under this section, to prescribe any rule with respect to unfair or deceptive acts or practices in or affecting commerce. . . . The preceding sentence shall not affect any authority of the Commission to prescribe rules (including interpretive rules), and general statements of policy, with respect to unfair methods of competition in or affecting commerce.

Id. § 202(a) (amending 15 U.S.C. § 18(a)(2)).

was substantially completed before that date is valid under Magnuson-Moss's grandfather clause.⁷³

The FTC Act's declaration that "unfair or deceptive acts or practices" are unlawful⁷⁴ was the basis on which the FTC asserted jurisdiction to regulate franchising. "In the past, this standard [was] employed primarily against deceptive advertising of products and services. Recently it has been evoked in franchising situations, with particular emphasis on deceptive advertising in the sale of franchises."⁷⁵

Prior to the promulgation of the Rule, the FTC had received complaints from franchisees "alleging a wide range of abuses associated with a variety of franchise and business opportunity offerings."⁷⁶ On a case-by-case basis, the Commission adjudicated such complaints: a franchisor of drive-in restaurants was ordered to cease using exaggerated earning claims and deceptive offers of training and advertising to promote the sale of its franchises;⁷⁷ a franchisor of personal improvement courses was ordered to cease misrepresenting that its products would be easy to sell.⁷⁸ While each complaint was thus resolved, "the Commission's individual case-by-case approach had not been sufficient to curb the abuses it found within the industry."⁷⁹ The goal of a bright line rule is solving this problem by "shortening

73. (c)(1) The amendments made by subsections (a) and (b) of this section shall not affect the validity of any rule which was promulgated under section 6(g) of the Federal Trade Commission Act prior to the date of enactment of this section. Any proposed rule under section 6(g) of such Act with respect to which presentation of data, views, and arguments was substantially completed before such date may be promulgated in the same manner and with the same validity as such rule could have been promulgated had this section not been enacted.

Id. § 202(c)(1) (adding 15 U.S.C. § 57a note).

74. See note 58 and accompanying text *supra*.

75. H. BROWN, *supra* note 35, at 159.

76. Memo from Edward W. Colbert (Feb. 4, 1975) (intraoffice FTC memo available from FTC by F.O.I.A. procedures).

77. *In re Meal or Snack System, Inc.*, 75 F.T.C. 497 (1969).

78. *In re Success Motivation Inst., Inc.*, 77 F.T.C. 943 (1970).

In *In re Redi-Brew Corp.*, 83 F.T.C. 1346 (1974), the FTC ordered a franchisor of vending machines to cease misrepresenting the quality of its machines, its affiliation with the Coca-Cola Co., its services, and its business activities.

In *In re Consolidated Chemical Corp.*, 84 F.T.C. 479 (1974), the FTC ordered a franchisor of vending machines to cease misrepresenting the nature and security of its franchises or distributorships. The franchisor was required to furnish a prospective franchisee with details of the franchise operation in writing at the first contact, and allow a ten-day cooling-off period to cancel the contract with full refund rights.

Note that both of these cases concerned business opportunity ventures.

79. Goldberg, *Federal Regulation of Franchises: The Federal Trade Comm'n Rule*, 59 CHI. B. REC. 338 (May-June 1978).

and simplifying the adjudicative process and . . . clarifying the law in advance."⁸⁰

THE RULE⁸¹

"The Franchise Rule was promulgated on December 21, 1978, pursuant to the Commission's rulemaking authority under section 18 of the FTC Act, as amended by . . . Magnuson-Moss . . ."⁸² It became effective October 21, 1979.⁸³ Revised Guides for compliance with the Rule were approved by the Commission on July 25, 1979.

"The Rule is designed to provide disclosure—not regulation of the business."⁸⁴ According to the FTC, the Rule was promulgated because the Commission found "widespread" evidence of deceptive and unfair practices in connection with the sale of franchises.⁸⁵ The intended benefit of the Rule is "to furnish prospective franchisees with essential and reliable information about the franchisor, the franchise business and the terms of the franchise agreement. These benefits will be accomplished by means of a disclosure statement containing the information necessary to make an informed investment decision"⁸⁶ which will

80. *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 679 (D.C. Cir. 1973) (quoting Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 HARV. L. REV. 921, 962 (1965)).

81. See notes 7-9 and accompanying text *supra*.

82. FTC Opposition Motion, *supra* note 6, at 5. The FTC further stated that "[t]he Rule serves the public interest by preventing both material misrepresentation and nondisclosure of material facts in connection with the marketing of franchises."

83. The Rule was originally scheduled to become effective July 21, 1979.

84. *Senate Hearing*, *supra* note 5, at 2 (Opening Statement of Senator Nelson).

85. *Id.* (Statement of Albert H. Kramer, Director, Bureau of Consumer Protection, FTC).

The Commission's Statement of Basis and Purpose accompanying the rule identifies certain factors which have often been present in the sale of those businesses and which have helped to create conditions under which consumer abuses occur. Among the major factors have been:

1. A serious informational imbalance between the franchisor and the prospective franchisee, which has meant that the franchisee often is unaware of relevant and essential facts germane to the proposed investment;
2. The prospective franchisee's relative lack of business sophistication;
3. The complexity of the proposed franchise agreements; and
4. The lack of adequate review time for franchisees prior to the establishment of a franchise relationship.

Id. at 1-2.

86. FTC Opposition Motion, *supra* note 6, at 25.

decrease the "potential for misrepresentation and unfairness which often accompanies a lack of information."⁸⁷

The Guides list as deceptive practices which violate the Rule: failure to furnish the franchisee with the Basic Disclosure Document;⁸⁸ making representations about sales or profits in a way other than as prescribed by the Rule; making claims inconsistent with the information required by the Rule; failure to furnish copies of the franchisor's standard franchise agreements; and failure to return deposits.⁸⁹ "Violators are subject to civil penalty actions brought by the Commission of up to \$10,000 per violation."⁹⁰

The franchisor is required to provide the prospective franchisee with the disclosure statement at their first meeting or ten days before they enter a contract, whichever is earlier.⁹¹ The disclosure statement must have a cover sheet giving the name of the franchisor and a statement warning the franchisee to read the information provided.⁹² The Basic Disclosure Document re-

87. *Id.*

88. See note 91 and accompanying text *infra*.

89. 44 Fed. Reg. 49,971 (1979).

It is an unfair or deceptive act or practice within the meaning of § 5 of the Federal Trade Commission Act for any franchisor or franchise broker:

1. to fail to furnish prospective franchisees with the Basic Disclosure Document in the manner and within the time frames established in the rule [§ 436.1(a)];

2. to make any representations about the actual or potential sales, income, or profits of existing or prospective franchises except in the manner and within the time frames established by the rule, including dissemination of the Earnings Claim Document [§ 436.1(b)-(e)];

3. to make any claim or representation (such as in advertising or oral statements by sales-persons) which is inconsistent with the information required to be disclosed by the rule [§ 436.1(f)];

4. to fail to furnish prospective franchisees, within the time frames established by the rule, with copies of the franchisor's standard forms of franchise agreements and copies of the final agreements to be signed by the parties [§ 436.1(g)]; and

5. to fail to return to prospective franchisees any funds or deposits (such as down payments) identified as refundable in the Basic Disclosure Document [§ 436.1(h)].

90. *Id.*

91. "The term 'time for making of disclosures' means ten (10) business days prior to (1) the execution by the franchisee of any franchise agreement . . . or (2) the payment by a prospective franchisee about which the franchisor . . . knows or should know, of any consideration in connection with the sale or proposed sale of a franchise."

16 C.F.R. § 436.2(g).

92. To protect you, we've required your franchisor to give you this information. *We haven't checked it, and don't know if it's correct.* It should help you make up your mind. Study it carefully. While it includes some information about your contract, don't rely on it alone to understand your contract. Read all of your contract carefully. Buying a

quires that the prospective franchisee be provided with twenty categories of information about the franchisor and his business.⁹³

Rationale of the Rule

The Rule "is designed to provide prospective investors with information which the FTC believes is necessary to make an informed investment decision."⁹⁴ Since the abuses to which the Rule is addressed stem from the nature of the franchise relationship, the FTC feels that a general regulation for all types of franchises is therefore justified.⁹⁵ Not surprisingly, franchisors

franchise is a complicated investment. Take your time to decide. If possible, show your contract and this information to an advisor, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, you should let us know about it. It may be against the law.

44 Fed. Reg. 49,987 (1979).

93. 1. Identifying information as to franchisor.
2. Business experience of franchisor's directors and executive officers.
3. Business experience of the franchisor.
4. Litigation history.
5. Bankruptcy history.
6. Description of franchise.
7. Initial funds required to be paid by a franchisee.
8. Recurring funds required to be paid by a franchisee.
9. Affiliated persons the franchisee is required or advised to do business with by the franchisor.
10. Obligations to purchase.
11. Revenues received by the franchisor in consideration of purchases by a franchisee.
12. Financing arrangements.
13. Restriction of sales.
14. Personal participation required of the franchisee in the operation of the franchise.
15. Termination, cancellation, and renewal of the franchise.
16. Statistical information concerning the number of franchises (and company-owned outlets).
17. Site selection.
18. Training programs.
19. Public figure involvement in the franchise.
20. Financial information concerning the franchisor.

Id. at 87-88.

94. *Senate Hearing, supra* note 5, at 2 (Opening Statement of Senator Nelson).

95. Rulemaking, unlike adjudication, does not require proof of the unfair or deceptive practices of every entity brought within the scope of the rule. To require such proof would reduce every rulemaking proceeding to a series of adjudications. Thus, evidence of unfair or deceptive practices in the marketing of one industry's franchise may be used as the evidentiary basis for a rule that applies to more than one industry.

in industries that do not have a history of abuse dispute the FTC's authority to apply the Rule to them. They argued that while a company may be regulated by an industry-wide rule, an entire industry may not be controlled by a rule applying to a method of doing business that applies across industry lines.⁹⁶

Who Is Affected

The Rule has an obvious impact on franchisors: they must disclose the information required, in the manner required, when it is required. Preparation of the disclosure document involves the expenditure of both time and money by the franchisor. In an effort to avoid coverage by the Rule, many companies have applied to the FTC for a stay of the Rule, or have filed suits challenging it.⁹⁷ For businesses which are not clearly franchises but

FTC Opposition Motion, *supra* note 6, at 45.

96. The Commission boldly asserts that evidence in the rulemaking record of abuses in connection with the sale of franchises in some industries permits the application of the rule to *all* industries in which franchising is used, and that there is no need to document in any way the existence of abuses in each industry covered by the rule (Citations omitted). We note that the Commission cites no authority for this novel interpretation of the law. This is so simply because there is no authority. The FTC cannot apply the rule to an *entire industry* in the absence of *any* evidence of unfair or deceptive acts in that industry. Evidence of unfair acts in one industry may not be used as the sole evidentiary basis for the application of the rule to another unrelated industry (Citation omitted). The fact that rulemaking may not require proof of unfair or deceptive acts involving every *company* brought within the scope of an *industry-wide rule* is clearly distinguishable from the outrageous proposition that an agency needs absolutely no evidence of unfair acts within an *industry* before bringing that industry within the purview of a rule that applies across industry lines.

Reply Memorandum of Automobile Importers of America, Inc., Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. FTC, No. 79-7144 (9th Cir. 1979).

97. Litigation challenging the Rule was consolidated in the Court of Appeals for the Ninth Circuit. Suit was first filed by the petroleum refiners: Shell Oil Co., Atlantic Richfield Co., Union Oil Co. of Cal., Exxon Corp., Mobil Oil Corp., Phillips Petroleum Co., Standard Oil Co. (Indiana), Standard Oil Co. of Cal., Chevron U.S.A., Inc., Chevron Chem. Co., Gulf Oil Corp., Getty Ref. and Mkt. Co., Kerr-McGee Refining Corp. See Emergency Motion for a Stay of the Effective Date of the Federal Trade Commission's Franchise Disclosure Rule, Shell Oil Co. v. FTC, No. 79-7076 (9th Cir. 1979) [hereinafter cited as Oil Co. Motion].

A number of other companies entered the litigation later: Snap-on Tools Corp., General Elec. Co., Farm and Indus. Equip. Inst., Marathon Oil Co., Schwinn Bicycle Co., The Motor Vehicle Mfrs Ass'n of the United States, Inc., General Motors Corp., Ford Motor Co., Chrysler Corp., American Motors Corp., Volkswagen of America, Inc., White Motor Co., International Harvester Co., Freightliner Corp., Paccar, Inc., Subaru of America, Inc., Subaru Atl., Inc. and Subaru of S. Cal., Inc., Automobile Importers of America, Inc., and Sinclair Mkt. Co. *Id.* at 2 n. 2. Some of these parties have received advisory opinions from the FTC (*see* note 126 and accompanying text *infra*) and are no longer parties to this action. The only remaining par-

which involve some of the elements of franchising, the Rule may create uncertainty about whether compliance is necessary. It could prove to be a deterrent to entry into business operations that include association with other businesses or even individuals.⁹⁸

Although the Rule has no effect on already-existing franchises,⁹⁹ it is specifically aimed at protecting prospective franchisees¹⁰⁰ through discouragement of fraudulent claims by franchisors. Disclosure requirements cannot prevent a prospective franchisee from making a bad business decision. They can provide him with the facts he needs to make an informed decision, if he has the good sense to use them.¹⁰¹

In addition to the parties to the franchise contract, the Rule also has an impact on administrators of state franchise regulations.¹⁰² Because the federal Rule would preempt an inconsis-

ties are the petroleum refiners and American Motors. (45 Fed. Reg. 26,347, Apr. 18, 1980).

98. "[T]he 'rush to regulation' in the franchising field has produced a significant area of legal uncertainty for businessmen contemplating operations which involve some degree of association with another business entity." Fern, *supra* note 24, at 1395.

99. "[T]he FTC Rule . . . suffer[s] from numerous deficiencies, principally through its failure to touch the damages inflicted on thousands of existing and former franchisees by the practices against which such a Rule might have provided substantial protection." H. BROWN, *supra* note 35, at 162.

As might be expected, those who are currently franchisees seem to agree with the opinion that the Rule's lack of effect on them is a deficiency. See generally comments submitted to the FTC: Letter from Gilbert A. Meisgeier, Executive Director, Nat'l. Franchise Ass'n Coalition (Feb. 2, 1979) [hereinafter cited as NFAC comment]; Letter from George O. Krueger, McDonald's franchisee, (Feb. 6, 1979) [hereinafter cited as McDonald's franchisee comment].

100. 16 C.F.R. § 436.2(e) defines prospective franchisee:

The term 'prospective franchisee' includes any person, including any representative, agent, or employee of that person, who approaches or is approached by a franchisor or franchise broker, or any representative, agent, or employee thereof, for the purpose of discussing the establishment, or possible establishment, of a franchise relationship involving such a person.

101. Though state and federal disclosure laws require that you be given the kind of information that can alert you to signs of a swindle or a bad business proposition, these laws won't protect you from yourself. You are deceiving yourself if you think that the next franchise project launched is bound to be another McDonald's or Holiday Inns or that you won't have to work just as hard as any independent business operator to make a franchise outlet succeed. You must have the good sense to watch for the warning signals and to investigate any deal thoroughly before laying your money on the line. Any business investment, including franchising, is risky.

CHANGING TIMES, *supra* note 1, at 23.

102. See notes 199-204 and accompanying text *infra*.

tent state law,¹⁰³ “franchise regulation at the state level could be placed in a tenuous position.”¹⁰⁴ In his comment on the Guides,¹⁰⁵ the San Francisco Assistant District Attorney pointed out that “[i]t is important that all areas of conflict [between the Rule and the state law] be identified and that the Guidelines be drafted in such a manner as to clear up any ambiguities created by such conflicts.”¹⁰⁶

Of the franchisors that are concerned about the Rule’s impact, “the group with the real problems [is] the selective distribution and special industry organizations caught in the cracks of the Commission’s interpretation of a ‘product franchise.’”¹⁰⁷ The selective distribution companies have objected to coverage by the Rule on the ground that they are not franchisors according to its definition: they do not exert a “significant degree of control” over their franchisees’ method of doing business, or

103. 44 Fed. Reg. 49,986 (1979).

104. Letter from James L. Karpen, Director, Office of Franchise and Agent Licensing, Department of Commerce, State of Michigan to FTC (Feb. 17, 1979) [hereinafter cited as Michigan comment] (comment submitted regarding the Rule).

105. Letter from S. Chandler Visher, Assistant District Attorney, City and County of San Francisco, to FTC (Feb. 20, 1979) [hereinafter cited as San Francisco comment].

106. This comment goes on to describe specific areas of potential conflict between the Rule and the California law, CAL. [CIVIL] CODE § 1812.200 *et seq.* (1979).

107. *FTC Franchise Rule and Proposed Guides: Comments and Concerns*, CONTINENTAL FRANCHISE REVIEW, May 16, 1979, at 3 [hereinafter cited as FRANCHISE REVIEW].

The “product franchise” and “package franchise” are functionally distinguishable. Indeed, the Guides themselves define product franchise and package franchise separately. 44 Fed. Reg. 49,965 (1979).

However, the Guides state that only “two types of commercial relationships are defined as a franchise by the Rule: ‘package and product franchises’ and ‘business opportunity ventures.’” The Guides include a rationale for this grouping of package franchises with product franchises (these terms are roughly equivalent to business format franchises and selective distributorships, respectively) by pointing out their common elements: “(i) distribution of goods or services associated with the franchisor’s trademark, (ii) significant control of, or significant assistance to, the franchisee’s method of operation, and (iii) required payments by the franchisee to the franchisor.” *Id.* See note 26 and accompanying text *supra*.

See also Letter from Richard W. Pogue on behalf of the Motor Vehicle Manufacturers Ass’n to FTC at 2 (Mar. 6, 1979) [hereinafter cited as MVMA comment] (comment submitted regarding the Rule):

[T]he loose definition of “franchise” as framed by the Commission is so vague as to raise questions as to whether it is to include relationships which have not been characterized by the abuses which the Rule is aimed to prevent. To the extent of that vagueness the Rule might be applied so as to impose onerous and burdensome requirements on certain parties without any demonstrated need or public benefit.

give them "significant assistance;"¹⁰⁸ they do not prescribe a marketing plan; and they do not require payment of a franchise fee.¹⁰⁹

These companies also argue that there is no justification for including them in the Rule's coverage because there is no history of abuse in their method of operation.¹¹⁰ The FTC's theory is that evidence of abuses in one industry can be used to justify coverage in another area of commerce where there is no evidence of abuse.¹¹¹ "The Commission's only justification for this theory is that its own definition of 'franchising,' which is so broad as to encompass dissimilar areas, makes the evidence relevant."¹¹² The selective distribution organizations feel that

108. Rexnord comment, *supra* note 23.

Many selective distributors claim that their businesses are individually tailored to the requests of each particular distributor. Since these companies deal with sophisticated businessmen, "there is no 'this is how you run a business' assistance of the nature found in franchising." *Id.* at 2.

"To be 'significant,' the control or assistance must result in a 'loss of independence' because of increased dependence upon the franchisor." Letter from John R. F. Baer on behalf of Schwinn Bicycle Co. to FTC at 4 (Feb. 14, 1979) [hereinafter cited as Schwinn comment] (comment submitted regarding the Rule).

109. See notes 37, 38, 42, 43, 46-51 and accompanying text *supra*.

110. The Commission claims that the Rule was promulgated "in response to widespread evidence of deceptive and unfair practices in connection with the sale of franchises and business opportunity ventures." 43 Fed. Reg. 59,614.

.....
An analysis of the complaints on the record made by Schwinn . . . reveals *not a single complaint relating to a conventional supplier-distributor arrangement* such as that used by Schwinn.

Schwinn Brief, *supra* note 7, at 29 (emphasis added).

"[I]n rulemaking it is important that the regulatory process, while necessary to correct ills which develop in a free marketplace, nevertheless regulate only to correct the abuses which create such ills and not to impinge on the free enterprise system where such abuses do not exist." Koehring comment, *supra* note 23, at 2.

See also *City of Chicago v. FPC*, 458 F.2d 731, 742 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 1074 (1972) ("[a] regulation perfectly reasonable and appropriate in the face of a given problem may be highly capricious if that problem does not exist").

111. FTC Opposition Motion, *supra* note 6, at 45.

112. Motion for Leave to File Reply Memorandum, *Motor Vehicle Mfrs. Ass'n v. FTC*, No. 79-7144, at 4 n.1 (9th Cir. 1979) [hereinafter cited as MVMA Motion to File Reply]. The footnote continued:

Suppose that "motor vehicle" were defined as any wheeled object containing a motor, thus including power lawn mowers. To protect highway motorists from collisions, a regulation requires all motor vehicle operators, including lawn mower users, to wear helmets. No evidence of collisions of lawn mowers is necessary because both lawn mowers and automobiles have been defined as motor vehicles and evidence of collisions exists as to a type of motor vehicle.

"[s]uch a broad Rule is clearly unsupported by the record."¹¹³

In the comment on the Guides which it submitted to the FTC, the Motor Vehicle Manufacturers Association observed that the Rule "essentially aims at the correction or prevention of two categories of abuse said to have been perpetrated by sellers of 'franchises': (1) Fraud or misrepresentation in the sale of the franchise . . . ; (2) Sale of a franchise for a fee . . . where the franchisor does not provide the promised value in return."¹¹⁴ The comment observes that abuses usually occur in franchise relationships that have some of these characteristics:

- (1) inexperienced and susceptible potential franchisees, *i.e.*, "ma and pa" . . . often undercapitalized;
- (2) . . . franchisees [who are] dependent upon the franchisor to "learn the business," . . . or who, in respect to the day-to-day management of the business, are substantially controlled by the franchisor and have no separate identity from that of the franchisor;
- (3) . . . undercapitalized, inexperienced and generally newly established franchisors with few, if any, established franchisees and a new or novel product or service; and
- (4) franchisors who succeed by "selling" the franchise instead of the product. . . .¹¹⁵

In response to a request to investigate the objection to the Rule of those types of business which have no history of abuse, the Senate Select Committee on Small Business conducted a hearing on July 17, 1979 to review the Rule's definition of "franchise" and its potential impact. The question addressed at the hearing was "whether the coverage of the Rule, in the manner the FTC suggests, is directed to the types of business which they have identified as a problem and from which potential 'franchisees' need protection through mandatory Federal disclo-

113. Letter from Winston & Strawn to FTC, at 1 (Feb. 20, 1979) [hereinafter cited as Winston & Strawn comment] (comment submitted regarding the Rule).

[T]he Rule requires compliance not only by traditional franchisors but also by virtually everyone selling trademarked goods at the wholesale level. This is true whether or not a franchise fee is paid and whether or not the trademark owner's control over the distributor is limited to that necessary to preserve its rights under trademark law.

Id.

"Labeling some wholesalers as franchisors and requiring disclosure by them creates competitive inequity with other wholesalers, cooperatives and chains who do not have the cost burden of assembling and printing and continuously updating disclosure statements." Letter from National-American Wholesale Grocers' Ass'n to FTC at 2 (Feb. 19, 1979) (comment submitted regarding the Rule).

114. MVMA comment, *supra* note 107, at 2-3.

115. *Id.* at 3.

sure."¹¹⁶ The Senate Committee made it clear that it believed that in the absence of a history of abuse in an industry, the industry should not be covered by the Rule.¹¹⁷ Furthermore, in response to the FTC's observation that an industry could be exempted from the Rule if it documented a record free of abuses, Senators Nelson and Boschwitz responded that the FTC should have the burden of demonstrating past abuses before undertaking to regulate that industry.¹¹⁸

On July 23, 1979, the Small Business Committee wrote the FTC chairman that "the coverage of the Rule has been extended to certain business relationships, including industrial distributors and farm equipment manufacturers, without any clear evidence of a need to do so."¹¹⁹ The Senators "urge[d] the Commission, at a minimum, to insure that the interpretations of coverage, as reflected in the final guide¹²⁰ accompanying the Rule, are significantly narrowed to exclude the normal wholesale-retail business relationship. . . ."¹²¹ They also recommended that

the Commission should seriously consider a further delay of the October 21, 1979 effective date of the entire Rule until such time as you (a) either demonstrate evidence of "deceptive and unfair practices" . . . in industrial distribution schemes . . . or clarify their exclusion from coverage . . . ; and (b) prepare analyses of the likely costs and paperwork which would be imposed. . . .¹²²

116. *Senate Hearing, supra* note 5 (opening statement of Senator Nelson).

117. Senator Nelson stated: "[I]f you do not have any documented significant abuses that are endemic in the business, why cover them [the selective distributors] even if your interpretation of the Rule does? What evil are you trying to cure, if the evil does not exist?" *Senate Hearing, supra* note 5, at 66.

118. [T]here is an exemption provided for in the Act, and in an industry that can come in and make a documented case—

Senator Nelson. Why should they make a documented case of [no] abuse to meet a goddamn rule that does not make any sense if there is no abuse.

Why is it not the other way, that you come in with the evidence of the abuse, or keep your nose out of people's business?

Senator Boschwitz. Why should they have the burden of proving no abuse?

Id. at 66-67.

119. Letter from Senate Select Committee on Small Business to Michael Pertschuk, Chairman, Federal Trade Commission (July 23, 1979) [hereinafter cited as *Senate Letter*] (Senate Hearings on FTC Franchise Disclosure Rule of July 17, 1979).

120. *See* note 7 *supra*.

121. *Senate Letter, supra* note 119.

122. *Id.*

It has been maintained by selective distribution companies that their doubt regarding whether they are covered by the Rule renders it void for vagueness.¹²³ It has also been suggested that the Rule might be an unconstitutional burden on interstate commerce.¹²⁴ Although these arguments have been raised, the companies' proceedings with the FTC have focused on other issues.

Shortly after the Guides were revised, Schwinn Bicycle Co. (a selective distribution organization)¹²⁵ received the first "informal staff advisory opinion" from the FTC that "the relationship between Schwinn and its dealers . . . does not constitute a franchise under the rule."¹²⁶ This opinion was based on the fact that the only payments made by dealers to Schwinn are to purchase bicycles at bona fide wholesale prices. The FTC decided that such payments do not constitute a "required payment" under the Rule,¹²⁷ an essential element of an FTC-defined "franchise." A necessary aspect of the bona fide wholesale price exclusion is that Schwinn does not dictate to its dealers what quantity of inventory to purchase.¹²⁸ Furthermore, the opinion applies only to Schwinn, "and only to the extent that Schwinn's

123. "The notice demanded by the Due Process Clause is wholly lacking in the Rule because its definitional element utilizes nebulous criteria which afford little effective guidance as to the scope of coverage." Schwinn Brief, *supra* note 7, at 49.

124. Winston & Strawn comment, *supra* note 113, at 4:

"On its face, the Rule is so broad and burdensome as to place it on the outer limits of substantive due process and to create an unreasonable burden on interstate commerce."

125. Schwinn Bicycle Co., a selective distributor, has received similar advisory opinions from California and Virginia. Cal. Dep't of Corporations, Interp. Op. No. 71/2F of Feb. 17, 1971. The bona fide wholesale price exemption is now available in some states. See CAL. [CORP.] CODE § 31011(a); ILL. REV. STAT. ch. 121 ½, § 703 (1977).

126. Letter from John M. Tifford, Program Advisor for Franchising, FTC, to John R. F. Baer, Keck, Mahin & Cate, representing Schwinn Bicycle Co. (Aug. 3, 1979) [hereinafter cited as Schwinn Advisory Opinion] (Informal Staff Advisory Opinion).

127. "Such payments do not constitute a 'required payment' pursuant to Section 436.2(a)(2)—as that term is interpreted by the Commission in its final guides at pages 5-6." *Id.*

"[T]he Commission's objective [is] that 'required payment' capture all sources of hidden franchise fees, [and] the Commission will not construe as 'required payments' any payments made by a person at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale." 44 Fed. Reg. 49,965 (1979). This is a significant change from the previous Guides.

128. "[T]he guidelines fail to indicate in what circumstances a person is deemed to have been 'required' to make payments." Letter from Lewis G. Rudnick, Rudnick & Wolfe, to Lawrence Mackey, Chief of the Franchise Division of the Office of the Illinois Attorney General at 2 (Feb. 23, 1979) [hereinafter cited as Rudnick & Wolfe comment] (comment submitted regarding the Guides).

present and future business activities conform to the information furnished in its request [for exemption from coverage]."¹²⁹

The FTC's decision on the above advisory opinion makes the Rule's scope of coverage more consistent with pre-existing state disclosure laws. In twelve of the fourteen states that have a franchise disclosure provision,¹³⁰ the purchase of goods at a bona fide wholesale price is an exception to the franchise fee requirement in the definition of franchise. A bona fide wholesale price is "a fair payment for goods purchased at a comparable level of distribution and no part of which constitutes a payment for the right to enter into the franchise business. Goods sold at a bona fide wholesale price include goods sold to the franchisee for resale. . . ."¹³¹ In response to the numerous objections of selective distribution companies to including purchase of inventory in the definition of required payment, the revised Guides state that "the Commission will not construe as 'required payments' any payments made by a person at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale."¹³²

According to the Statement of Basis and Purpose,¹³³ "the main benefit of franchising to the franchisor is to raise low-cost capital by collecting franchise fees from franchisees, and . . . the attractiveness of this low-cost capital creates the potential for deception."¹³⁴ Selective distribution companies are not rais-

129. Schwinn Advisory Opinion, *supra* note 126 (This opinion is based on the specific facts furnished to the Commission by Schwinn; it is not binding. Other companies have subsequently received similar Advisory Opinions, as well as concurrences by the Commissioners.).

130. The states which now have statutes requiring disclosure by franchisors are: California (CAL. [CORP.] CODE § 3100 *et seq.* (West Supp. 1980)); Hawaii (HAW. REV. STAT. § 482 E-1 *et seq.* (1976)); Illinois (ILL. REV. STAT. ch. 121 ½, § 701 *et seq.* (1977)); Indiana (IND. CODE, tit. 23, ch. 2.5, § 1 *et seq.* (1972)); Maryland (MD. CODE ANN., art. 56, § 345 *et seq.* (Cum. Supp. 1977)); Michigan (MICH. COMP. LAWS § 445.1501 *et seq.* (1977)); Minnesota (MINN. STAT. § 80C. 01 *et seq.* (1976)); North Dakota (N.D. CENT. CODE § 51-19-01 *et seq.* (Supp. 1977)); Oregon (OR. REV. STAT. § 650.005 *et seq.* (1977)); Rhode Island (R.I. GEN. LAWS § 19-28-1 *et seq.* (1956)); South Dakota (S.D. COMPILED LAWS § 37-5A-1 *et seq.* (1977)); Virginia (VA. CODE § 13.1-557 *et seq.* (1950)); Washington (WASH. REV. CODE § 19.100.010 *et seq.* (1976)); Wisconsin (WIS. STAT. § 553.01 *et seq.* (1975)).

131. Winston & Strawn comment, *supra* note 113, at 5 (quoting Franchise Disclosure Act of Illinois, Rules and Regulations, Rule 106).

132. 44 Fed. Reg. 49,968 (1979).

The Rule says that a franchise fee must exceed \$500 within the first six months. 16 C.F.R. § 436.2(a)(2). The Proposed Guides included purchases of inventory in this \$500 minimum; the Revised Guides do not include inventory purchases. *Id.*

133. 43 Fed. Reg. 59,621-59,733 (1978).

134. MVMA Motion to File Reply, *supra* note 112, at 6 n. 4 (referring to 43 Fed. Reg. 59,698-99 (1978)).

ing capital when they sell merchandise at a bona fide wholesale price.¹³⁵ The abuses at which the Rule is directed are unlikely to occur in this situation because "[t]here is no incentive to 'take the money and run;'. . . such an action would only destroy the distribution system upon which [the selective distributor] depends to market its product."¹³⁶

Selective distribution companies have claimed that even where the franchisor "suggests" a minimum purchase of initial inventory to the franchisee, where the goods are sold at a bona fide wholesale price no franchise fee is involved because the purchase price is not a source of low-cost capital.¹³⁷ This claim is modified by the concession that the franchisor may not require purchase of inventory that cannot be turned over within a reasonable time without running afoul of a franchise fee problem.¹³⁸

Issues Raised by the Rule

The basis for the issues raised by the Rule is the problems inherent in trying to apply a common standard across broad industry lines.¹³⁹ "Because franchising is *not* an industry, a product, or a service, but is instead a method of doing business or a method of distribution,¹⁴⁰ the Franchise Rule is not limited in its application to any particular industry or industries."¹⁴¹ A

135. Schwinn Brief, *supra* note 7, at 43-44; MVMA Motion to File Reply, *supra* note 112, at 6 n. 4.

136. Schwinn Brief, *supra* note 7, at 44.

137. Koehring comment, *supra* note 39, at 4 ("It should . . . be recognized that such an adequate inventory requirement [where goods are sold at a bona fide wholesale price] is not the equivalent of a minimum inventory purchasing requirement where the producer is seeking sales to dealers as a source of low cost capital.").

138. If the producer suggests to a new dealer, without imposing any requirement of a specified minimum amount of inventory, that his initial inventory purchase should be \$100,000 in order to adequately service his customers, and the dealer proceeds to "turn" that inventory five times during the year, producing a profit of \$50,000, or 50% return . . . it should be clear that no "initial fee" has been packaged into the initial inventory purchase. Both producer and dealer are making their profit through a normal buy-sell relationship.

Letter from Val. A. Weber and Charles N. Besser, Reuben & Proctor, on behalf of Snap-on Tools Corp. to FTC at 4-5 (Mar. 6, 1979) [hereinafter cited as Snap-on Tools Corp. comment] (comment submitted regarding the New Guides).

139. See notes 94-96 and accompanying text *supra*.

140. 43 Fed. Reg. 59,623 (1978).

141. FTC Opposition Motion, *supra* note 6, at 7.

The rulemaking record contains overwhelming evidence of abuses in the sale of franchises, as defined in the rule. Because such abuses

spokesman for the FTC justified this approach with the explanation that "[i]f we had to go on an industry by industry basis it would in essence work a regulatory burden that might be unmanageable."¹⁴²

Those companies that are disputing their coverage by the Rule point out that the Franchise Rule disregards significant differences which exist between industries. In their emergency motion for a stay of the Rule, the oil companies pointed out that even the FTC staff had "called into doubt the basic concept of regulating with one rule the marketing practices of industries 'as disparate as gasoline and hamburgers.'"¹⁴³ "The Rule as it is promulgated is unreasonably and unnecessarily vague and overbroad. The Proposed Guidelines magnify instead of minimize this problem. The result is the unjustified imposition of a substantial economic burden upon a class substantially larger than the target class."¹⁴⁴

Those companies (and in some cases entire industries) which have no record of abuse in their business relations with their dealers/distributors probably have the strongest argument against coverage under the Rule. It is difficult to understand the justification for imposing the burden of compliance on a company which has done nothing to demonstrate that it requires administrative regulation. Senator Nelson acknowledged the basic injustice of this approach when he asked an FTC official, "What evil are you trying to cure, if the evil does not exist?"¹⁴⁵ The Senate Committee on Small Business seems to feel that an industry should not have the burden of documenting a problem-free history to obtain exclusion from coverage by a Rule that "does not make any sense if there is no abuse. Why is it not the

stem from the nature of the franchise relationship rather than from the characteristics of any particular industry, such evidence is sufficient to warrant application of the rule to all franchises, as defined, without need to document the existence of numerous abuses in each and every one of the many industries in which franchising is used.

Schwinn Brief, *supra* note 7, at 34 (quoting FTC's response to Oil Co. application to the Commission for a stay of the Rule).

142. *Senate Hearing, supra* note 5, at 81.

143. *Id.* at 13 (quoting 1977 Trade Comm'n Hearings, at 9). The staff further stated: "Is the broad sweep of the definition justified? Should all industries that franchise be included? Should particular types of franchises be excluded, such as those involving minimal investments, sophisticated and experienced franchisees or business opportunity schemes?"

144. Winston & Strawn comment, *supra* note 113, at 3.

145. *Senate Hearing, supra* note 5, at 66. See note 117 and accompanying text *supra*.

other way, that you [the FTC] come in with the evidence of the abuse, or keep your nose out of people's business?"¹⁴⁶

It has already been mentioned that Schwinn, a selective distribution organization, had received an advisory opinion from the FTC that it is not covered under the Rule because the payments it receives from its dealers are limited to purchases of inventory at a bona fide wholesale price.¹⁴⁷ On the basis of this advisory opinion, Schwinn and the FTC have stipulated that Schwinn's petition for a stay of the Rule in the Ninth Circuit will be dismissed.¹⁴⁸ Although the advisory opinion applies only to Schwinn,¹⁴⁹ other selective distributors have received similar opinions because they do not collect a franchise fee.

While these companies may thus be through with their dispute with the FTC, potential problems still lurk behind this seemingly-conclusive resolution. In the first place, there is no assurance that just because one company which charges no franchise fee received an advisory opinion of no coverage, the next company with a similar method of doing business will receive a similar opinion; the FTC makes these decisions on a case-by-case basis.¹⁵⁰ In the second place, any company that receives such an advisory opinion runs the risk of losing it if it makes any change in its method of doing business.¹⁵¹ Because the other possible reasons for excluding a selective distributor from coverage (they do not prescribe a marketing plan for the franchisor, and do not give him significant assistance or control) were not addressed by the FTC, loss of the bona fide wholesale price exemption might have serious consequences: possible renewed coverage by the Rule.

146. Senate Hearing, *supra* note 5, at 67. See note 118 and accompanying text *supra*.

147. See note 126 and accompanying text *supra*.

148. The "proceeding is stayed with respect to Schwinn until October 18, 1979 and shall be dismissed on October 18, 1979 if the Commission concurs in the staff advice letter on or before October 8, 1979. . . ." Stipulation for Dismissal of Schwinn Bicycle Co.'s Petition for Judicial Review of the Franchise Rule, Schwinn Bicycle Co. v. FTC, No. 78-3680 at 3 (1979).

It should be noted that according to the Commission's internal rule, in an important decision, the Commissioners must concur in the staff advisory opinion.

149. Schwinn Advisory Opinion, *supra* note 126 ("[t]he views expressed in this informal staff opinion may be relied upon only by Schwinn").

150. The goal of a bright line rule is solving this problem by "shortening and simplifying the adjudicative process and . . . clarifying the law in advance." See note 80 *supra*. Arguably, then, the Commission's case-by-case decision process on coverage ineffectuates the advantages of rulemaking.

151. The "informal staff opinion may be relied upon . . . only to the extent that Schwinn's present and future business activities conform to the information furnished in its request." Schwinn Advisory Opinion, *supra* note 126.

It has already been mentioned that the doubt as to their coverage under the Rule is at the very least an inconvenience to selective distribution organizations.¹⁵² At this point the doubt remains for the hundreds who have not received a staff advisory opinion, and it also remains to a lesser extent even for those who are excluded because they do not charge a franchise fee. What these companies need, and deserve, from the FTC is consistency and clarity of coverage. As one of them observed in its comment on the Rule, "it would be well to include certain changes to the regulations which would make it crystal clear that companies which do business under conventional distributorship arrangements with little or no control over the distributor are not covered by the proposed regulations."¹⁵³

These arguments have in common an underlying acceptance of the need for the Rule in appropriate circumstances; their claim is just that it should be applied to someone else. There is an even more basic argument that could be made by any of the three types of franchisors:¹⁵⁴ The Rule itself is invalid. Two arguments have been advanced in support of this proposition: (1) The FTC lacked the authority to promulgate such a rule when it undertook the project; and (2) the FTC failed to follow the rulemaking procedure required by Magnuson-Moss.

A threshold question is whether pre- or post-Magnuson-Moss rulemaking procedures are applicable. The key to this issue is whether the FTC's receipt of evidence was "substantially completed" at the time the Magnuson-Moss Amendments to the FTC Act took effect.¹⁵⁵ "Perhaps the most salient fact refuting any claim that the rule was substantially completed prior to the effective date of the Magnuson-Moss Amendments is the FTC's own inability to promulgate the rule sooner than December 21, 1978, four years after the final closing of the public record."¹⁵⁶

The FTC closed the public rulemaking record on November 20, 1974, but it appears that it continued to receive information pertinent to the Rule after that date.¹⁵⁷ The argument is that the

152. See notes 98 & 123 and accompanying text *supra*.

153. Koehring comment, *supra* note 39, at 2. These are business format and business opportunity, as well as selective distribution, franchisors.

154. See notes 26 & 27 and accompanying text *supra*.

155. Oil Companies' Reply to the FTC's Opposition Motion, Shell Oil Co. v. FTC, No. 79-7076 (9th Cir. 1979) at 8-9 [hereinafter cited as Oil Co. Reply].

156. Oil Co. Motion, *supra* note 97, at 52.

157. Schwinn Brief, *supra* note 7, at 54.

That information includes ex parte consultations with a number of companies involved, as well as ex parte contacts with the International Franchise Association and a Franchise Rule Baseline Study which the FTC retained Arthur Young & Co. to prepare.

Commission's reception of data after the effective date of Magnuson-Moss¹⁵⁸ invokes its rulemaking procedure. The FTC claims that the Rule is not a Magnuson-Moss rule because it falls within the grandfather clause.¹⁵⁹ Those who dispute the Rule's validity maintain that the grandfather clause is inapplicable because the Rule was not close enough to completion at the time Magnuson-Moss became effective.

The other argument that the Rule is invalid is that even if the FTC was not required to follow the Magnuson-Moss rulemaking procedures, the Commission nevertheless failed to comply with the rulemaking requirements of Section 553 of the APA.¹⁶⁰ These requirements are notice, an opportunity to comment, and a concise general statement of the rule.¹⁶¹ The two goals of such requirements are "to require the agency to educate itself before promulgating rules that bind the public," thereby "avoid[ing] ill-informed and imprudent administrative action,"¹⁶² and to guarantee fairness to those affected by the Rule.

The FTC's reception of information after it closed the public record on the Rule may not have violated the first of these goals, since the information may have served to educate the Commission, but it did deny fair treatment to those affected by the Rule by denying them notice and an opportunity to comment. The Court of Appeals for the District of Columbia Circuit has pointed out "the inconsistency of secrecy with fundamental notions of fairness implicit in due process and with the idea of reasoned decision making on the merits which undergirds all of our administrative law."¹⁶³

It has been held that an administrative rule which is not promulgated in accordance with rulemaking procedures is

158. July 4, 1975.

159. See note 73 and accompanying text *supra*.

160. Schwinn Brief, *supra* note 7, at 62.

161. The Administrative Procedure Act (APA), 5 U.S.C. § 551 *et seq.* (1976), describes three procedural requirements: notice of the proposed rulemaking, § 553(b); an opportunity for interested persons to comment, § 553(c); and a concise general statement of basis and purpose of the rule, § 553(c).

Magnuson-Moss adopts these procedures as well. Pub. L. No. 93-637 § 202(a) (1975). Therefore, the following arguments are applicable whether or not Magnuson-Moss is found to be operative.

162. Oil Co. Motion, *supra* note 97, at 53.

163. Home Box Office, Inc. v. Federal Comm. Comm'n, 567 F.2d 9, 56 (D.C. Cir. 1977). The court also stated that "[e]ven the possibility that there is here one administrative record for the public and this court and another for the Commission and those 'in the know' is intolerable. . . ." *Id.* at 54. "Moreover, a dialogue is meaningless unless the agency responds to significant points raised by the public." *Id.* at 54, 56.

void.¹⁶⁴ Since they received negative advisory opinions, the oil companies and American Motors Corp. are continuing the court fight using these arguments.¹⁶⁵ The Ninth Circuit is faced with a twofold decision: It must decide whether pre- or post-Magnuson-Moss rulemaking procedures were applicable, and then decide whether the appropriate procedural requirements were properly adhered to.

In addition to these attacks on the Rule's validity and application, numerous comments have addressed themselves, not to the Rule itself, but to the Interpretive Guides. Marathon Oil's comment pointed out that there is "an apparent inconsistency, perhaps deriving from no more than ambiguous language, between the Guides on the one hand and the Rule and Statement of Basis and Purpose on the other."¹⁶⁶ The major problem seems to be the scope of coverage. Companies which feel their exclusion from the Rule's definition of "franchise" is clear are worried that the "misleading and ambiguous" Guides might draw them back into the Rule's grasp.¹⁶⁷ The oil companies claim that the Guides vary from the text of the Rule so much that they "constitute an illegal and improper rulemaking proceeding under the label of 'guides.'"¹⁶⁸ The International Franchise Association observed that "the Rule and the Statement are consistent with the requirements of the Uniform Franchise Offering Circular¹⁶⁹ while the Guidelines are not."¹⁷⁰

Furthermore, "[i]t appears to be unprecedented for the Federal Trade Commission to have both an Industry Guide and a Trade Regulation Rule on the very same subject matter."¹⁷¹ The following dialogue occurred during the Senate Committee on Small Business hearing on the Rule:

164. See generally *Portland Cement Ass'n v. Ruckelshaus*, 486 F.2d 375, 393 (D.C. Cir. 1973), cert. denied, 217 U.S. 921 (1974) ("It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of . . . data that, [to a] critical degree, is [*sic*] known only to the agency."); *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971) ("The rule making provisions of the [APA] . . . were designed to assure fairness and mature consideration of rules of general application.").

165. See note 97 *supra*.

166. Letter from Richard W. Pogue on behalf of Marathon Oil Co. to FTC at 1 (Mar. 5, 1979) [hereinafter cited as Marathon Oil Co. comment].

167. Schwinn comment, *supra* note 108, at 2-3.

168. Oil Co. Motion, *supra* note 97, at 15.

169. 44 Fed. Reg. 49,970 (1979). The UFOC provides acceptable franchise disclosure requirements in lieu of the disclosure requirements set forth in § 436.1(a)-(e) of the Rule.

170. Letter from Philip F. Zeidman on behalf of International Franchise Association to FTC at 7 (Mar. 6, 1979) [hereinafter cited as IFA comment].

171. Schwinn comment, *supra* note 108, at 18.

Senator Nelson: I guess this is the first time they have undertaken to have an interpretive guideline to go along with the rule, to advise what the rule means.

Senator Boschwitz: Maybe they should write the rule a little more clearly.¹⁷²

The Motor Vehicle Manufacturers Association's position is that "[t]he applicable statute does not provide for the Proposed Guides . . . and we therefore submit that they are gratuitous, confusing and misleading and that they have no effect in law, and that therefore they should be withdrawn."¹⁷³

Comments from Those Affected

Business format franchisors have complained that the language of the Rule should be clarified with respect to some of the terms used. For instance, "parent" and "holding company" are not distinguished or defined. The International Franchise Association suggests a specific definition,¹⁷⁴ since "[i]nformation concerning the parent . . . can be of substantial significance to the prospective franchisee."¹⁷⁵ "Similar products or services" also needs more specific definition, to protect franchisors from having to disclose *all* their operations to a franchisee who might establish such other operations.¹⁷⁶

Others commented on "significant assistance or control." One company felt "[t]he concept of assistance to the dealer, as an element of a 'Product' Franchise, should be abandoned. Protection of the franchisee is the premise upon which the Rule is founded. Rendering assistance *benefits* the franchisee and therefore is in keeping with the intent of the Rule."¹⁷⁷ The problem with this suggestion is that it is based on a misconception of the Rule's premise. The Rule *is* intended to benefit the franchisee, not through any means imaginable, but only by requiring the franchisor to disclose the information necessary to make an informed decision. Assistance is one of the elements in the Rule's definition of "franchise;" all this means is that it indicates a franchise relationship, not that assistance is bad or should be avoided (unless one is trying to avoid coverage as a franchisor under the Rule).

172. *Senate Hearings, supra* note 5, at 24.

173. MVMA comment, *supra* note 107, at 1.

174. "A 'parent' should not include other subsidiaries of the parent since such a broad requirement would place an undue burden on franchisors." IFA comment, *supra* note 170, at 5.

175. *Id.*

176. *Id.* at 16-17.

177. Snap-on Tools Corp. comment, *supra* note 138, at 10.

A more typical comment was that it is "critical that the final Guidelines specifically define 'significant degree of control or assistance.'"¹⁷⁸ Since a certain amount of control is inevitable in any distributorship, the Rule would be clarified by a careful delineation of what control is "significant."¹⁷⁹ The Rule's definition should be limited to provisions that "make the distributor substantially dependent upon the producer's expertise . . . for making the distributorship profitable Significant control should . . . be defined to include such controls as . . . go to the internal operations and management of the franchisee."¹⁸⁰ "The important question . . . is whether the assistance or control exercised by the producer is so great as to subjugate the independence and identity of the dealer to that of the producer."¹⁸¹

The "substantial dependence" of the franchisee must be carefully defined to avoid any danger that franchises may be treated as securities,¹⁸² which may be broadly defined as putting one's money in the hands of another. Because the success of the typical franchise (and therefore the return on the franchisee's investment) depends to some extent on the efforts of the franchisee, franchises have generally been held not to be securities.¹⁸³ Nevertheless, it was held that where risk capital was paid to the franchisor but the franchisee "received no 'practical and actual control over the managerial decisions of the enter-

178. Winston & Strawn comment, *supra* note 113, at 10.

[T]he Final Guidelines should state that certain provisions which commonly appear together in distributorship agreements do not individually or collectively constitute a "significant degree of control or assistance over the franchisee's method of operation." Among these common provisions are terms

(1) requiring the distributor to periodically furnish the Producer with financial, sales, inventory, etc. data;

(2) designating the territory within which the distributor may use the trademark;

(3) requiring distributor compliance with applicable governmental rules and regulations;

(4) requiring the distributor to promote the sale of the Producer's products; or

(5) requiring the distributor to purchase a specified amount of the Producer's goods or to maintain a specific sales volume.

Id. at 11-12.

179. *Id.* at 10-11. See Rexnord comment, *supra* note 108, at 4.

180. *Id.* at 12 n. 17.

181. Koehring comment, *supra* note 39, at 4.

182. See IFA comment, *supra* note 170, at 30.

183. *Mr. Steak, Inc. v. River City Steak, Inc.*, 460 F.2d 666 (10th Cir. 1972) (franchise to operate a steak house was not a "security"); *accord*, *Nash & Assocs., Inc. v. Lum's of Ohio, Inc.*, 484 F.2d 392 (6th Cir. 1973) (franchise to operate a restaurant was not a "security").

prise' in return, an investment contract security existed."¹⁸⁴ Thus, a franchisor must avoid exercising supervision so close that the franchise contract can be classified as a security, with its attendant state and federal securities law regulation.

A common criticism from franchisors was that this is an awkward effort to regulate three different methods of distribution by one rule.¹⁸⁵ The selective distribution organizations object to being combined with business format franchisors in the Guides.¹⁸⁶ Because the varieties of franchises differ so widely, attempts to develop rules applicable to all of them are bound either to be so broad as to be meaningless, or to be qualified to death.¹⁸⁷ "[C]haracteristics of the different types of franchise agreements may lead to different treatments of apparently common legal problems."¹⁸⁸

A basic objection that selective distribution franchisors have to the Guides is the use of the term "distributorship" to describe business opportunity ventures, because this terminology leads to confusion between the two types of franchising.¹⁸⁹ The San Francisco Assistant District Attorney made the point that work-at-home business opportunity schemes are covered by the California statute, but have been omitted from coverage by the Rule.¹⁹⁰

The National Franchise Association Coalition, which consists of seventeen franchisee organizations, wrote the FTC "to express the gratification of franchisees to the Commission for having passed the rule . . . [i]n spite of the fact that this rule does not have any great effect upon those franchisees who are already locked into one-sided agreements that fail to protect

184. CUMBERLAND-SAMFORD, *supra* note 20, at 512 (quoting *State v. Hawaii Market Center, Inc.*, 52 Haw. 642, 648, 485 P.2d 105, 109 (1971)).

185. IFA comment, *supra* note 170, at 1.

186. *See* note 107 and accompanying text *supra*.

187. Oil Co. Motion, *supra* note 97, at 71 (citing Statement of Paul Rand Dixon, Chairman, hearings pursuant to S. Rep. 40 before the Subcomm. on Antitrust and Monopoly of the Sen. Comm. on the Judiciary, 87th Cong., 2d Sess. Part I, at 81 (1965)) (emphasis added):

The many varieties of the franchise systems differ among themselves so widely that any attempt to state rules applicable to all such systems must either be so broad as to approach the meaningless or tailored with numerous qualifications in order to fit all varieties of franchises. *It would be foolhardy for one to issue flat pronouncements declaring the state of the law as it pertains to franchise agreements.*

188. Caine, *supra* note 12, at 352. *See* notes 95, 96, 139-43 and accompanying text *supra*.

189. "The most common types of business opportunity ventures are *distributorship*, rack jobbing and vending machine routes." 44 Fed. Reg. 49,968 (1979) (emphasis added).

190. San Francisco comment, *supra* note 105, at 2.

them from abuses of franchisors."¹⁹¹ A McDonald's franchisee wrote that the Rule is "a most welcomed development."¹⁹² He felt, though, that "the ruling falls short of the mark in that it attempts to bring equity only prior to the initiation of a franchise agreement and nothing [*sic*] about guaranteeing equity during the course of the agreement."¹⁹³

The Minnesota Department of Commerce suggested that filing the proposed disclosure document with the FTC by the franchisor should be required.¹⁹⁴ Even in the absence of any review by the Commission of the substance of the document, which would be the aim of a registration requirement, it is "in the best interests of the Commission to know the type of disclosure which is actually being used pursuant to its rule."¹⁹⁵ The FTC chose not to require registration of the document, however, to avoid "a massive new federal bureaucracy comparable in scope and size to the Securities and Exchange Commission."¹⁹⁶ "Although the agency thus avoided any self-burden, it also forfeited the implicitly cleansing impact of any public filing. . . ."¹⁹⁷ Furthermore, "the mere filing of such information with the federal government would subject the material to the deterrent effect of a criminal penalty for any fraudulent information."¹⁹⁸

The Kentucky Attorney General felt that his office was much more capable than the FTC of protecting state consumers under state law.¹⁹⁹ Adopting a basic states' rights position, he pointed out that the federal bureaucracy is too often inefficient and ineffective.²⁰⁰ Michigan's comment expressed concern that the Rule could impair the states' ability to modify franchise regulations as needed.²⁰¹ "[I]t seems likely that an unintended

191. NFAC comment, *supra* note 99, at 1. See note 98 and accompanying text *supra*.

192. McDonald's franchisee comment, *supra* note 99.

193. *Id.*

194. Letter from Minnesota Dep't of Commerce to FTC 3 (Feb. 12, 1979) (comment submitted regarding the New Guides).

195. *Id.*

196. FTC Opposition Motion, *supra* note 6, at 4 ("The current franchise Rule staff consists of four attorneys and several others throughout is [*sic*] 10 regional offices, as contrasted with the SEC staff of 691 attorneys."). See *id.* at n.3.

197. H. BROWN, *supra* note 35, at 167.

198. *Id.*

199. Letter from Kentucky Attorney General to FTC (Feb. 12, 1979) (comment submitted regarding the New Guides).

200. *Id.*

201. Michigan comment, *supra* note 104.

side effect of the Commission's approach to preemption²⁰² will . . . result in the elimination of the Uniform Franchise Offering Circular²⁰³ as a viable alternative to the Commission's disclosure format."²⁰⁴

The requirement that financial information be disclosed²⁰⁵ prompted several criticisms. In the first place, it is not unusual for financial statements received by franchisors from franchisees to be unreliable²⁰⁶ so that for the prospective franchisee such disclosure would be deceptive.²⁰⁷ Furthermore, receipt of financial information may "giv[e] a prospective franchisee a false sense of security. . . ."²⁰⁸

To the requirement that a franchisor supply an income statement,²⁰⁹ one small businessman replied "Nuts!"²¹⁰ He said that he had taken initial losses to build his system, and objected to being required to disclose his costs of doing business.²¹¹ He argued that the prospective franchisee should base his investment decision on a " 'free market judgment' of relative values he receives from competing franchisors."²¹² The FTC might respond that knowledge of the franchisor's taking losses is relevant to the franchisee's decision, since in this situation the exhaustion of the franchisor's personal fortune could have serious consequences for the franchisee.

A related objection came from Mr. Hero Sandwich Systems: "[I]t seems a violation of our privacy to be forced to release complete, detailed financials to *every* prospective franchisee. . . . What right has that person been granted . . . [to] know our salaries, life insurance, etc.?"²¹³ Apparently Mr. Hero

202. See 44 Fed. Reg. 49,971 (1979).

203. *Id.* at 49,970. But see note 169 and accompanying text *supra*. See also note 30 *supra*.

204. Michigan comment, *supra* note 104.

205. 16 C.F.R. § 436.1(a) (1980).

206. "[Statements would be unreliable] for such reasons as varying accounting practices, extravagant salaries and expense accounts for owner-employees and inclusion of personal expenses." Rudnick & Wolfe comment, *supra* note 128, at 19.

207. *Id.*

208. Minnesota comment, *supra* note 194, at 4.

209. 16 C.F.R. § 436.1(a)(20) (1980).

210. Letter from Sheldon Leighton, President, Bailey Employment System, Inc. to FTC (Jan. 2, 1979) (comment submitted regarding the New Guides).

211. *Id.*

212. *Id.*

213. Letter from Robert S. Ginsberg, Vice-President of Mr. Hero Sandwich Systems, Inc., to FTC at 5 (Feb. 21, 1979) [hereinafter cited as Mr. Hero comment] (comment submitted regarding the Rule).

would not object to providing this information to a serious prospective franchisee; the problem is the requirement that it be given to every casual inquirer. The International Franchise Association²¹⁴ commented that if the disclosure of excessive detail is mandated, "trade secrets and other confidential matters may be jeopardized. It is doubtful that this harsh result was intended by the Rule."²¹⁵

Impact of the Rule

"Be fruitful and multiply, and replenish the earth and subdue it, and have dominion over the fish of the sea and over the fowl of the air, and every living thing that moveth on the face of the earth." So sayeth the Lord in the Book of Genesis.

This quotation has been taken literally by Arthur Treacher as to the fish, Colonel Sanders as to the fowl, and Ray Kroc as to every other living thing. It would seem that franchisors are indeed on the side of the angels. Not necessarily so. The Bible can be quoted to support any given premise; it is well known that the Lord giveth and the Lord taketh away. His avenging angel this year is the Federal Trade Commission.²¹⁶

For most package or business format franchisors, disclosure has always existed. Their objection is to the FTC's "heavy handed" attempt to regulate the relationships between the franchisor and the franchisee.²¹⁷ Since most states have some type of franchise law, and fourteen currently have disclosure requirements, package franchisors expect to be regulated. For the large franchisors, who already have sophisticated accounting procedures and who currently provide prospective franchisees with financial information about the business, disclosure will be a relatively simple matter of producing one more statement.²¹⁸ The impact of the Rule will be much heavier on the smaller, less affluent franchisors, for whom compliance will require an additional load on existing staff, as well as outside assistance.²¹⁹

Obviously, franchisors' expenses of compliance will be passed on to new franchisees, and from them to consumers. Snap-on Tools warned that "the Commission should stop and carefully consider the inflationary impact which added govern-

214. See note 52 *supra*.

215. IFA comment, *supra* note 170, at 13.

216. J. Thomas Brown, attorney, Miami, Florida, formerly senior vice president, Burger King Corp., in *FRANCHISE REVIEW*, *supra* note 107, at 8.

217. *Id.*

218. See Mr. Hero comment, *supra* note 213, at 4.

219. Letter from Marc B. Rubin, Vice President, National Fire Repair, Inc. to FTC (Feb. 9, 1979) [hereinafter cited as National Fire Repair comment] (comment submitted regarding the Rule).

ment regulation will have"²²⁰ Inflationary additional costs include preparation of offering circulars, amending registered circulars with the states, and preparing separate statements of change in financial position.²²¹ Estimates of the cost of compliance vary widely,²²² but whatever the costs are, they will ultimately be borne by the consumer.

The Rule's costs of compliance will weigh most heavily on those least able to afford compliance: new companies. Its economic impact on the price of franchises will have the effect of frightening prospective franchisees and franchisors out of the market and will therefore have an adverse impact on competition.²²³ It may stifle the growth of franchising. Economic competition is commonly believed to be in the public interest. Yet it has been argued that the Rule "would preempt the field to only large corporations and thus impede competition. Most present franchisors probably would not be in existence if some of these rules had been in effect earlier."²²⁴

The final issue with respect to the Rule's impact is whether those who are covered will have a private right of action under the Rule. "The Commission believes that the courts should and will hold that any person injured by a violation of the rule has a private right of action against the violator, under the Federal

220. Snap-on Tools Corp. comment, *supra* note 138, at 6.

221. Letter from Watercare Corp. to FTC at 4 (Feb. 20, 1979) [hereinafter cited as Watercare Comment] (comment submitted regarding the Rule).

222. The Commission estimates that cost of compliance would be about \$10,000 in legal fees for a large firm, \$2500 for a small firm. *Senate Hearing, supra* note 5, at 89 (statement of Mr. Kramer, FTC).

Private industry estimates of cost of compliance vary: \$7000-\$10,000 for a small company (National Fire Repair comment, *supra* note 219); \$125,000 for a large company (Schwinn Brief, *supra* note 7, at 18); \$640,000-\$2,400,000 for a large public corporation (Oil Co. Motion, *supra* note 97, at 83 (citing affidavits of S. Peter Manchester (Mobil) and J.D. Froggatt (Chevron))).

223. Watercare comment, *supra* note 221, at 4.

"It will stifle competition rather than enhance it! This smothering of competition will particularly affect the 'small' businessman, the entrepreneur who [*sic*] government should be protecting and encouraging." Mr. Hero comment, *supra* note 213, at 1.

"Larger manufacturing firms may wish to consider arguing for a very broad definitional interpretation in hope of creating another legal barrier to new prospective entrants to their markets and another costly legal burden to small competitors already present." Rollinson, Editorial Comment, in Fern, *The Overbroad Scope of Franchise Regulation: A Definitional Dilemma*, 34 BUS. LAW 1387, 1400 (Apr., 1979).

224. Watercare Corp. comment, *supra* note 221, at 4.

"The young man who testified here this morning . . . said if he had to comply . . . he would never have gotten into the business. . . ." *Senate Hearing, supra* note 5, at 89 (Senator Nelson).

Trade Commission Act, as amended, and the rule."²²⁵ Although the FTC's view is that "private actions would add a valuable dimension to its own enforcement efforts,"²²⁶ it concedes that "there is some question about whether federal courts will permit individual investors to sue for relief from a Rule violation."²²⁷

In fact, there really appears to be little question that federal courts will *not* permit private suits. Decisions on this issue with respect to another administrative agency, the SEC, indicate that the Supreme Court is becoming hostile to implied private causes of action. Furthermore, there is no longstanding tradition of private rights; their first recognition by the Supreme Court was in *J.I. Case Co. v. Borak*²²⁸ in 1963. Almost immediately, the Court began to retrench from this decision, until in 1979 it said that "in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today."²²⁹ Finally, the FTC Act does not provide for private enforcement.²³⁰ The Securities Exchange Commission Act of 1934 also provides no private cause of action, and in a 1977 case²³¹ the Supreme Court labeled this a factor that weighed heavily in its decision not to permit a private action under the 1934 Act. These precedents make it extremely doubtful that a court will permit a private right of action under the Rule.²³²

225. 44 Fed. Reg. 49,971 (1979):

The existence of such a right is necessary to protect the members of the class for whose benefit the statute was enacted and the rule is being promulgated, is consistent with the legislative intent of the Congress in enacting the Federal Trade Commission Act, as amended, and is necessary to the enforcement scheme established by the Congress in that Act and to the Commission's own enforcement efforts.

226. FTC letter of Dec. 21, 1978 (*Questions & Answers*).

227. *Id.*

228. 377 U.S. 426 (1963).

229. *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) (holding that a private remedy is not implicit in a statute which does not expressly provide one).

230. At least one commentator has noted that "[i]n the absence of special enabling legislation, there will be no direct private enforcement of the new FTC trade regulation on disclosure to prospective franchisees." H. BROWN, *supra* note 35, at 180.

231. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (holding that breaches of fiduciary duty, which would give rise to a private cause of action, were not actionable under § 10(b) of the Securities Exchange Act of 1934).

232. While the Supreme Court has not ruled on a private right of action under the FTC Act, a line of lower court cases has held that there is no private right. *See, e.g., Fisher v. Coca-Cola Bottling Co. of Los Angeles*,

The Rule in Perspective

More than nine years have elapsed since the FTC began the proceedings which ultimately resulted in promulgation of the Franchise Rule. Over seven years have passed since the FTC first proposed the Rule. More than four years have passed since the FTC claimed to have completed taking evidence on which it now purports to have relied in promulgating the final Rule.²³³

In response to a suggestion that "consistent with this liesurely [*sic*] approach"²³⁴ the FTC should postpone the Rule's effective date, the Commission responded that "the period after the public comment ended was spent . . . in a careful evaluation of the material . . . in the administrative record [and] preparation of the statement of basis and purpose. . . ."²³⁵ The FTC claimed that "[f]ar from being an indication of indifference, this lengthy review process reveals the Commission's concern for promulgating a well-reasoned and fair rule."²³⁶ Whatever the motivation for the delay, one of the consequences is that fourteen states enacted disclosure laws in the meantime, and it is now necessary to deal with questions of preemption and use of the Uniform Franchise Offering Circular which could have been avoided by more timely federal action.²³⁷

Most of the problems likely to result from the Rule have been discussed above. The FTC's broad definition of franchise, which lumps together "package and product franchises,"²³⁸ has generated the most opposition from selective distribution organizations. At this writing, their arguments appear to have prevailed. Some selective distribution companies have received FTC staff advisory opinions that they are not franchisors because they charge no franchise fees,²³⁹ and other similar organizations will probably escape coverage on the same ground. However, a great deal of confusion as to the scope of coverage remains.²⁴⁰

1979-1 CCH Trade Cases ¶ 62,514, at 76,987 (C.D. Cal. Mar. 12, 1979); *Carlson v. Coca-Cola Bottling Co.*, 483 F.2d 279, 280 (9th Cir. 1973).

233. Oil Co. Reply, *supra* note 155, at 2.

234. Oil Co. Motion, *supra* note 97, at 29.

235. FTC Opposition Motion, *supra* note 6, at 18 n. 14.

236. *Id.*

237. See notes 202 & 203 and accompanying text *supra*.

238. 16 C.F.R. § 436.2(a)(1)(i) & (a)(2) (1980). See notes 107 & 108 and accompanying text *supra*.

239. See notes 126-29 and accompanying text *supra*.

240. See text accompanying notes 98, 144-46 *supra*.

Federal/state jurisdictional questions are of concern to those states that already have disclosure laws.²⁴¹ Extra costs are an obvious problem for franchisors.²⁴² "The Commission apparently relies upon the ability of manufacturers to pass onto [*sic*] the consuming public the expense of unnecessary and burdensome regulation, since these expenses are unrecoverable. This argument is not worthy of a regulatory agency charged with achieving fairness in the marketplace and protecting the consumer."²⁴³ Finally, the tendency of the Rule to reduce competition through its disproportionately heavy impact on new franchisors is a concern to consumers as well as to the parties to franchise agreements.²⁴⁴

Franchisors have claimed that the prohibition against including information in the disclosure document which is not required by the Commission²⁴⁵ "may violate the First Amendment rights of both potential franchisees and franchisors by forcing participation in speech which does not reflect their opinion[s] and [is] against their will[s]."²⁴⁶ The FTC responds that franchisors "are free to distribute any information they choose in addition to the information required . . . provided . . . [it] is not inconsistent with the information contained in the . . . disclosure document."²⁴⁷

Another requirement in the Rule that causes trouble is disclosure of indictments of directors, even when the indictment was dropped, the case was settled, the person was found not guilty, or the indictment is not yet resolved.²⁴⁸ "The Commission is taking the attitude that an accusation is the same as a

241. See San Francisco comment, *supra* note 105. See also notes 199-204 and accompanying text *supra*.

242. See notes 220-24 and accompanying text *supra*.

243. MVMA Motion to File Reply, *supra* note 112, at 9.

244. The Securities and Exchange Commission over the years has eliminated the competition in the securities market, making it almost impossible for the small and medium size companies to finance, thereby forcing mergers vertically and horizontally. They have done all this for the "benefit of the consumer." The FTC in its zeal to get into the franchising act is following in the footsteps of its sister, the SEC. Neither will help the consumer.

FRANCHISE REVIEW, *supra* note 107, at 11.

245. "e. *Certain Prohibitions*. [N]o information may appear in the disclosure document unless it is required either by the rule or by non-preempted state law." 44 Fed. Reg. 49,971 (1979).

246. Oil Co. Motion, *supra* note 97, at 75.

"The Commission is in effect saying: 'You may speak only as we say you may speak, or you may not speak at all.'" MVMA Motion to File Reply, *supra* note 112, at 10.

247. FTC Opposition Motion, *supra* note 6, at 16.

248. 44 Fed. Reg. 49,973 (1979).

conviction."²⁴⁹ The obligation to report pretrial settlements "will severely retard a company's willingness to settle what it considers to be unmeritorious cases."²⁵⁰ And the Rule's requirements on disclosure of indictments are inconsistent with those of the Uniform Franchise Offering Circular.²⁵¹

CONCLUSION

There is no doubt that the goal of the Rule to prevent fraud in franchising by requiring that prospective franchisees be given the information necessary to make an informed decision is commendable.²⁵² But while "in theory the Rule is proper, . . . there is a vast difference between theory and practicality."²⁵³ Along with the Rule, the FTC promulgated a lengthy statement of basis and purpose, and unprecedented Guides for application of the Rule.²⁵⁴ The length of these documents, and the apparent disagreement as to coverage between the Rule and the Guides,²⁵⁵ have produced doubt in some businesses about whether they must comply with the Rule's requirements.²⁵⁶ One businessman expressed his frustration with the scope of coverage to the Senate Small Business Committee: "It is like trying to develop a safety standard to cover both a tricycle and a double bottom semi, because they're both *vehicles*."²⁵⁷

Such problems may force a franchisor to seek professional help to determine whether, and how, to comply with the Rule. In addition, the Rule requires the franchisor to recommend on the cover of the disclosure statement that the franchisee consult

249. FRANCHISE REVIEW, *supra* note 107, at 11.

250. Oil Co. Motion, *supra* note 97, at 23 n. 23.

251. "The Statement indicates that the required settlement disclosure is 'consistent' with the UFOC. However, the UFOC only requires disclosure of the precise terms of settlement if they were approved by a court and are a matter of public record. . . ." IFA comment, *supra* note 170, at 6.

252. If franchising is to fulfill its claim as the nation's last frontier for the small businessman, it cannot be based on fraud in any form. Profit must be taken out of all such misrepresentation, regardless of the cost. In fact, there is ample proof that legitimate joint ventures can be maintained in franchising without resort to such abusive tactics. Those assumptions underlie all current legislative efforts.

H. BROWN, *supra* note 35, at 182.

253. Mr. Hero comment, *supra* note 213, at 4.

254. See text accompanying notes 171-73 *supra*.

255. See text accompanying notes 166-70 *supra*.

256. See text accompanying notes 166-70 *supra*. See also notes 98 & 123 and accompanying text *supra*.

257. Senate Hearing, *supra* note 5, at 12 (Frank E. Bauchiero, President, Material Handling Group of Rexnord, Inc.).

an advisor.²⁵⁸ One commentator has observed that "[t]his is not a franchise rule, it's a lawyers' and accountants' employment act. (The FTC tells you to check with these people before investing; even the SEC doesn't do that.)"²⁵⁹ And, "[w]ho says that a government agency has the right to decide where or when a person speculates with his money, or if he even should?"²⁶⁰

Several comments have observed that the end result of the Rule is to increase the costs of doing business, and ultimately the costs of goods to the consumer,²⁶¹ with little resulting benefit to the franchisee or the public.²⁶² This is the kind of problem addressed by President Carter in a March, 1979 press release announcing major reforms in the regulatory process:

Regulation has a large and increasing impact on the economy. Uncertainty about upcoming rules can reduce investment and productivity. Compliance with regulations absorbs large amounts of the capital investments of some industries, further restricting productivity. Inflexible rules and massive paperwork generate extra costs that are especially burdensome for small businesses, state and local governments, and non-profit groups. Regulations that impose needless costs add to inflation.²⁶³

Government regulations that do not serve the public interest should be simplified or eliminated. KFC Corporation suggested that a one-sentence rule forbidding fraud might be all

258. See note 92 *supra*.

259. FRANCHISE REVIEW, *supra* note 107, at 12. See Mr. Hero comment, *supra* note 213, at 3 ("[the Rule] greatly enhanced the need for, and fees of, the accounting profession").

260. FRANCHISE REVIEW, *supra* note 107, at 12.

261. See notes 220-22 and accompanying text *supra*.

262. The most pessimistic conclusion concerning the effect of the Rule was that "not only is the small franchisor doomed . . . but the Rule is a real threat to the American entrepreneur. The result of this Rule is that few franchises will remain available to the public and they will only be available to the rich." Mr. Hero comment, *supra* note 213, at 7.

More typical of the comments on the effect of the Rule are these: "[T]he Rule will result in another costly, unreasonable and unnecessary burden on American business." Winston & Strawn comment, *supra* note 113, cover letter at 2. "[I]n rulemaking it is important . . . [to] regulate only to correct the abuses which create such ills and not to impinge on the free enterprise system where such abuses do not exist." Koehring comment, *supra* note 23, at 2.

263. Exec. Order No. 12044, 43 Fed. Reg. 12,661 (Mar. 23, 1979).

Since the first federal regulatory agency was established nearly a century ago, regulatory programs have grown steadily in number, scope, and impact. During that time, however, little attention has been paid to the management of the regulatory process. . . . The time has come to stop this neglect. . . . [W]e must reform the government's regulation of others' resources.

Id.

H.R. 2313, proposed FTC Improvement Legislation, would require the FTC to submit final rules to Congress for review.

that is required to protect franchisees.²⁶⁴ Since fraud is illegal anyway, even that is probably more than necessary. In today's economy, business needs fewer, not more, restrictions.

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264. Letter from KFC Corp. to FTC at 6 (Nov. 19, 1974) (comment submitted regarding the Rule):

Perhaps a one-sentence rule would be all that is required to protect franchisees. For example: "In connection with the grant of any franchise, no franchisor shall make any false or misleading statement of a material nature, nor omit to make any statement that is necessary to make any statements that are made not materially false or not materially misleading."

