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Franchise Full Disclosure

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Comment

FRANCHISE FULL DISCLOSURE

I. INTRODUCTION

Along with the chain stores system, the marketing phenomenon called franchising has assisted in the architectural standardization of modern America's suburban business establishments. But behind the regimented exterior of the franchise outlet is a new and extremely popular contractual arrangement that claims to be the savior of the small businessman. For a fee, the local investor can own and operate a unit of a proven business enterprise of national renown and receive expert assistance in making the local unit profitable.

Franchising has reached its current stage of popularity without notable conflict with established law except for its fundamental conflict with antitrust regulations. In 1970, however, the federal and several state governments showed a great deal of concern for the future of franchising and the protection of the potential franchise investor. The result of the first extensive federal investigation of franchising was the conclusion that the franchise arrangement

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1 On the basis of architecture, goods sold, or services rendered, it is not easy to distinguish between a corporate owned and managed chain store and an independently owned and operated franchised unit. There may even be a mix of chain and franchised units behind one facade. Kentucky Fried Chicken makes more profit on a company owned outlet and has established a policy of "buying back" profitable franchised units. Burck, Franchising's Troubled Dream World, FORTUNE, March 1970, at 116. The franchising process may be used as a "short-run, transitory stage for an expanding company." Id. at 121.

2 The growth of franchising has been astonishing. "Franchising now accounts for approximately $90 billion in annual sales, or about 10 percent of our country's entire gross national product." Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of the Senate Select Comm. on Small Business, 91st Cong., 2d Sess., at 1 (1970) [hereinafter cited as 1970 Hearings]. It is estimated that 90% of the franchise companies existing today began after 1954. Burck, supra note 1, at 117. As a result of this growth, it is said that franchising "represents the best, if possibly not the last, opportunity for the small businessman to survive in our economy." 1970 Hearings 49.

3 "Price fixing, exclusive dealing, tie-ins, territorial allocation, customer restrictions, price discrimination, monopolization—whatever it may be, franchising has it, at least potentially." Pollock, Antitrust Problems in Franchising, 15 N.Y.L.F. 106 (1969).
COMMENT

is so unique that its proper development can not be assured under existing law.  

Although there is no "typical" franchise contract, the franchise purchaser, or franchisee, is usually required to pay a fee for the privilege of opening a franchise outlet, and must then rely upon the franchise seller, the franchisor, to provide guidance and support in the operation of the enterprise. If the venture fails, the franchisee may lose his entire investment. In the past, there have been attempts to regulate substantive provisions of franchise agreements in order to reduce the instances of investment loss by franchisees. The focus of recent concern over franchising practices has not involved the objection to particular contract provisions so much as the desire to insure that the investing franchisee is aware of the true nature and scope of the risks he is undertaking. This comment will trace the extent of regulatory practices, with particular emphasis placed upon recent state and federal legislative proposals that require full disclosure of material information by the franchisor prior to any contractual undertaking with a prospective franchisee.

II. BACKGROUND

As a modern business relationship, franchising has been avidly denounced and aptly defended, but never adequately defined. Since any particular arrangement may contain only a modicum of similarity with any other, the franchising concept is susceptible only to general description. Essentially, the granting of a franchise

5 As a representative case, a New Jersey dentist testified that he lost $27,000 in one year as an equipment rental franchisee. After accumulating sufficient assets by selling an idea to franchisees, the equipment rental franchisor went "public." "A million shares were sold at $13.75 each. With over $14 million they embarked upon an aggressive program of corporate acquisitions, buying up one company after another within a year's time. The price of the stock soared to $54 before a stock split. Within 21 months of going public, they declared bankruptcy." Statement of Victor J. Nitti, D.D.S., 1970 Hearings 409, 412.
6 For a review of past legislative attempts by Congress, see Zeidman, Legislative Supervision of the Franchise Contract: Throwing Out the Baby with the Bath Water?, 15 N.Y.L.F. 19 (1969).
9 "The word 'franchise' has been applied so indiscriminately, and to such divergent business arrangements as to defy consistent definition." Wilson, An Emerging Enforcement Policy for Franchising, 15 N.Y.L.F. 1, 2 (1969). For an insight into what a franchise contract might entail, see Van Cise, A Franchise Contract, in 1970 Hearings 277.
is the granting of a license, but with the added interest of the franchisee in the continued assistance of the franchisor.  

This continuing relationship between franchisor and franchisee is important to both parties. The franchisee may be entirely dependent upon the franchisor's guidance, but most often he is also seeking to maintain some degree of independence. Besides having contractual obligations to aid the franchisee, in most instances the franchisor is obligated to oversee the conduct of the franchisee at least to the extent of protecting the public from the possible misuse of the franchisor's trademark, trade name or service mark.  

But as the franchisor's degree of control over the franchisee increases the risk of an antitrust violation increases, and some have argued that the degree of control may reach the point where the relationship qualifies as that of principal and agent. In a recent landmark decision, a Canadian court held that a franchise relationship was in fact a fiduciary relationship that had many attributes of a partnership.  

Being a relationship founded upon trust and cooperation, a bilateral evaluation of capability to perform and establish a successful operation would appear to be a prerequisite to any agreement. Unfortunately, many enterprising franchisors conceal the information a prospective franchisee would need to make an intelligent decision as to the investment risks involved in the franchise. They hide the fact of their undercapitalization in misleading accounting methods that treat franchise fees as income when in actuality the fees have been obligated for the further expansion of franchise operations. They refuse to provide facts concerning their history, the names of other franchisees, and their future intentions relating to the franchise operation. Some franchisors purposely overesti-

10 "Basically, a franchise is a license. But it's much more than that. It's a continuing commercial relationship (either of a definite or indefinite duration) in a particular area under which one person (the franchisee) is given the right to offer, sell and distribute (1) goods manufactured, processed or distributed, or (2) services organized and directed, by the other person (the franchisor). The franchise is associated with the franchisor's trademark, trade name, some service mark or commercial symbol." CCH Corp. Forms ¶ 177 (1970).  

11 Lanham Act, 15 U.S.C. §§ 1051-1127 (1964) (requires the registration of and regulates the use of trade marks used in commerce).  

12 Pollock, supra note 3, at 107.  


15 Burck, supra note 1, at 121.
mate expected profits and underestimate the efforts required of the franchisee in order to make the business successful. The techniques franchisors have used to distort reality are limitless, but few have presented disenchanted franchisees with cases of actionable fraud and misrepresentation against the franchise promoters.

The practices of some franchisors have met criticism for several years, but until recently there has been an attitude of hesitancy toward governmental interference with the offer and sale of franchises. One consideration has been the desire to preserve contracting freedom. Many also feared a snuffing of the economic spark that franchising has provided, and the destruction of the small businessman's last bastion. It has been argued that the promise franchising offers minority groups to participate more actively in the economy is another reason for not imposing restrictions on franchising's development. However, the purpose and effect of full disclosure legislation does not run contrary to any of these considerations. A full disclosure of material facts concerning the franchise that is being offered for sale will not retard the growth of franchising or interfere with contractual freedom, but will merely "provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered."

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16 The equipment rental franchisee mentioned in note 5 supra found the operation involved much more effort than expected and his first year gross income to be only "a shade above 50% of the franchisor's projection." 1970 Hearings 409.
19 "The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. . . . If our economy had not developed that system of operation these individuals would have turned out to have been merely employees." Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), aff'd, 332 F.2d 505 (2d Cir. 1964), cert. dismissed as improvidently granted, 381 U.S. 125 (1965).
20 Sayre, Franchising in the Ghetto, 25 BUS. LAW. 73 (Special Issue 1969).
III. CORRECTIVE FORCES

A. SELF REGULATION

The majority of franchisors, those that have made the system so successful, have recognized the need to expose fraudulent and unethical franchisors to prospective franchisees. These more reputable franchisors do not fear a disclosure of material facts, but encourage the franchisee's full understanding of obligations and risks. They have attempted to remove the undesirables from their ranks, but have found self regulation to be extremely difficult.

The International Franchise Association, the leading organization of franchisors, has a Code of Ethics that its members are expected to support, and has taken other steps to promote ethical conduct in franchising. An excellent trade publication, Continental Franchise Review, has pleaded for self regulation from within the franchising system and has its own policy of challenging questionable franchise operations. Major newspapers and business magazines have voluntarily established various procedures aimed at preventing distorted promotional materials used by some franchisors from receiving the implied support of their publications. But the concerted efforts at private regulation have not been effective and most authorities and leading franchisors look to some form of governmental assistance.

B. FEDERAL TRADE COMMISSION

Some authorities argue that the federal government has sufficient power at the present time to regulate fraudulent franchising practices, and that full disclosure legislation is therefore unnecessary. They look to the Federal Trade Commission and its power to eliminate "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce." The commission has had several years' experience in protecting the public from deceptive business practices, and recently special attention has been given to franchising. A study of selected franchisors has been initiated,

22 1970 Hearings 584.
23 "By far, the best publication in the franchising field." Blackford, Book Review, 40 CLEV. B.J. 239 (1969).
24 Statement of Thomas H. Murphy, Publisher, CONTINENTAL FRANCHISE REV., 1970 Hearings 204. See also 3 CONTINENTAL FRANCHISE REV. July 20, 1970, at 4.
and, "on the basis of its study, the FTC will consider guidance for the industry to follow in framing contracts and carrying them out, and in advertising franchising opportunities to the public. . . ." 29 In a recent complaint and subsequent consent order, 30 the Commission required a franchisor to provide each future prospect with relevant information "reasonably prior to such persons agreeing to become franchisees." In oral statements and promotional materials, the franchisor had distorted facts concerning the personal qualities a franchisee must have to succeed, the difficulties to be expected in selling the product, the success of previous franchisees, and the expectation of substantial income. The order from the Commission required that the franchisor perform a good faith evaluation of the prospective franchisee's ability to succeed in the undertaking since successful operation of the franchise was dependent upon specific personality and communications skills. The franchisor was also required to furnish precise information concerning the number of successful franchisees, the number of franchise outlets planned, the number terminated, and gross sales figures.

Although the Federal Trade Commission has initiated a policy of increased surveillance of franchising practices, the question seems to be whether it is capable of effectively policing the broad spectrum of franchising abuses. While the FTC changes from "tennis shoes to cleats" in regard to franchising, other means of regulation are being pursued.

C. Securities Laws

Some have suggested that the offer and sale of franchises be subjected to state and federal securities regulations. 31 They see no reason why the franchisor should be given preferential treatment in the competition for the public's capital since most other competitors must comply with securities regulations in order to acquire


needed capital.\textsuperscript{32} However, most courts have rejected the argument that the franchise is a security.\textsuperscript{33}

A few state securities agencies have attempted to regulate the offer and sale of some of the more "security-like" franchises.\textsuperscript{34} The State of California was the first to try, but it soon found that adequate protection was not being given to most prospective franchisees.\textsuperscript{35} The Securities Exchange Commission has not made the attempt,\textsuperscript{36} but some have argued that it could do so easily and provide uniform and effective regulation.\textsuperscript{37}

Several suits have been brought in federal courts on the theory that a franchise is a security and therefore subject to the Securities Act of 1933,\textsuperscript{38} Securities Exchange Act of 1934,\textsuperscript{39} and the liberal anti-fraud provisions of S.E.C. Rule 10b-5.\textsuperscript{40} Although it is reported that several 10b-5 suits have been settled out of court for large amounts,\textsuperscript{41} as of this writing, a $100,000 suit by a franchisee is pending in a federal district court.\textsuperscript{42}

In view of the legislation to be discussed, the mental gymnastics involved in calling a franchise a security seems to be totally unnecessary. However, awaiting progressive legislation, the security argument may serve the individual case and securities agencies may develop the means to adequately police franchising activities.

\textsuperscript{32} Goodwin, supra note 31, at 1312.


\textsuperscript{34} State attempts at applying their securities regulations to franchising have been too involved to be discussed in this article. For further discussion, see Green, The Regulation of Franchising Under the Securities Laws, 6 GA. ST. B.J. 357 (1970); Pierno, Franchise Regulations, The Need for a New Approach, 44 LOS ANGELES B. BULL. 501 (1969).

\textsuperscript{35} Pierno, supra note 34.

\textsuperscript{36} "[I]f disclosure is to be obtained in the franchising area, this should be done by the enactment of separate legislation rather than, as has been suggested, by simply changing the definition of security in the Securities Act so as to make a franchise a security thereunder." Statement of Philip A. Loomis, Jr., General Counsel, Securities and Exchange Commission, 1970 Hearings 706, 710.


\textsuperscript{40} 17 C.F.R. § 240.10b-5 (1970).

\textsuperscript{41} Goodwin, supra note 37.

\textsuperscript{42} Bergener v. Diners/Fugazy Travel, Inc., Cause No. 69C2183 (N.D. Ill., filed Nov. 22, 1969).
IV. PROTECTIVE LEGISLATION

A. FEDERAL ACTION

Hearings were held early in 1970 by the Senate Subcommittee on Urban and Rural Economic Development of the Select Committee on Small Business to investigate "The Impact of Franchising on Small Business." After investigating both sides of the franchisor-franchisee relationship in depth, it was found that:

[In consequence of fraud and other practices, numerous purchasers of business franchises have suffered substantial losses as a result of the failure or omission by franchisors to provide full and complete disclosure concerning the prior business experience of the franchisor, the nature of the franchisor-franchisee relationship, the nature of the franchise contract, the prospects of the franchised business and other facts essential to a businessman's determination of the desirability and profitability of the franchise.

The resulting legislative proposal, "The Franchise Full Disclosure Act of 1970" (S.3844), was introduced by Senator Harrison Williams (Dem. N.J.) and would require not only that disclosure be made, but that the franchises be registered with the Securities Exchange Commission, unless specifically exempted by Commission ruling.

The Williams Bill is constructed along the lines of the Securities Act of 1933 and the Interstate Land Sales Full Disclosure Act of 1968. One of the most difficult problems with any legislation in the franchise area has been the defining of franchise. The Williams Bill's definition includes what seems to be two common elements of any franchise arrangement, the payment of a fee by the franchisee and reliance on the franchisor for support and guidance.

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43 1970 Hearings.
49 S. 3844, 91st Cong., 2d Sess. (1970). Section 3(3) provides: "The term 'franchise' means a contract or agreement, either expressed or implied, oral or written, between two or more persons under which (A) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor, (B) the operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate and (C) the franchisee is required to pay, directly or indirectly, a franchise fee. Unless specifically stated otherwise, such term includes an area franchise as hereinafter defined."
The application for registration with the Commission must contain the specific business data required by the bill and any additional information that the Commission may decide is necessary. Leaving an open end as to disclosure requirements allows the Commission to close any "fresh traps" that franchisors might develop. Disclosure must also be made to each prospective franchisee forty-eight hours prior to any contractual undertaking. This provision would counteract "pressure" sales tactics and give the prospective franchisee ample time to consult an attorney. If this provision is violated, the contract entered into is voidable at the franchisee's option.

It would be unlawful for a franchisor or his agent to use any means of transportation or communication in interstate commerce or the mails to sell franchises unless the franchise was (1) registered and a prospectus was properly submitted to the franchisee, and (2) the sale was made without the use of fraudulent devices, material misrepresentations, or any practice "which operates or would operate as a fraud or deceit upon a franchisee." It would appear that the "federal common law of corporate responsibility" that has developed with Rule 10b-5 could be applied to this bill to ease the proof requirements for fraud or deceit.

The civil liability provision of the bill would allow the franchisee to collect treble damages. Criminal penalties for any willful violation establish the possibility of $5,000 fines, five years imprisonment, or both. The bill would allow the states to exercise jurisdiction over franchising has provisions for the determination of federal court jurisdiction concurrent with state court jurisdiction, and denies the removal to federal court of any action brought under the bill in a state court of competent jurisdiction. There are also provisions requiring that the Commission be provided with an irrevocable power of attorney to accept service of process in any civil action brought under the provisions of the bill.

Probably the most important part of the bill is the schedule of information that must be disclosed to the Commission and prospec-
tive franchisees. With this information, the franchisee will know the character, background, experience, and financial status of the franchisor. Disclosure of the nature and extent of fees that will be required of the franchisee will provide a better forecast of the profitability of the franchise. Knowing what equipment, supplies, and services will be necessary “by the terms of the franchise agreement or by other device or practice” will also give greater insight of the future. The past practice of some franchisors has been to spring undisclosed fees upon the franchisee, or coerce the franchisee into equipment, service, or supply purchases that were not disclosed in the franchise contract.

The federal legislation attempts to further the franchisee's evaluation of the investment risk in other areas. Although termination and “buy back” procedures are not directly regulated by the bill, these procedures must be explained fully in the prospectus. Franchisees have argued, often unsuccessfully, that termination provisions allowing the franchisor to terminate the franchise without cause were unconscionable. With disclosure required the franchisee should be aware of the conditions upon which he might lose his franchise.

The terms of any financial arrangement to be offered by the franchisor and any intent the franchisor has to sell or assign any obligation of the franchisee must also be disclosed. The franchisee must be told facts concerning the past success, present operation, and future plans of franchises under the franchisor's control. Another interesting disclosure provision would require stating the compensation given to a “public figure” for the use of his name in the name or symbol of the franchise.

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61 Id. Schedule A; see Appendix.
62 Id. Schedule A (3) to (6).
63 Id. (8) and (9).
64 Id. (11).
65 See generally Brown, supra note 7.
66 S. 3844, 91st Cong., 2d Sess. Schedule A (10) (1970); see Appendix.
68 S. 3844, 91st Cong., 2d Sess. Schedule A (13) and (14) (1970); see Appendix.
69 Id. (15) and (16).
70 Id. (20). See also Statement of Joe Namath, 1970 Hearings 300: “In other words, my own future and that of the company, Broadway Joe's, are one and the same.” And it has come to pass, leaving behind
Except for provisions allowing the Commission to require additional information at its discretion and allowing the franchisor to add any that he wishes, the last two provisions of importance require the franchisor to disclose (1) whether the franchisee is limited to the goods and services he can offer, and (2) whether the franchisee will receive an exclusive area or territory.

It would seem that a discussion of proposed federal legislation relating to franchising would be of limited value in light of the demise of every past attempt. However, the Williams Bill was the first to be based upon a full scale investigation of franchising, bringing together an unprecedented collection of franchising statistics and expert opinion. In introducing his carefully drafted proposal before the Senate, Senator Williams concluded:

The only course of action to provide protection for the potential franchise holder and to restore an ethical balance to franchising is legislative action at either the State or Federal level. I believe franchising, by its very unique nature, should be regulated by a properly drawn Federal law.

Although his conclusive remarks may have been accepted, the Williams Bill did not leave the Senate Committee on Banking and Currency in 1970. A companion measure in the House (H.R. 19022) may have a better chance of survival in Congress. It is reported that by providing for the preemption of state laws in the area and limiting the civil liability of the franchisor to the franchisee's actual damages, H.R. 19022 is a more politically palatable version of the basic regulatory scheme set forth in the Williams Bill. But, while full disclosure legislation is still being considered on the federal level, legislative action on the state level is a fact.

B. STATE ACTION

In 1967, California attempted to correct an accelerating frequency of fraudulent practices in franchise sales by applying their state…
securities regulations to the area.\textsuperscript{77} Because of a complicated qualification test,\textsuperscript{78} not all franchise sales were made subject to regulation and state authorities decided that a choice had to be made as to a more effective regulatory scheme:

Either the definition of security in the California Corporate Securities Law should be expanded to include "franchise" (with appropriate specific exemptions also being added), or the securities concept should be abandoned and franchises \textit{per se} should be subject to some form of review, licensing, permit or qualification procedure.\textsuperscript{79}

In November 1969, the California Legislature held hearings "to determine the nature and extent of the franchise problem in California."\textsuperscript{80} The state attorney general's office reported that franchise fraud had become the biggest problem for their business fraud division.\textsuperscript{81} Through the combined efforts of legislators, the attorney general's office, the corporations commissioner's office and the franchising industry, a modified full disclosure bill was drafted, requiring full disclosure and vesting extensive administrative powers in a state agency.\textsuperscript{82} Signed into law on September 18, 1970, the California "Franchise Investment Law" became "the first major piece of legislation aimed at protecting the consumer from unethical franchising techniques and practices."\textsuperscript{83}

Operative on January 1, 1971, California's law is a comprehensive and forceful example of protective legislation. The basic procedure is for franchisors to register with the commissioner of corporations prior to offering any franchise for sale unless specifically exempted from the registration requirement.\textsuperscript{85} The registration application must disclose relevant information concerning the franchise to be offered, and the same information must be provided in prospectus form to each prospective franchisee at least forty-eight hours before a contract is signed or the receipt of any consideration, whichever occurs first.\textsuperscript{86} According to the specific exemption pro-

\textsuperscript{78} Id. at 504.
\textsuperscript{79} Id. at 504.
\textsuperscript{81} Id. at 596.
\textsuperscript{82} The Knox-Bradley Bill (AB 1309-SB 647) was introduced into the California Legislature on March 18, 1970.
\textsuperscript{83} \textit{3 Continental Franchise Rev.}, Aug. 10, 1970, at 3.
\textsuperscript{85} Id. § 31100.
\textsuperscript{86} Id. § 31111.
visions, those franchisors that have the required financial backing, the required experience in franchising, and who disclose essential information to their franchisees need not register.\textsuperscript{87} Thus, a definition of franchise\textsuperscript{88} that is virtually identical to the Williams Bill definition is narrowed, in effect, by provisions that exempt well-funded and experienced franchisors from registration with the state but still require them to disclose specific information to their franchisees.

Going beyond any federal proposal, the California law restricts the number of individuals who will do the actual selling of the franchise. Without specific exemption, it will be unlawful for any individual to sell a franchise in California unless (1) properly identified in a registration statement, or (2) a licensed real estate broker, or (3) a licensed stock broker.\textsuperscript{89}

And, going even farther beyond full disclosure protection, California has vested substantial power in their commissioner of corporations to oversee franchisor-franchisee dealings. The commissioner has the power to summarily suspend or revoke a registration statement for noncompliance with the law or the commission's rules, or whenever an unreasonable risk to prospective franchisees is determined to exist.\textsuperscript{90} If it appears that a franchisor will not be able to fulfill his promises, the commissioner may demand that the franchisee fee be placed in escrow or a survey bond be issued at the franchisor's option.\textsuperscript{91} The commissioner is also given the power to review advertisements prior to publication within the state\textsuperscript{92} and to bring action in the name of the state to enjoin acts or practices in violation of the law.\textsuperscript{93} By such conduct, those violating the law, including nonresidents, are said to have consented to the appointment of the commissioner as agent to receive service of process.\textsuperscript{94}

Any offer or sale in violation of the act will result in the franchisor's being liable for damages, and if the violation is willful the franchisee may also sue for rescission.\textsuperscript{95} Any willful violation will also result in criminal prosecution with penalties of up to ten years' imprisonment and ten thousand dollar fines, if convicted.\textsuperscript{96}

\textsuperscript{87} Id. § 31101.
\textsuperscript{88} Id. § 31005.
\textsuperscript{89} Id. § 31210.
\textsuperscript{90} Id. § 31115.
\textsuperscript{91} Id. § 31113.
\textsuperscript{92} Id. § 31156.
\textsuperscript{93} Id. § 31400.
\textsuperscript{94} Id. § 31420.
\textsuperscript{95} Id. § 31300.
\textsuperscript{96} Id. §§ 31410–31412.
On the whole, the California Franchise Investment Law is an extremely powerful measure. The forcefulness of the legislation reflects both the seriousness of the franchising problem in California and the peculiar organization and regulatory capability of California administrative agencies. It is evident that a modified full disclosure scheme may provide more restraint on franchising than many states would require and may also create unreasonable administration problems in other states. However, the basic requirement of a full disclosure of material facts by franchisors should appeal to states interested in fostering the future development of franchising within their jurisdictions. While it has yet to prove itself effective, the California law has blazed a trail in franchise regulation that other states and perhaps the federal government may one day follow.

V. CONCLUSION

The problems involved in the offer and sale of franchises today are reminiscent of those that once plagued the offer and sale of securities. In both situations, fraudulent representations, material omissions and self-deceptive dreams of easy money have added up to misunderstandings, business failure and serious financial loss. Through a full disclosure requirement, it is hoped that the franchise investor will have the opportunity to objectively evaluate the investment before obligations are incurred. In other words, merely requiring the presentation of all material facts should substantially reduce the risks undertaken by both parties to the franchise contract just as it has reduced risks in purchasing securities.

There seems to be little doubt that the most effective means of restoring vitality to franchising is through legislation. And there are several reasons why federal legislation requiring full disclosure would be the most desirable course of action. First of all, it would provide uniform regulation specifically designed to deal with problems peculiar to the franchise relationship. Secondly, effective federal regulation would make it unnecessary for many states to take further action. Legislation on the order of that proposed by Senator Williams would not preempt state regulation but the effects of federal law might foreclose the need for supplemental action by the states. A final reason for favoring federal regulation is the simple consideration of getting the best possible policing effort at the least expense. Both the Securities Exchange Commission and the Federal Trade Commission are experienced administrative agencies and either could be adapted to enforcing a franchise full disclosure requirement. Thus, for elementary reasons, federal legislation implementing a full disclosure requirement seems to be the most practical solution to the problems of franchising.
The proposed Franchise Full Disclosure Act of 1970 offered a reasonable means of providing franchise investors with the same type of protection that the federal government has given to securities investors. The failure to enact such legislation is not encouraging. Investigation has shown that deceptive practices in franchising is a national problem. The magnitude of the problem is exemplified by the comprehensive nature of California's new law and the proposals that have been considered by other states. While Congressional enactment of franchise full disclosure legislation continues to be delayed, it can be expected that the other fragmented campaigns to curb abusive practices in franchising will continue. The Federal Trade Commission will inch toward a full disclosure requirement in its methodical, case-by-case fashion, and more states will be considering independent action along the lines of that taken by California. But in the meantime, many more disenchanted franchisees will be wondering where law was when they needed it.

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Best Student Article Award 1971

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97 See proposed Massachusetts Franchise Fair Dealing Act (H. 2279) and proposed New York Franchise Law (S. 8408-A. 5767) in 1970 Hearings 15, 543.
COMMENT

APPENDIX

May 15, 1970 [S. 3844] A bill to require under the supervision of the Securities and Exchange Commission a full and fair disclosure of the nature of interests in business franchises, and to provide increased protection in the public interest for franchises in the sale of business franchises.

SCHEDULE A

(1) The name of the franchisor, the name under which he intends or is doing business, and the name of any parent or affiliated company that will engage in transactions with franchisees.

(2) The name of the State or other sovereign [sic] power under which the franchisor is organized and the location of the franchisor's principal place of business.

(3) The names and addresses of the directors or persons performing similar functions and the chief executive, financial, accounting and principal executive officers, chosen or to be chosen, if the franchisor is a corporation, association or other entity; of all partners, if the franchisor is a partnership, and of the franchisor if the franchisor is an individual.

(4) A statement disclosing whether any person identified in the registration statement

(a) has been convicted of a felony, or pleaded nolo contendere to a felony, or been held liable in a civil action by final judgment, if such felony or civil action involved fraud, embezzlement, fraudulent conversion, or misappropriation of property; or

(b) is subject to any currently effective order or ruling of any State or federal agency.
Such statement shall indicate the court, date of conviction or judgment, or any penalty imposed or damages assessed.

(5) The general character of the business actually transacted by the franchisor for the past five years, and the business to be transacted by the franchisor.

(6) Recent financial statements of the franchisor. The Commission may by rule or regulation prescribe the form and content of financial statements required under this Act, the circumstances under which consolidated financial statements may be filed, and the circumstances under which financial statements shall be certified by independent certified public accountants or public accountants.

(7) A copy of the franchise agreement proposed to be used.

(8) A statement of the franchise fee charged, the proposed application of the proceeds of such fee by the franchisor, and the formula by which the amount of the fee is determined if the fee is not the same in all cases.

(9) A statement describing any payments or fees other than franchise fees that the franchisee or subfranchisor is required to pay to the franchisor, including royalties and payments or fees which the franchisor collects in whole or in part on behalf of third parties.

(10) A statement of the conditions under which the franchise agreement may be terminated or renewal refused, or repurchased at the option of the franchisor.

(11) A statement as to whether, by the terms of the franchise agreement or by other device or practice, the franchisee or subfranchisor is required to purchase from the franchisor or his designee services, supplies, products, fixtures, or other goods relating to the establishment or operation of the franchise business, together with a description thereof.
(12) A statement as to whether, by the terms of the franchise agreement or other device or practice, the franchisee is limited in the goods or services offered by him to his customers.

(13) A statement of the terms and conditions of any financial arrangements when offered directly or indirectly by the franchisor or his agent.

(14) A statement of any past or present practice or of any intent of the franchisor to sell, assign, or discount to a third party any note, contract, or other obligation of the franchisee in whole or in part.

(15) A statement of available earnings of past and present franchises.

(16) A statement of the number of franchises presently operating and proposed to be sold.

(17) A statement as to whether franchisees and subfranchisors receive an exclusive area or territory.

(18) A statement setting forth such other information as the Commission may require.

(19) A statement setting forth such information as the franchisor may desire to present.

(20) A statement of any compensation or other benefit given or promised to a public figure arising, in whole or in part, from the use of the public figure in the name or symbol of the franchise.

(21) When the person filing the registration statement is a subfranchisor, the statement shall include the same information concerning the subfranchisor as is required from the franchisor pursuant to this schedule.