



1 APPEARANCES:

2

3 ON BEHALF OF THE FEDERAL TRADE COMMISSION:



1 would encourage you to supplement your written  
2 comments. Also as in previous workshop conferences,  
3 we will allot time at the end of today for anyone who  
4 wants to make any additional comments on the issues  
5 that we discuss today.

6 Further Staff, meaning Myra and myself,  
7 will be here again tomorrow from 9:00 to 3:00 to take  
8 the statements of anybody wishing to offer any comment  
9 at all on any franchise or business opportunity issue.

10 To keep things orderly, if you want to  
11 make a comment or ask a question, again please signal  
12 us by standing up your name tent. It is very  
13 difficult for the stenographer to pick up random  
14 voices, so if you're going to speak, please identify  
15 yourself first if I don't identify you for you.

16 With that let's begin. I briefly want to  
17 go around the table. If you could just state your  
18 name and any association or law firm or other interest  
19 that you may represent, that will be fine, and then  
20 we'll get under way. So let's start this way with  
21 Myra.

22 MS. HOWARD: Myra Howard. I'm also at  
23 the Federal Trade Commission working with Steve on the  
24 Franchise Rule.

25 MR. GERDES: My name is Roger Gerdes. I'm

1 a business development --

2 THE COURT REPORTER: I'm sorry. I'm a  
3 business development --

4 MR. GERDES: Business development manager  
5 with Microsoft Corporation responsible for the  
6 franchise industry.

7 MS. KEZIOS: I'm Susan Kezios president of  
8 the American Franchisee Association.

9 MS. GITTERMAN: Judy Gitterman. I'm with  
10 the law firm of Jenkins & Gilchrist in the franchise  
11 and distribution law department.

12 MR. FERBER: Brad Ferber. I'm an examiner  
13 for Washington state securities.

14 MR. JEFFERS: Carl Jeffers with Intel  
15 Marketing Systems, a franchise consulting firm  
16 specializing in franchise development and also  
17 franchise marketing and sales for clients.

18 MR. DUVALL: I'm Gary Duvall. I'm an  
19 attorney in Seattle. I work with the law firm of  
20 Graham & Dunn.

21 MR. WIECZOREK: Dennis Wieczorek. I'm a  
22 partner with Rudnick & Wolfe in Chicago.

23 MR. BUNDY: I'm Howard Bundy. I'm an  
24 attorney with the law firm of Bundy & Morrill in  
25 Seattle, Washington.

1                   MR. CORDELL: I'm Martin Cordell. I'm a  
2 staff attorney with the Washington State's security  
3 division.

4                   MR. CASILLAS: I'm Emilio Casillas,  
5 securities analyst with the securities division of  
6 the Department of Financial Institutions. I'm in  
7 charge of reviewing the franchise applications.

8                   MR. TOPOROFF: Okay. Thank you.

9                   Well, I want to welcome everybody. I  
10 understand that many people have taken out significant  
11 time out of their day and their work schedule and have  
12 flown here from various points, so again I appreciate  
13 everyone who has been willing to participate in this  
14 and other Commission meetings.

15                   For the benefit of those who have not  
16 participated in one of these meetings before, let me  
17 give you a little bit of background.

18                   The Commission, as you know, published an  
19 Advance Notice of Proposed Rulemaking in February of  
20 this past year. And in the ANPR, the Commission set  
21 forth tentative findings and conclusions about where  
22 it wants to go in revising the Franchise Rule and also  
23 asked for comments.

24                   Among the questions that the Commission  
25 asked are: Does the Franchise Rule continue to serve

1 a useful purpose? Should franchising be separated  
2 from biz ops? Should the Commission revise the rule  
3 along the UFOC guidelines approach? And if so, should  
4 there be specific changes to the UFOC, and in  
5 particular Item 3, litigation, Item 19, earnings  
6 disclosures, Item 20, failure rates, and related  
7 issues in item 20, which we will get to?

8           We are also exploring new marketing  
9 practices and technological developments, such as the  
10 advent of the internet, expanded international sales,  
11 and co-branding.

12           We are not going to discuss each of these  
13 issues today; however, if time is available at the end  
14 to the extent that people want to talk about issues  
15 like the international sales or co-branding, then  
16 we'll try to accommodate that.

17           I wanted to report to date that I believe  
18 we've received 110 comments. We are trying our best  
19 to get all of the comments posted on our web site, but  
20 sometimes that is difficult because people do not give  
21 us necessarily electronic copies. So the ones that  
22 come in by telephone or just generally in writing  
23 need to be downloaded or scanned, and that does take  
24 some time. But we are trying to accomplish that as  
25 quickly as we can.

1           And also just to make sure that everybody  
2 understands, the comment period is open and will  
3 remain open until the end of the year, so there is  
4 certainly ample time for people who have not submitted  
5 comments to do so. Hopefully everyone here either  
6 directly or through their law firm have submitted a  
7 comment. But if you haven't, again there is time to  
8 do so.

9           We're certainly encouraging people to  
10 supplement their comments if you believe that there  
11 are issues that we have not touched upon where you  
12 have additional thoughts.

13           Again I reference the New York meeting  
14 that was held in September. I believe we had about 16  
15 panelists and including a demonstration -- an internet  
16 demonstration from a company called PR One.

17           And again, as I mentioned before, several  
18 of the panelists, Susan and Dennis in particular, are  
19 here today, and again I want to thank them for their  
20 time and their effort.

21           At the New York meeting we discussed pretty  
22 much the issues that we're going to discuss today.  
23 There's some additional ones today. And, as I  
24 mentioned before, we're not necessarily going to touch  
25 on international sales or co-branding.



1           But one of the things that we did after the  
2 New York meeting is we analyzed the comments, and we  
3 studied the transcript to try to revise some of the  
4 thoughts and some of the proposals that were developed  
5 in New York.

6           So it's Myra's hope and my hope that by the  
7 end of today we'll have fleshed out some of those  
8 proposals, and when we go back to Washington D.C., we  
9 can use them as a springboard to develop them further.

10           But I should mention before we get into the  
11 substance that any proposal that we offer is strictly  
12 a thought piece. The Commission has not seen our  
13 proposals. They have not reviewed our proposals. And  
14 obviously any proposal is just that until the  
15 Commission opines on them, which will not happen for  
16 quite a while.

17           So just because we offer a particular  
18 approach through a proposal does not mean that that is  
19 the proposal that ultimately will find itself in the  
20 revised rule. The Commission may accept some of them,  
21 all of them, or none of them. That has yet to be  
22 seen. But at least it's a thought piece for  
23 discussion.

24           So on that note, we're going to start off  
25 by talking about exemptions.

1

MS. KEZIOS: Excuse me, I have a question.

1 for their thoughts.

2           I really cannot predict when the Commission  
3 will turn this around for a few reasons. One is there  
4 is going to be a significant change at the commission  
5 level. One commissioner, Janet Steiger, has already  
6 left, and her place has been taken. There are two  
7 additional commissioners who may leave while this  
8 process is underway, which may mean by the time  
9 recommendations are up at the Commission, three out  
10 of the five commissioners who are already familiar  
11 with these issues will have changed. And I have no  
12 prediction at all what their views are on franchise  
13 issues, what priority they will assign to this whole  
14 project. So there is somewhat of a vacuum of  
15 information, which makes it very difficult for me to  
16 predict.

17           The most that I could say is the next stage  
18 is -- assuming that the Commission wants this project  
19 to go ahead, is the publication of what we call an  
20 NPR or Notice of Proposed Rulemaking. As opposed to  
21 the ANPR, which is more here's what the Commission  
22 thinks and here is where the Commission would like to  
23 go, the next step would be the publication of a  
24 revised rule or rules depending upon how we treat  
25 franchises and business opportunities.

1           So again all that will take some time, and  
2 I really don't have any prediction for you other  
3 than to say that it's going to be several months. So  
4 I hope that clarifies matters.

5           Once an NPR, a Notice of Proposed  
6 Rulemaking, is published, that goes on the public  
7 record as well, and again there's another round of  
8 comments. I don't know to what extent we will be  
9 holding workshops.

10           The purpose of holding six workshops now is  
11 to try to get everyone's input early on in the process  
12 so that the NPR, the Notice of Proposed Rulemaking,  
13 stage can go quicker. So that's the most that I can  
14 say about the process.

15           But Dennis Wieczorek had a question.

16           MR. WIECZOREK: You answered it in part,  
17 but when you say the NPR, the NPR is a publication of  
18 the Staff, or is it a publication of the Commission?

19           MR. TOPOROFF: A Commission publication.  
20 Anything that gets published in the Federal Register  
21 is a Commission publication.

22           MR. WIECZOREK: And then after that is  
23 published, there will be at least written comments  
24 allowed for some period of time?

25           MR. TOPOROFF: That's correct.

1           MR. WIECZOREK: There may be a public  
2 workshop, a public hearing, but certainly there will  
3 be an opportunity --

4           MR. TOPOROFF: Absolutely --

5           THE COURT REPORTER: I'm sorry. You're  
6 both speaking at the same time.

7           MR. WIECZOREK: There possibly will be a  
8 public workshop or public hearing, but at a minimum  
9 there will be public comments?

10          MR. TOPOROFF: That's correct.

11          Are there any other questions about the  
12 next steps involved in the process or the process  
13 itself?

14          (No audible response.)

15          MR. TOPOROFF: Okay. Well, moving on, the  
16 first item on the agenda is the exemptions. And we  
17 put this one right up front because this seems to be  
18 the one issue that gets the short end. It seems that  
19 every time we talk about exemptions, it's late in the  
20 day, and we really don't give it its due.

21          By exemptions this is what we mean. Under  
22 the UFOC -- under the Commission's Franchise Rule and  
23 under State statutes that enforce the UFOC, there are  
24 certain exemptions. An obvious one comes to mind, the  
25 minimum payment exemption. If a franchise sale is

1 less than \$500, it's going to be exempt from the rule.

2 But from time to time various commenters  
3 and others raise with us whether there should be  
4 additional exemptions. For example an exemption for a  
5 sophisticated investor has come up, and there are  
6 others.

7 So what I would like to do is open the  
8 discussion to the floor so to speak, and if anyone has  
9 any thoughts on what exemptions the Commission might  
10 consider to make the rule better, we would be very  
11 interested in hearing from you. Any thoughts?

12 MR. WINTERS: Steve Winters.

13 THE COURT REPORTER: I'm sorry. You're  
14 going to have to come forward. I'm not going to be  
15 able to hear you from there.

16 MR. TOPOROFF: Off the record for one  
17 second.

18 (Discussion off the record.)

19 MR. TOPOROFF: Back on the record.

20 Okay. We're back on the record. And again  
21 we were talking about possible exemptions. Well,  
22 no one -- Gary Duvall.

23 MR. DUVALL: Someone has to say something  
24 about this. I'm Gary Duvall. I co-authored a fairly  
25 lengthy article in the American Bar Association

1 Journal on franchising, on exemptions this last year,  
2 and as part of that I did a study on Federal and State  
3 exemptions for franchisor compliance with disclosure  
4 and registration laws.

5           And what I found was that franchisors are  
6 faced with inconsistent exemptions from state to  
7 state. So, for example, if a franchisor is offering a  
8 fractional franchise, it may be exempt from Federal  
9 disclosure requirements, but only two or three of the  
10 registration states have such an exemption, so the  
11 exemption is of very limited use.

12           There are many other exemptions that exist  
13 in one state or another, and a number of the State  
14 exemptions do not exist under Federal law.

15           The purpose of the franchise registration  
16 disclosure law of course is to protect franchisees who  
17 frequently are in a position of having less information  
18 than the franchisor in terms of the proposed investment.

19           There are a number of franchisees who are  
20 not in that position when they purchase, and those  
21 franchisees then should support an exemption from  
22 registration and disclosure. The exemption would  
23 allow transactions to occur more efficiently and at  
24 lower cost, which helps franchisors and franchisees.

25           I wasn't actually prepared to detail those

1 exemptions today. Among other things I didn't see a  
2 call for that in the ANPR. But I can give you some  
3 examples.

4           One example would be a sophisticated  
5 franchisee exemption. There are franchisees, for  
6 example, who work for the franchisor. Some  
7 franchisees are either current or former employees of  
8 the franchisor. They typically have access to the  
9 same sort of information as the franchisor entity  
10 itself.

11           Another example would be franchisees who  
12 already own franchises. There are exemptions for  
13 franchisees for their second franchises in some  
14 situations and not others. It's a matter of making it  
15 consistent.

16           I mentioned fractional franchises. Large  
17 franchise -- excuse me, large entities frequently  
18 purchase franchises for a very small portion of their  
19 business. In that situation frequently the  
20 franchisee, who, for example, may be a department store  
21 chain or a hotel chain or a large publicly-held  
22 company that owns franchisees in a variety of  
23 industries, in those cases those large franchisees  
24 will frequently demand and receive access to  
25 information from the franchisor that goes beyond the



1 offering circular disclosures.

2           In addition those franchisees frequently  
3 are in a position to bargain for and receive  
4 concessions so that they get a better deal than the  
5 standard franchisee. So an exemption should be  
6 considered for a large franchisee -- a large  
7 franchisee apart from the sophisticated franchisee  
8 exemption.

9           I think those are probably enough examples.  
10 But the main issue that I think the FTC ought to  
11 address is the issue of the lack of uniformity. Many  
12 states have very well thought out exemption schemes.

13           The FTC exemptions are generally well  
14 thought out, but they're not consistent. And if  
15 they're not consistent, then they're of little use to  
16 the franchisor, who typically would be trying to sell  
17 franchises throughout the country.

18           MR. TOPOROFF: Okay. I have one question.  
19 You mentioned an ABA article. Is it possible that we  
20 can get a copy of that?

21           MR. DUVALL: Yes.

22           MR. TOPOROFF: If so, could you mail it to  
23 us? Is that something that we could put on the public  
24 record?

25           MR. DUVALL: If you would like, sure.

1 MR. TOPOROFF: Okay.

2 MR. DUVALL: I may need permission from the  
3 ABA forum on franchising, the American Bar Association  
4 on franchising. I don't think that that would be a  
5 problem.

6 MR. TOPOROFF: Because that would be  
7 helpful.

8 Dennis Wieczorek.

9 MR. WIECZOREK: The -- to echo Gary's  
10 comments, when a company decides to do some form of  
11 distribution that they contend is not franchising,  
12 what we have to contend with as lawyers is a  
13 patchwork quilt of regulation.

14 And while there may be an exemption under  
15 the FTC Rule and under some State laws, you may have  
16 the strange circumstance of a franchisor or a  
17 non-franchisor let's call it for the moment, where  
18 they have to register in several states and not in  
19 others, or they may have exemptions under a number of  
20 the State laws but are covered by the FTC Rule.

21 One of the major areas that I see that  
22 happening in is although the rule exempts the purchase  
23 of inventory at bona fide wholesale price for resale,  
24 many of the State laws exempt the purchase of  
25 non-inventory let's call it for the moment, whether

- 1 it's equipment or software or computer hardware or
- 2 entering into a commercial lease, at fair retail
- 3 value.

1 argument for narrowly drafted exemptions of the type  
2 that have been discussed, for example on the extremely  
3 sophisticated investor level -- I don't have a problem  
4 with an exemption in that setting, excuse me, because  
5 those extremely sophisticated investors for the most  
6 part are going to be represented by counsel. They're  
7 going to have access to competent accounting assistance.  
8 They will probably extract more disclosures from the  
9 franchisor than are required by the rule or the uniform  
10 franchise offering circular guidelines.

11           The concern that I have is how do we in a  
12 world of inflation define a sophisticated investor?  
13 I'm no longer convinced that the securities model for  
14 a sophisticated investor works because there are an  
15 increasing number of people that I sometimes refer to  
16 as refugees from corporate America who have been  
17 downsized out of a job and suddenly have the kind of  
18 cash that allows them to qualify as a sophisticated  
19 investor, but they are anything but a sophisticated  
20 investor. And almost inevitably they land in my  
21 office within three years having lost that nest egg  
22 that they had when they left the large corporation.

23           So although I can see a justification for  
24 some limited exemption, I urge you not to sweep the  
25 baby out with the bath water. It is just as bad for a

1 person who is unsophisticated but happens to have a  
2 million dollars in the bank to lose that million  
3 dollars as it is for me to lose the \$10 that I have.

4 I would also submit that at least for any  
5 franchisor who is otherwise franchising to non-exempt  
6 buyers that the incremental burden of supplying that  
7 disclosure document that they otherwise will have  
8 to provide anyway to their sophisticated investor  
9 franchisees is nominal or diminimus or both.

10 To the extent that there's any burden, it's  
11 that they have to wait the ten days that the rule  
12 requires and give them the documents five days in  
13 advance that the rule requires. You know, I'm sorry,  
14 but I can't cry any big tears over that particular  
15 burden.

16 As to the existing franchisee exemption  
17 proposal -- and I would say that we have a form of  
18 such an exemption under the Washington Act, but it may  
19 or may not apply to disclosure as well as to  
20 registration. I think it's important that we look  
21 carefully at it because there are situations that  
22 we've seen in representing franchisees where the facts  
23 and circumstances have changed materially since they  
24 bought the last franchise.

25 They are making a material additional

1 investment in a new portion of their business, an  
2 expanded portion of their business, a new outlet or  
3 whatever. And if, for example, it is the case that  
4 the franchisor now -- unlike two years ago if the  
5 franchisor now knows that every other franchisee of  
6 that system is experiencing what everybody would agree  
7 is an inadequate return on their investment, there is  
8 probably an affirmative duty both under the common law  
9 duty to speak doctrine and under the State 10(B)5  
10 standard disclosure and antifraud provisions to make  
11 that additional disclosure.

12           That information may not be -- in fact  
13 probably is not available to existing franchisees  
14 unless they are in that category that I've identified  
15 as extremely sophisticated.

16           If Microsoft wants to buy a Pizza Haven  
17 franchise, they may not need disclosure because they  
18 will extract a lot more information than you and I  
19 would in buying that same franchise or any other  
20 business deal.

21           I think I've talked long enough for now.

22 Thank you.

23           MR. TOPOROFF: Martin Cordell.

1 the patchwork quilt of regulation. I think our State  
2 certainly is aware that that's been a problem for the  
3 industry. And I know that the North American  
4 Association of Securities administrators is also  
5 aware of the problem and is doing what it can to work  
6 on those type of issues.

7           And so in brief I would like to make the  
8 comment that I would like to see the Commission in its  
9 review process to really work with the states to makes  
10 sure that we're moving in unison or in lock-step so  
11 that there is a coordination of the various exemptions  
12 and other requirements, because I think that's  
13 certainly been one of the goals of NASAA over the last  
14 several years, and it would be nice to see some  
15 initiation on the part of the Commission to also make  
16 that same reciprocal effort.

17           MR. TOPOROFF: Mr. Jeffers.

18           MR. JEFFERS: Yes, I want to make just a  
19 general comment based on the specific comments that  
20 have been made by the learned attorneys. It is my  
21 experience that franchisors as a class or as a group  
22 of corporate entities are not overwhelmingly concerned  
23 with the specific issue of exemptions per se in the  
24 application of the rule but rather much more concerned  
25 about what is required under the rule to be prepared.

1           Once that is done, whether or not the  
2 company has to then give this same information to group  
3 A because they happen to be large franchisees,  
4 Microsofts or hotel chains, is really secondary once  
5 they've prepared that information.

6           And the real question in their minds is,  
7 you know, what body of information are they going to  
8 be required to prepare for franchisee -- prospective  
9 franchisees in general.

10           And once that is prepared, the point was  
11 well taken, there is no -- it's not much more of a  
12 burden to then simply provide that same information to  
13 one group or another if it's already prepared. The  
14 key is what has to be prepared itself.

15           And with the question of exemptions with  
16 the exception of the show promoters one, which I  
17 assume is perhaps being treated separately because  
18 I want to address that later, and I did provide  
19 comment on that, other exemptions are not really that  
20 vital.

21           I mean, even multi-unit franchisees, I do  
22 agree, even though they've already been through the  
23 disclosure process -- they may now be buying a second  
24 unit. I think they should get the new documents. I  
25 mean, there are material changes that most likely have



1 taken place in the nature of that company that  
2 ironically if they aren't provided with that  
3 information, if store No. 3 or 4 doesn't turn out to  
4 be as high a producer as No. 1 was, and that's  
5 probably why they were motivated to go to store 3 or  
6 4, then they're going to claim later that one of the  
7 reasons was that the company was no longer able to  
8 give them the kind of support they expected and that  
9 that should have been obvious had they been given some  
10 of this original information.

11               So I'm not sure that this is a crux --  
12 crucial kind of point issue as far as exemptions  
13 unless you are talking about changing what the  
14 companies had to prepare to start with to make  
15 available.

16               But once they have it prepared, if you say  
17 that it has to go to everybody no matter what their  
18 class or -- one, it's prepared, so it's ready. And I  
19 think that might be something to consider as we go  
20 forward.

21               MR. TOPOROFF: Dennis Wieczorek.

22               MR. WIECZOREK: In general I agree with  
23 Carl that most companies -- most franchisors will have  
24 the documents available and ready. There may be a  
25 very, very small class of franchisors that always deals

1 with sophisticated franchisees -- hotels maybe is an  
2 example -- where maybe exemption is helpful.

3                   But the other reason the exemption is

1 documents where you are dealing with a sophisticated --  
2 a clearly sophisticated franchisee who is negotiating up  
3 until the last minute.

4           Those negotiated changes where the franchisee  
5 is represented by counsel, et cetera, and so forth, are  
6 exempt from re-registration and redisclosure under at  
7 least some of the State statutes.

8           And to the extent that there might be some

1 concessions to a large powerful franchisee.

2           You know, only a few of the states have  
3 laws that specifically limit the ability of the  
4 franchisor to discriminate between similarly situated  
5 franchisees. And in those states the State law would  
6 cover.

7           But we need to make sure that in drafting  
8 the exemption it doesn't deprive that subsequent buyer  
9 of the protection of full disclosure, including of any  
10 negotiated changes in an existing franchisee's deal  
11 that are not being offered to the subsequent buyer.  
12 Thank you.

13           MR. TOPOROFF: Gary Duvall.

14           MR. DUVALL: I agree with Mr. Jeffers that  
15 what we're talking about here is fine-tuning some what  
16 might seem on the face of them unimportant details.  
17 But I'm really glad that the FTC is taking comments on  
18 this issue because this fine-tuning in these details  
19 do make a huge difference in the marketplace.

20           In the securities area, I think the  
21 securities disclosures work a lot better than the  
22 franchise offering circular disclosures, and that's  
23 partly because the securities laws have been around  
24 a lot longer.

25           And one of the aspects of the securities

1 law is that most of the securities transactions are  
2 carried out under exemptions. There are Rule D --  
3 Regulation D exemptions. There are 504 exemptions.  
4 There are a number of types of exemptions that are  
5 complex but extremely useful for those that use them.

6           In the franchise area there was a case  
7 involving the Continental Basketball Association where  
8 a court recently said that despite the fact that there  
9 was a State franchise disclosure and registration  
10 law, the basketball team simply didn't need the  
11 protection of that statute.

12           And that's a very unique decision, and it

1 inconsistent from state to state. There are many,  
2 many situations in which companies are franchisors in  
3 some states but not in others.

4           And they then are in a very difficult  
5 position deciding whether to be franchisors, whether  
6 to change their business system, which is the frequent  
7 result. They're required to change their business  
8 system from one state to another, which is  
9 unfortunate and detrimental to both franchisees and  
10 franchisors.

11           So I think it is a very important issue,  
12 and one that bears some review by the FTC.

13           MR. TOPOROFF: Mr. Jeffers.

14           MR. JEFFERS: The only thing that I would  
15 add to that is that there may be one subtle difference  
16 though in how those exemptions play out with regard to  
17 most of the securities transactions under the  
18 securities rules and under the franchise laws, because  
19 it seems to me that in many cases the securities  
20 rules, those exemptions enable that applicant to  
21 exempt himself from having to go through that entire  
22 process in order to either do whatever particular  
23 transaction they want to involve themselves in, to  
24 raise money or sell stock. In other words, it's an  
25 exemption from the entire rule itself.

1           For the most part there are very few  
2 franchisors who only deal with a specific class. So  
3 for the most part most franchisors, even if there is  
4 an exemption -- and I do feel Dennis's point is very  
5 well taken. In that particular narrow group of  
6 transactions, I agree completely.

7           But the fact is that the franchisors are  
8 never, however, exempt from having to comply with the  
9 overall rule so that they still have to go through  
10 that process even if there's one group of activities  
11 they're engaged in that exempt them, and that is a  
12 little bit of a distinction.

13           MR. TOPOROFF: Okay. Thank you.

14           Susan Kezios.

15           MS. KEZIOS: This kind of follows up a  
16 little bit with what Carl is saying, but, Gary, in  
17 your article, do you define what -- are you talking  
18 in your article for the ABA forum exemptions for  
19 franchisors or large franchisee exemptions or both?

20           MR. DUVALL: We discuss both.

21           MS. KEZIOS: I'm curious as to the  
22 definition or if the Commission has a definition on  
23 what a large franchisee is?

24           MR. DUVALL: Yes, there is a definition  
25 available. I think the best definition is the new

1 California definition. Last year California passed  
2 a statute that is unique as far as I know, and it  
3 defines three different classes of sophisticated  
4 franchisees.

5 I don't have it in front of me, so I'm not  
6 really prepared to discuss it in detail, but my guess  
7 is that most of the people around the room, whether  
8 they are advocates for franchisees or franchisors,  
9 would agree that that was a good definition; that  
10 those are persons that are not in need of the type of  
11 protection that is called for with franchise  
12 registration disclosure.

13 One example is that if the franchisee is a  
14 current employee of the franchisor, which happens more  
15 frequently than you might think, or has been an  
16 employee for a certain amount of time and fairly  
17 currently -- I don't recall what the time periods are,  
18 but not an employee that was an employee ten years  
19 ago; an employee that just left the franchisor -- with  
20 some other requirements, sophistication requirements,  
21 than that transaction is exempt.

22 It also happens -- well, I'm going on.

23 MS. KEZIOS: But you're answering my  
24 question, some of the information that I needed, and  
25 part of it is you want certain franchisees exempt from



1 disclosure; they should not even have to be presented  
2 a disclosure document?

3 MR. DUVALL: Yes, that's my proposal.  
4 There is another possibility which is that they have  
5 abbreviated disclosure.

6 One interesting aspect of the securities  
7 laws is that under these exempt offerings, the  
8 registration or filing, if any, occurs after the sale,  
9 which would be extremely useful for franchisors,  
10 particularly those that are doing unique, one-time  
11 deals. They're being negotiated. Perhaps it's the  
12 first licensing dealing they're doing. They don't  
13 intend to be a franchisor. That kind of exemption  
14 would be extremely useful.

15 And there's an abbreviated disclosure to  
16 answer your question. So there's filing after the  
17 fact and an abbreviated disclosure. That might work  
18 very well in some of these transactions.

19 MS. KEZIOS: My reason for asking these  
20 questions is because we've had experience with I would  
21 consider them large franchisee -- prospective  
22 franchisees, but they are not current franchisees.  
23 They've never been involved in franchising. They are  
24 hospitals that are going to buy a franchise.

25 These people even though they have legal

1 counsel don't know what they're doing in a franchise  
2 realm. I don't want an exemption for those people.  
3 They are like babes in the woods just like Mr. and  
4 Mrs. Smith who have got 30 grand to buy into a  
5 franchise.

6           So that is of concern. Even though they  
7 have corporate counsel, they don't have franchise  
8 lawyers. And there are some franchise lawyers who  
9 will -- again I think Howard made the comment or maybe  
10 Carl made the comment that if I lose a million dollars  
11 that -- I'm a large buyer, but I've still lost a  
12 million dollars, and it's like somebody losing  
13 \$35,000.

14           So I need to -- I guess need to educate  
15 myself as to what your article says and what this new  
16 California exemption is.

17           MR. TOPOROFF: Well, let me ask this --  
18 this was a point that David Kaufmann brought up in the  
19 New York meeting. Let's say Marriott is negotiating  
20 with Burger King. We have two sophisticated  
21 franchisors who at the end of the day, at the end of  
22 their discussions are going to somehow combine, and I  
23 don't mean necessarily in the co-branding sense. But  
24 let's say Marriott is going to have Burger King  
25 outlets in some or all of its hotels.

1           Where you have the situation of franchisor  
2 negotiating with franchisor, at least in those  
3 circumstances should disclosure be exempt? Any  
4 thoughts?

5           We'll start with Howard Bundy.

6           MR. BUNDY: At the risk of violating some  
7 constitutional prohibition, I would simply say that  
8 there probably is honor among thieves, and I see no  
9 problem with such an exemption --

10          MR. TOPOROFF: Martin Cordell.

11          MR. BUNDY: -- if narrowly constructed.

12          MR. TOPOROFF: Martin Cordell.

13          MR. CORDELL: I don't think I would  
14 personally have a problem with that particular  
15 transaction because you do have a high degree of  
16 sophistication. And in this particular example, you  
17 have two extremely well-capitalized companies who  
18 certainly have the financial wherewithal to do their  
19 own due diligence and who probably do have equal  
20 bargaining powers. And that does not sound like a  
21 problem.

22          MR. TOPOROFF: Dennis Wieczorek.

23          MR. WIECZOREK: I would agree with the  
24 proposition. And it highlights a situation that I'm  
25 dealing with right now, and that is -- although it's

1 similar to what Susan is describing about large  
2 franchisees who don't necessarily know what they're  
3 doing.

4           Give you an example, a company that is  
5 selling a software product to educational  
6 institutions. And this software product will be used  
7 under a particular name because it is a name that they  
8 believe is known. And they will be selling the  
9 software, and they will be providing training to the  
10 educational institutions to use the software.

11           And at the end of the day the result is  
12 that they're probably exempt under the FTC rule as a  
13 fractional franchise, probably, and I think they're  
14 exempt under -- I think it's six states that have  
15 fractional exemptions.

16           But there are probably three or four or  
17 five states where they're not exempt. And so in 45  
18 states or so they're exempt, and in 5 states they  
19 happen to be a franchisor. And you would think that  
20 really doesn't make any sense at all, but that is the  
21 state of the law.

22           And I would agree that a Marriott -- a Host  
23 Marriott that controls the Seattle Airport should be  
24 able to enter into transactions, and they probably do  
25 today, with numerous franchisors, and they don't

1 consider themselves to be franchisees. In fact they  
2 probably don't necessarily get disclosure documents.  
3 And there's probably nothing wrong with that.

4 I think with the fractional franchise  
5 issues, there is still some lack of understanding and  
6 lack of clarity as to how the fractional franchise  
7 exemption works.

8 I think that some people construe it to  
9 mean that fractional means on the premises, that you  
10 have a location, and you're adding a little kiosk over  
11 to the side to sell yogurt, and that's the only aspect  
12 in which the fractional franchise exemption works.

13 And in actuality you could construe the  
14 fractional exemption to apply across the board to a  
15 large company that is putting franchise outlets in  
16 numerous locations. So I think there could be some  
17 clarity -- more clarity on the fractional exemption.

18 And this goes back to the earlier point  
19 that some of these situations are nonsensical in the  
20 sense that you are required to do a disclosure  
21 document and get registered in certain states, and in  
22 the rest of the United States you do nothing. And  
23 that just doesn't make any sense.

24 MR. TOPOROFF: I just want to clarify  
25 for the record, the California law that Gary Duvall

1 referred to, is that the California Franchise Act  
2 or amendments to?

3 MR. DUVALL: I don't think that's the  
4 complete name. I think it's the California Franchise  
5 Relations or Investor Protection Act or something.

6 MS. GITTERMAN: California Franchise  
7 Investment Law is the full name.

8 MR. TOPOROFF: Okay.

9 MR. DUVALL: I vote yes on that comment.

10 MR. TOPOROFF: Okay. A second point, how  
11 -- putting aside the situation that I just described  
12 where you basically have two franchisors who are  
13 negotiating, if the Commission were to formulate some  
14 kind of sophisticated franchisee exemption, putting  
15 aside whatever the California law might have as a  
16 model, what kind of factors should the Commission  
17 consider?

18 MS. KEZIOS: That's what I was going to  
19 get to.

20 MR. TOPOROFF: Judy Gitterman.

21 MS. GITTERMAN: Well, some of the factors  
22 have been mentioned. They would include the  
23 experience of the franchisee in having pre-existing  
24 franchises, even within another system perhaps.

25 And I just wanted to add something in

1 regards to the last comment concerning the Burger  
2 King/Marriott scenario; that it would be very  
3 consistent to allow that exemption because of the way  
4 the courts have been interpreting franchise agreements  
5 between these type of entities.

6           Where you have a large sophisticated  
7 franchisee, oftentimes the courts do recognize that  
8 the State protections that may be required for an  
9 unsophisticated investor do not apply.

10           So getting back to your second issue,  
11 that would probably be one of the primary criteria,  
12 the experience of the franchisee and the number of  
13 units that they may or may not already have either in  
14 that system or another system.

15           MR. TOPOROFF: So would it be fair to say  
16 if we are going to carve out a sophisticated  
17 franchisee exemption, it should reflect at least two  
18 factors; one is the experience that the particular  
19 franchisee has in franchising, so that would avoid the  
20 situation that Susan Kezios raised of a hospital,  
21 presumably the hospital isn't experienced in  
22 franchising; and, two, some kind of financial status,  
23 some indication of wealth? So if we combine wealth  
24 with prior experience, would that do it? Would that  
25 make a useful exemption, or would there still be

1 problems?

2                   A number of people have indicated that they  
3 want to speak, so what I'm going to do is just go  
4 around the table.

5                   Martin Cordell.

6                   MR. CORDELL: In addition to experience in  
7 franchising, experience in the business that the  
8 franchise -- in the business of the franchise itself  
9 would be significant. So if Burger King is  
10 negotiating with a privately-held restaurant chain,  
11 this should be sufficient also.

12                   MR. TOPOROFF: Very well taken.

13                   Howard Bundy.

14                   MR. BUNDY: If and only if the barrier to  
15 entry is very high in terms of the financial status/  
16 wealth, then the other two suggestions, your  
17 suggestion of experience in franchising and Martin's  
18 suggestion of experience in the business of the  
19 franchise, may get us close to an adequate definition  
20 of that sophisticated investor.

21                   My concern though is that regardless of  
22 the financial status or wealth of that prospective  
23 franchisee, unless that person or entity is truly  
24 sophisticated in the way that I've tried to articulate  
25 in terms of being represented by competent franchise



1 counsel, and there are precious few of those  
2 available, of being -- of having substantial wealth  
3 and substantial business experience, including  
4 experience with franchising, then it makes sense to  
5 have an exemption for that person.

6           But, you know, let's go back again to the  
7 nature of the investment. In your typical securities  
8 investment situation, at least the ones that we read  
9 about in the public media and that we sometimes get  
10 exposed to, you're talking about somebody who made a  
11 discrete investment of 5,000, 10,000, \$100,000 in a  
12 security.

13           In the franchise context, we often are  
14 talking about not only the initial franchise fee and  
15 the ongoing royalty obligations that are being  
16 undertaken, but a substantial additional investment in

roitil001001

1 said a while ago. It is very unusual except in a few  
2 very isolated industries for people to be only  
3 offering franchises to people that I would regard as  
4 truly sophisticated investors. It is a subjective  
5 standard that I wish to apply on a sliding scale.

6 MS. HOWARD: Let me ask you or ask everyone  
7 here. You talk about a limited number of industries.  
8 Can you name them? I mean, are there -- I think  
9 Dennis mentioned the hotel industry. Are there others  
10 that you can --

11 MR. BUNDY: I would submit that it's  
12 probably limited to the major hotels, not the small  
13 ones, the major hotel chains, the airport type of  
14 situation that Dennis described where you have a very,  
15 very sophisticated investor, and possibly, and I'm  
16 not sure I understand it well enough to articulate it,  
17 some of the software industry companies that may  
18 want to license their product or service through some  
19 means. I would hold out the possibility there may be  
20 a justifiable exemption in that area. Those are the  
21 ones I can think of.

22 MR. TOPOROFF: Dennis Wieczorek.

23 MR. WIECZOREK: I would say that there's an  
24 opportunity to do the exemption on something of a --  
25 almost a check-off in a sense. And before I get to

1 that, I think the investment is probably the issue.

2           If the franchise calls for an investment --  
3 and I'll throw a number into the hat, and that's a  
4 million dollars. If the franchise requires an  
5 investment of a million dollars or more, you can  
6 virtually guarantee that the franchisee needs to have  
7 counsel, needs to have sophisticated advice, and needs  
8 to have money, and needs to have a sizeable net worth  
9 in order to purchase that kind of a franchise.

10           That would cover certain kinds of  
11 restaurants also, a sit-down restaurant, because then  
12 you're talking about an investment of two or three  
13 million dollars potentially. So I think that might

1 million dollars in it, and you're out there looking  
2 for investments, you're almost certainly going to be  
3 represented by counsel, and I don't think they  
4 necessarily have to know how to cook hamburgers or  
5 have restaurant experience.

6           So I would say that when I was mentioning a  
7 check off, that you may have a series of possibilities,  
8 and one might be experience with the franchisor. One  
9 might be a net worth above a certain level or an

1           The reason you can't is there are virtually  
2 an unlimited number of industries that this would  
3 apply to. As an example, one of the trends in  
4 franchising now is franchisees are getting larger and  
5 larger. There's a number of widely reported mergers  
6 among franchisees. Franchisees acquiring one another.  
7 And sometimes holding not only multiple franchises  
8 within one system but multiple franchises within a  
9 number of systems. That's going to continue.

10           Many of those franchisees and prospective  
11 franchisees are looking to acquire multiple  
12 franchises, sometimes 10 or 20 or more franchises at a  
13 time. Those would be typically very wealthy investors  
14 and very sophisticated experienced investors. And  
15 that could occur in hundreds of industries that are  
16 already franchising.

17           My experience is that there are many other  
18 non-franchised industries in addition to hotels and  
19 restaurants and the others mentioned by Mr. Bundy that  
20 offer deals that may or may not be franchises under  
21 certain state laws. And there's no limitation to  
22 those industries. So this exemption would have to  
23 cover a variety of industries.

1 points. Myra, to also add to your question, you could  
2 also add in addition to hotels, hospitals, and others,  
3 some same food-to-food examples. Even in the  
4 automotive areas, rental agencies, there are still  
5 some situations where this would apply.

6           With regard to -- I'm not sure who made the  
7 point; I think it was Dennis -- the possibility of  
8 using the bench mark of a million dollars as the  
9 investment required for a franchise, I would say yes,  
10 that's an automatic. But I think that if you check  
11 the Franchise 500 or the Franchise Times 200 or even  
12 the handbook, all of the listings, you'll find that  
13 98 percent of all of the franchises listed today as  
14 offering franchises are requiring a total investment  
15 of substantially under that.

16           And they all in many cases I think do have  
17 a legitimate need to have the notion of the exemption  
18 for a sophisticated franchisee addressed. And I think  
19 it perhaps might be more appropriate to make the  
20 bench mark a financial capability tied not to the  
21 investment required for the franchise but rather to the  
22 net worth of the asset base of the franchisee  
23 because I think you could have a sophisticated  
24 investor who is looking at a franchise requiring an  
25 investment of 150,000, he may want a three store or

1 five store package, and if there's going to be an  
2 effort to put in place an exemption, then he should be  
3 entitled to that even though the investment he's  
4 considering is much less than a million dollars, which  
5 is what was suggested as another bench mark.

6 MR. TOPOROFF: I see Howard has his sign  
7 up. Is there anyone else who has any comments on  
8 this issue before we get to Howard; otherwise, Howard  
9 will have the last word?

10 MS. KEZIOS: Well, before that happens --

11 MR. TOPOROFF: We're already into break  
12 time, so I want to wrap up this particular discussion.

13 But, Susan, did you have any comments?

14 MS. KEZIOS: Yes. I have some problems  
15 with just one criteria for an exemption. I mean, if  
16 you've got an experienced franchisee, experienced in  
17 the industry, you've got net worth of the individual,  
18 and you've got the investment criteria, I mean, I  
19 don't think they should just be able to check off one  
20 and be exempt because that's going to get potential  
21 buyers of franchises in a lot of trouble down the  
22 road.

23 Even if they are buying a ten unit deal,  
24 and even if they have six or ten million dollars in  
25 the pool, if they have never been in franchising

1 before, they still are going to need the benefits of  
2 disclosure, et cetera. There should be no burden  
3 there. Maybe it needs to be specific for certain  
4 industries.

5           It's interesting to hear franchisor lawyers  
6 talk about, oh, we need something for all franchising  
7 because usually what I'm hearing from you all is, oh,  
8 you can't possibly come up with one law or one  
9 oversight for everybody. So it's very interesting to  
10 hear you say that, Gary, that you want it for  
11 everybody because I think that there are only specific  
12 clients that you're looking for this for, and that's  
13 who you're going to craft that exemption for.

14           MR. TOPOROFF: On that note, we'll go to  
15 Howard Bundy for the last word.

16           MR. BUNDY: That's always a terrifying  
17 position to be in. I would say ditto to what Susan  
18 just said and perhaps throw out a suggestion, a  
19 thought that occurred during the time that Gary and  
20 Carl were speaking; that an additional element you  
21 might want to consider in crafting a definition of a  
22 sophisticated franchisee or prospective franchisee  
23 is the ratio of their net worth to the amount of the  
24 investment.

25           I would suggest starting the discussion at



1 ten X just because with the franchisees and  
2 prospective franchisees that I've worked with, if they  
3 have that kind of a cushion, they can afford to lose  
4 the million dollars.

5           And if you can combine that with an initial  
6 threshold of a million -- in other words, this thing  
7 doesn't even kick in until you hit a million dollars,  
8 and then once you hit a million dollars -- if the  
9 person's net worth is 1.2, they can't afford to risk  
10 it. They need the disclosure. They are not  
11 sophisticated. They just sold their Microsoft stock.  
12 That's all. They've been in the company for a few  
13 years. I'm picking on Roger over here.

14           But I would suggest a starting place would  
15 be ten X, the amount of the initial investment, and  
16 the initial investment be over a million dollars.  
17 Then that prospective client will have representation  
18 and will have the things they need.

19           Thank you.

20           MR. TOPOROFF: Okay. Well, thanks. This

5t ald tth,                   areØ a                   ict.nt bAns kela lfkelesd greatly cla

1 (Short recess.)

2 MR. TOPOROFF: We're back on the record.

3 And as I mentioned before we're going to  
4 change the agenda slightly. We're now going to touch  
5 on the internet issue. And let me just give a little  
6 bit of background where the Commission is coming from  
7 on this point.

8 The Commission is very interested in  
9 clarifying all of its rules to make it clearer for  
10 business and consumers to understand how internet  
11 technologies can be used. So this is not just a  
12 concern for franchising. It's a much broader one.  
13 But obviously we're here today to discuss the  
14 franchise aspects.

15 In a nutshell what this issue boils down  
16 to is how can franchisors use the internet to comply  
17 with the rule. In New York City, as I mentioned  
18 before, we had a demonstration from folks from a  
19 company called PR One of a possible approach.

20 And to boil it down to its essence, it  
21 required a few steps. One was the company, a  
22 franchisor, has a web site that disseminates general  
23 information about the company. Those who are  
24 interested in possibly becoming franchisees would do  
25 so by filling out an on-line application for one.

1           The company, the franchisor, in turn if  
2 they accepted the applicant would give the applicant  
3 a password. Based upon the use of the password, the  
4 prospective franchisee would then gain access to a  
5 part of the web site that would feature state-specific  
6 disclosure documents, and there would be some kind of  
7 on-line receipt that the franchisee would use to  
8 acknowledge that in fact they've received the  
9 disclosures.

10           Now, that is just one possibility of how  
11 on-line disclosure may work. There may be other  
12 approaches. We are not going -- we are not going to  
13 review the merits of that particular proposal right  
14 now.

15           What we're going to do is discuss a  
16 possible approach that we have developed at the  
17 Commission -- again this is -- I put this in the  
18 category of a proposal -- which is based upon the  
19 Securities and Exchange Commission model.

20           The SCC published a number of years ago,  
21 I think it was in 1995, a release -- it was also  
22 published in the Federal Register -- that talked  
23 about how security sellers could use the internet to  
24 sell -- to deliver prospectuses and I also believe  
25 proxy information. And it had various categories of

1 concerns and how those could be addressed. And again  
2 we were advised to look at the SCC model, and that's  
3 basically what we have done.

4           In a nutshell the SCC did not prescribe  
5 specific steps or specific requirements that a  
6 security seller must use. What they did was set out  
7 broad principles that if a securities seller abided by  
8 -- and there's plenty of flexibility thrown in the  
9 mix, but if they abided by the general principles,  
10 that would be fine.

11           And that more or less is our starting  
12 point. What we did was we took the SCC suggestions,  
13 thought about them in the franchise context, and again  
14 have come up with certain again basic principles that  
15 might work.

16           With us today is Roger Gerdes from  
17 Microsoft. And we're very pleased that he's here.  
18 Before we get into a substantive discussion, I would  
19 like Roger to talk a little bit about what he does at  
20 Microsoft.

21           And hopefully as our discussion moves along  
22 of again these different basic principles, Roger could  
23 give us feedback from at least his experience as well  
24 as from a technological standpoint.

25           So I just want Roger to introduce himself

1 and give us a brief overview of the work that he does  
2 at Microsoft.

3 MR. GERDES: Thank you. Again my name is  
4 Roger Gerdes. I'm a business development manager  
5 with the Microsoft Corporation. I am specifically  
6 responsible for manufacturing wholesale and retail.  
7 As it relates to those vertical industry-specific  
8 orientations, I focus very heavily upon the franchise  
9 industry and a cross-section of the supply chain.

10 And within those horizontal focuses, being  
11 the franchise arena and the supply chain, I spend most  
12 of my time helping franchise systems, franchisors and  
13 suppliers, understand how to leverage the internet to  
14 effectively communicate with and better serve the  
15 customers that they either sell to or sell through  
16 and/or represent, which would be the case with respect  
17 to franchising.

18 So that is to say that my efforts really  
19 focus on clearly defining the internet technologies  
20 that exist today that are usable or can be used by  
21 franchisors to replace or support the communication  
22 mediums that they use today, which are typically  
23 phone, fax, and mail, to really drive the essence of  
24 more timely communications with ultimately franchisees  
25 and small business retail.

1 MR. TOPOROFF: Thanks.

2 Before we get into again what I call these  
3 basic principles, I just want to acknowledge certain  
4 points that were related to us in the comments.

5 A theme that developed in the comments is  
6 that right now at least very few franchisors are  
7 contemplating franchise sales strictly through the  
8 internet. There may be a mix. There could be the use  
9 of the internet as one tool. There could be  
10 face-to-face meetings. There could be still trade  
11 show sales. There could be any number of ways to sell  
12 a franchise, the internet being one aspect of that.  
13 And we appreciate that.

14 A concern that we have is as we revise this  
15 rule -- this rule is going to be around for quite  
16 awhile, and we have to be able to predict what is  
17 going to happen in 10 years from now, 15 years from  
18 now and indeed what may already be occurring.

19 So some of this is reaching. There's no  
20 question about it. But I think it behooves us to  
21 think about internet sales and to come up with  
22 approaches again that will last for -- into the next  
23 decades and approaches that make sense.

24 So with that I'm going to go to the first  
25 item. The first principle that we have come up with

1 is the issue of consent. And that is the SCC and I  
2 think Commission Staff -- I won't speak for the  
3 Commission at this point because they haven't had  
4 opined yet, but at least Commission Staff agrees  
5 that not everyone has a computer. Not everyone who  
6 has a computer is necessarily savvy with regard to the  
7 internet, may not want disclosures on an internet,  
8 so there has to be an element of consent that  
9 franchisors at the very least should continue to have  
10 an obligation to give out paper disclosure documents,  
11 but if they so wish to make a disclosure document  
12 available on the internet, they can do so.

13 Does anyone have any concerns at all with  
14 the notion that a prospective franchisee should have  
15 to consent to having access to a disclosure document  
16 on the internet?

17 Martin Cordell.

18 MR. CORDELL: Well, actually you answered  
19 my question because it seems to me that if a  
20 franchisor only wants to make sales through an  
21 electronic means, we ought to be able to accommodate  
22 them. So in terms of kind of broad principles,  
23 flexibility in terms of allowing business to do  
24 business, I think they should have that option.

25 MR. TOPOROFF: Let me just make sure I

1 understand you correctly. You're proposing that a  
2 franchisor have the option of disclosing -- providing  
3 its disclosure document strictly through the internet  
4 and no other vehicle?

5 MR. CORDELL: I would say that if we're  
6 going to look down the road, there are certain type of  
7 companies that for whatever efficiency reasons may  
8 only want to do business electronically, and I'm not  
9 so sure that we want to require them to make an  
10 alternative distribution channel, you know, to make  
11 sales.

12 And in addition I was thinking just kind of  
13 -- we're dealing with the internet right now, but you  
14 brought up a point that I've been thinking about  
15 or had to think about in terms of working with the  
16 NASAA committee on internet issues, that is long term  
17 the internet may not actually be the vehicle.

18 In two or three years the internet may  
19 not be around. There may be other systems or  
20 proprietary systems or otherwise that may be the  
21 primary source of conducting commerce.

22 And so in terms of drafting something,  
23 actually I'm trying to think of more broadly -- rather  
24 than internet offers but alternative methods of  
25 offering.



1                   MR. TOPOROFF: Well, I should say that  
2 when we think about these issues, we're not just  
3 thinking about the internet. We're also thinking  
4 about other electronic means, such as computer  
5 diskettes, CD Rom, E mail, and others. So those do  
6 all get thrown into the mix as well.

7                   MR. CORDELL: And this ties in kind of with  
8 some of the discussions you've already had regarding  
9 face-to-face meetings because I think it's clearly  
10 anticipated that there will be transactions in which  
11 there are no face-to-face meetings.

12                  MR. TOPOROFF: And we're going to get to  
13 that topic and --

14                  MR. CORDELL: And I did want to talk about  
15 that, but I'll get back to my point about I certainly  
16 can see a situation where franchisors -- there are  
17 already businesses where the only way you can  
18 communicate with them is electronically. And why not  
19 allow franchisors that option if they want it? As  
20 long as we're meeting the goals of investor protection,  
21 I don't see the reason to put any impediments to  
22 allowing them to do that.

23                  MR. TOPOROFF: Howard Bundy.

24                  MR. BUNDY: I want desperately to agree  
25 with Martin because I believe that as time progresses

1 we will hopefully see less and less paper in commerce.  
2 The concern I have, and I don't know -- I don't have  
3 an answer, but I want to try to articulate -- the  
4 concern -- is that of record keeping requirements,  
5 particularly given the fact that franchisors that are  
6 here today, only about 24 or 25 percent of them are  
7 likely to be here five years from now.

8           There are mergers, sales, acquisitions,  
9 transfers, purchases out of bankruptcy, et cetera and  
10 so forth of franchisors, and record keeping in those  
11 kinds of transactions and maintenance of old records  
12 becomes very, very difficult, particularly if they are  
13 available only in electronic form.

14           Electronic form of documents is evolving  
15 at such a rapid clip that something that is available  
16 in Microsoft Word 97 today may not be readable in  
17 Microsoft Word 99 tomorrow.

18           So we've got a lot of record-keeping issues  
19 that become very important to the franchisee who needs  
20 to be able to show what form of document he or she  
21 relied upon.

22           The easy solution would be to say that the  
23 franchisee in order to review that document had to  
24 download that document onto their hard drive. Maybe  
25 that's true today, but I don't think that's

1 necessarily true tomorrow.

2           And once that is downloaded, we wind up  
3 with the situation where the franchisor says that's  
4 not the document I provided. The document I provided  
5 said this, in other words allegations of modification  
6 of the document downstream.

7           I have to look at it from an evidentiary  
8 point of view. When I'm suing that franchisor on  
9 behalf of that franchisee, I need to be able to prove  
10 what document my client saw and relied upon. I have  
11 the initial burden there.

12           So in terms of looking at how to develop  
13 this part of the rule -- I think it's really an  
14 important area -- we need to -- somebody needs to look  
15 hard and long at record keeping requirements, how to  
16 enforce it, and what happens if they aren't available.

17           MR. TOPOROFF: I just want to interrupt  
18 one second. We're going to get to those types of  
19 issues later on. Right now what I want to focus on is  
20 strictly the consent aspect.

21           On the issue of consent, Gary Duvall.

22           MR. DUVALL: I think that the suggestion  
23 that you have made is the only sensible one, and I  
24 agree with it, which is that in order to deliver an  
25 offering circular over the internet, there has to be

1 the consent of both the franchisor and the franchisee.  
2 This should not be a method of delivery that is  
3 mandatory on either the franchisor or on the  
4 franchisee. There has to be mutual consent.

5           MR. TOPOROFF: Which gets right to one of  
6 the next points that I had, and again this is one of  
7 these principles, that no franchisor should compel a  
8 prospect to receive disclosures via any particular  
9 electronic media or in any specific form.

10           So, for example, a franchisor cannot say I  
11 am making my disclosure documents available only in  
12 DOS format on a disk. Take it di doave it. The

1 Dennis Wieczorek.

2 MR. WIECZOREK: I don't have any problem  
3 with that. And even if any of these documents are on  
4 some form of electronic media, it's not a major  
5 undertaking for a franchisor to download it on a piece  
6 of paper and mail it. It should not be an issue.

7 The only concern I have is about the  
8 terminology consent, and I hope there's not another  
9 document that needs to be signed; that we don't need  
10 -- we have receipts. We have things now that are  
11 routinely screwed up to use a terminology, are not  
12 receipted properly, are not signed properly, are not  
13 dated properly.

14 And to now have an FTC-specified form that  
15 says I hereby consent to the delivery of the document  
16 via the internet, signed and dated, I think that's a  
17 mistake.

18 MR. TOPOROFF: Okay. We're going to get to  
19 proof issues and receipts and all of that in a little  
20 bit. Dennis's point is very well taken. What we're  
21 talking again is just the broad concept of consent.

22 Gary Duvall.

23 MR. DUVALL: I have something more specific  
24 on consent. If I understand you correctly, if the  
25 franchisor wants to deliver an offering circular let's

1 say through the internet and a franchisee does not  
2 want to receive that for whatever reason, then the  
3 franchisee can refuse that and ask for paper. And if  
4 that's the concept, I agree with it.

5           If the concept is that the franchisor and  
6 the franchisee both want to receive the offering  
7 circular through the internet, and it occurs that way,  
8 that the franchisor also has to provide paper, then I  
9 don't agree with that.

10           MR. TOPOROFF: No, that's not what we're  
11 talking about.

12           MR. DUVALL: Okay.

13           MS. HOWARD: I've got a question following  
14 up on what Martin suggested. If what we're looking at  
15 here in the big picture is getting a disclosure  
16 document to a prospective franchisee and if, say, a  
17 prospective franchisee only wants to receive it on  
18 the internet or refuses to receive it on the internet,  
19 and that franchisor, for instance, will only send it  
20 out on the internet, is there a problem there, and, you  
21 know, what exactly is the problem?

22           It seems to me that at that point the  
23 franchisor and the franchisee aren't going to come to  
24 an agreement, and that's it.

25           MR. JEFFERS: I think that problem is

1 resolved by the economics of the business commercial  
2 transaction. If the franchisee is saying I want it on  
3 the internet, and the franchisor says no, then I  
4 don't see how -- they don't get together, and that  
5 means that deal doesn't get consummated.

6           And I don't really think you need a rule or  
7 an addendum or a proviso. I mean, let the economics of  
8 the marketplace dictate that that's a deal that won't  
9 get done? And you don't need to legislate -- how do  
10 you register the fact that that deal doesn't get done.  
11 It is just not going to happen.

12           I completely agree with the way that you  
13 stated it. As long as there is that option, one can  
14 request it, and then if it's available, it can be  
15 provided that way. If it's not available, then it has  
16 to be provided in the conventional way at either's  
17 request. And on that basis I think it covers that  
18 particular scenario.

19           MR. TOPOROFF: Howard.

20           MR. BUNDY: I think Carl has covered what  
21 I was going to say very well.

22           MR. TOPOROFF: Roger.

23           MR. GERDES: Just to clarify from a  
24 technology standpoint, which I assume is why I'm here  
25 in the first place, the idea of sending out a

1 disclosure circular document, whatever the case may  
2 be, can be facilitated over the internet in a number  
3 of different ways, that is to say it can be pushed  
4 out via fax, via E mail, via physical letter, as well  
5 as a downloadable document, as well as something that  
6 can be read on-line in HTML, et cetera.

7           So it's not as though you're introducing a  
8 requirement that says if you do it this way, then you  
9 don't have to do anything else. And much to the point  
10 at the end of the table by Carl, you're going to find  
11 a lot of self-selection by franchisors based upon the  
12 technology they want to use. If a deal isn't  
13 consummated, that's fine. It's kind of a natural sort  
14 of principle.

15           But the simple -- I guess the main point is  
16 because you're using the internet does not mean that  
17 you can't push out information via your more  
18 conventional mediums at the request, interestingly  
19 enough, of the client.

20           So if I'm looking at a user interface,  
21 there may be a check box that says please send this to  
22 me via fax. I also want to download this. Please  
23 send me a hard copy. And there really isn't much of a  
24 resource requirement on behalf of the franchisor to  
25 facilitate any or all of the above.



1 MR. TOPOROFF: Dennis Wieczorek.

2 MR. WIECZOREK: I guess this goes to Myra's  
3 question, and that is why legislate in this area? If  
4 a -- and maybe this picks up on what Carl says. If a  
5 franchisor chooses to have its document available in  
6 DOS only available by a disk that the franchisee  
7 requests, to some respect -- in some respects if the  
8 franchisor wants to cut off its nose to spite its face  
9 because of its limited delivery method, why don't we  
10 let them do that? What difference does it make?

11 If any franchisor has any brains at all,  
12 they're going to use as many delivery methods as are  
13 possible. But if some franchisor, and I can't even  
14 think of any, would say, look, we're the technology  
15 gurus, and we're only going to do it by method X, we're  
16 not going to send it by paper, we're not going to do it  
17 any other way, why should the FTC care about that?

18 MR. TOPOROFF: Okay.

19 MR. JEFFERS: They'll need an SBA loan,  
20 but that's another agency.

21 MR. TOPOROFF: Another concern that we have  
22 is disclosure of the medium and the format, and let me  
23 explain that a little bit.

24 Let's say that a franchisor wants to give  
25 its disclosures through a diskette again using DOS.

- 1 For a prospective franchisee to be able to consent

1 invest in that franchise unless they've received that  
2 document, we don't -- the Federal government really  
3 has no role in facilitating or helping the franchisor  
4 get that information out. It's up to them to figure  
5 out how to get it there.

6           If they're only going to offer it in some  
7 obscure operating system that no longer is widely  
8 available, that's their problem. Let them die on the  
9 vine. Let's not get involved in facilitating those  
10 communications that are one way.

11           And the group of the class of people that  
12 the Commission is here to protect is not affected  
13 because if they don't get that document, they're not  
14 affected by it. They can't buy it.

15           MR. TOPOROFF: Let me ask you, Howard: Let's  
16 say you have a situation where you have a prospective  
17 franchisee who is interested in a particular outlet, and  
18 they negotiate with the franchisor, and the franchisor  
19 says here's my disclosure document and again hands them  
20 let's say for argument sake a computer disk, and they  
21 have 14 days or whatever the magic number is, and they  
22 sign the agreement, are these people -- these  
23 prospective franchisees now franchisees likely to come  
24 to your office two or three months down the road and  
25 say, you know, they gave me this disk, I don't know what

1 it is, I tried to put it into the computer, it came up  
2 with all different kinds of chicken scratch, I had no  
3 idea what it was, and I never got proper disclosure? Is  
4 that a concern for you?

5 MR. BUNDY: That is a concern, but I think  
6 that is handled by existing law in the same way that  
7 if that same franchisee comes into my office and says  
8 -- and they didn't realize that they were supposed to  
9 have audited financial statements in the middle of it.  
10 You know, prospective franchisees don't know that the  
11 Federal Rule or the State statutes require audited  
12 financial statements. They don't know that Item 19  
13 has to contain the only earnings claim information.

14 I discover daily missing parts of franchise  
15 disclosure documents. And frankly for that franchisee  
16 who comes in fairly soon and still has the resources  
17 to pursue it, you've given me a slam dunk. I will be  
18 able to help that franchisee.

19 It is the franchisor's duty to get  
20 meaningful disclosure to the franchisee. No judge, no  
21 jury will ever stick that franchisee with having an  
22 affirmative duty to be able to read something that is  
23 printed in Greek. Won't happen. Not in this country.

24 MR. TOPOROFF: Well, that raises the  
25 precise problem that we're facing. We could take a

1 wait-and-see attitude and see if problems bubble up,  
2 or we could recognize that there may be problems in  
3 furnishing disclosure documents electronically,  
4 whether it's again through diskette or CD Rom or  
5 whatever, and give some guidance to the franchise  
6 industry beforehand.

7           And I'm not saying to regulate it. Again  
8 these are broad concepts. We're not saying you have  
9 to give it in CD Rom, or you have to give a disclosure  
10 document in any particular format.

11           I mean, I know and many of you know that  
12 there was an advisor opinion request not too long  
13 ago that the Commission Staff issued about giving a  
14 disclosure document through a computer diskette. And  
15 we could foresee if we don't clarify the rule in some  
16 respect, that we'll forever get advisory opinions from  
17 franchisors wanting to know am I furnishing a  
18 disclosure document.

19           So I think we need to think a little bit  
20 about the process and some of the vehicles. And again  
21 we're not dictating -- we're not suggesting that the  
22 Commission dictate specific modes of transmission or  
23 whatever. We're just talking very broad principles  
24 of what a franchisor may have to do in order to use  
25 electronic means.

1

Howard.

1 points. I think that it's extremely important to try  
2 to stay away from any language that would suggest a  
3 type of medium in light of the fact that we now have  
4 organic cubes and flash cards and various other things  
5 that will completely strike the usefulness of terms  
6 like disks and things that are very common today.

7           And the other is just to kind of echo a  
8 thought about format. Format really does in my mind  
9 parallel with language. And I think it's important  
10 that any kind of language that would be used by the  
11 Commission, that it would be to kind of take a tone  
12 that would suggest that -- I kind of lost my thought.

13           Any language would be based upon principle  
14 and that things would be received in a manner that  
15 would be understandable by the recipient and again  
16 staying away from things like format, language,  
17 medium, et cetera.

18           MR. TOPOROFF: One second.

19           Gary Duvall.

20           MR. DUVALL: Steve, I was also going to  
21 refer to your informal advisory opinion regarding the  
22 receipt of computer disks. When I first read that, I  
23 thought, boy, that's an obvious statement by the FTC  
24 and probably didn't have to be made. And I think I  
25 agree with the earlier comments that this is also sort

1 of an obvious statement.

2 My suggestion is to issue another informal  
3 advisory opinion that says essentially that -- what  
4 Roger just said, that is that the offering circular  
5 can be received by consent of the franchisor and the  
6 franchisee in whatever format the franchisor and the  
7 franchisee consent to.

8 And I think that would really cover it.  
9 And I don't think there's much more needed. And if  
10 the word format needs to be changed, Roger can come up  
11 with something that includes, what did you call those,  
12 cubes?

13 MR. GERDES: Organic cubes.

14 MR. DUVALL: Organic cubes.

15 MR. TOPOROFF: Judy.

16 MS. GITTERMAN: Concerning the timing of the  
17 consent, I have a question as to what the Commission  
18 anticipates would be done by the franchisors in terms of  
19 insuring that the franchisee at the time it consents  
20 actually receives the document, or is there going to be  
21 a second verification that it has been received and  
22 read, which might solve your format problem, because  
23 obviously if you send somebody a disk in DOS, and they  
24 can't read it, they can never get to that second step?  
25 Is that contemplated at all?



1                   MR. TOPOROFF: Yes, we're going to get to  
2 that in a second. Moving along -- off the record.

3                   (Discussion off the record.)

4                   MR. TOPOROFF: Okay. We're back on the  
5 record.

6                   MS. HOUSTON-ALDRIDGE: My name is Tee  
7 Houston-Aldridge. I represent World Inspection  
8 Network, a franchisor here in Seattle. Is that  
9 enough?

10                  MR. TOPOROFF: Yes. Please go ahead.

11                  MS. HOUSTON-ALDRIDGE: What I was going to  
12 suggest in terms of the comments that have been made  
13 is that I couldn't agree more with what Roger said. I  
14 thought it was superbly stated. But I think that  
15 where as a franchisor I would like to see more clarity  
16 is in making sure that we live by the recommendations  
17 of the FTC in terms of the acceptance of the document,  
18 the validity of the dating and the signatures, and the  
19 format in that light that we would need to have for  
20 our records and the franchisee would need to have for  
21 their records. What kind of validation do we need?  
22 That's what I'm looking for.

23                  MR. TOPOROFF: And we're going to get to  
24 that again in a second. What we're concentrating  
25 right now is just on the preliminary notion of

1 consent.

2           Maybe it's helpful for the discussion if I  
3 just go through the big topics here, so that if you  
4 have a question, you'll know where it fits into the  
5 general discussion.

6           So the first item we're going to talk about  
7 is consent. Next is revocation of consent. Notice,  
8 adequate notice. Labeling as a subset of notice.  
9 Access issues. And proof of delivery. So in a  
10 nutshell, there are two proof issues. There's proof  
11 of access and proof of delivery, and we're going to  
12 get to those.

13           So I just want to get to another point, and  
14 that is revocation of consent. Many people have  
15 brought to our attention and the SCC in particular is  
16 concerned that even if a franchisee -- a prospective  
17 franchisee agrees to get a disclosure document  
18 electronically or through computer diskette or CD  
19 Rom or whatever, there could be system failures.  
20 There could be incompatibilities of systems. There  
21 could be any number of reasons why a prospective  
22 franchisee ultimately may not get a disclosure  
23 document.

24           So a key concern that the Commission I think  
25 would have and certainly Staff has is the ability of a

1 prospective franchisee to revoke its consent to receive  
2 a disclosure document electronically and to get a paper  
3 copy at some point. Is there any problem with that?

4 Martin.

5 MR. CORDELL: I sort of have the same point  
6 that I raised earlier. If the franchisor chooses to  
7 do business in only one media and doesn't wish to  
8 do business in some other media, I'm not sure that we  
9 ought to try to regulate that or mandate the use of  
10 any particular media.

11 MR. TOPOROFF: Let me ask you: Again if we  
12 have two people who are a franchisor and a prospective  
13 franchisee who are trying to hammer out a deal, and  
14 the franchisor gives a disclosure in a format or  
15 through a system that they can't access -- that the  
16 prospective franchisee can't access, has the franchisor  
17 complied with the rule? Have they furnished a  
18 disclosure document?

19 MR. CORDELL: I would say no, but I see  
20 that as kind of a proof of delivery issue. I mean,  
21 that's the problem. The burden of proof is on the  
22 franchisor to ensure that there was delivery. And how  
23 are they going to document that? They're going to  
24 document it through whatever technological means they  
25 have available.

1           Even if they're delivering the UFOC by  
2 electronic means, they may actually want to take  
3 the step to get a -- assuming we allow for electronic  
4 acknowledgment, they may go ahead and require that a  
5 written acknowledgment be submitted. At least for the  
6 short term I see that that's going to happen.

7           But again just kind of looking down the  
8 road, I'm thinking that there really shouldn't be any  
9 problems with electronic acknowledgments.

10           MR. TOPOROFF: And again we're going to get  
11 to those.

12           Gary Duvall.

13           MR. DUVALL: Well, I realize we're going to  
14 get to those, but I still agree with Martin. I think  
15 that franchisees -- the burden is on the franchisor to  
16 draft a receipt, an electronic receipt I'm talking  
17 about for example, that will in one step establish  
18 consent, and it will establish the record-keeping  
19 requirement, it will establish the proof of consent,  
20 the fact that consent hasn't been revoked, and proof  
21 of delivery all in one document at one time.

22           So I don't think a separate step is needed  
23 to allow a franchisee to revoke consent because the  
24 franchisee can exercise that right by not signing the  
25 franchise agreement ten business days later. And the

1 problem is one just of proving that the franchisee  
2 received the document, read it, and the format was  
3 such that would permit him to do so.

4 MR. TOPOROFF: Dennis Wieczorek.

5 MR. WIECZOREK: A similar comment, and that  
6 is that again franchisors should have the ability to  
7 do -- to limit their market, and I don't think it is  
8 necessary for the FTC to specify any particular type  
9 of transmission or to specify that paper be available.

10 If a franchisor says that it's available on  
11 America On Line, and that's where you'll find it, as

1 it in a particular media.

2           And again the market will dictate that  
3 franchisors are going to use broad disclosure  
4 distribution methods. But if somebody chooses not to,  
5 let them blow their opportunity. Let them lose their  
6 market. That's their choice.

7           MR. TOPOROFF: Roger Gerdes.

1                   And certainly an extension of that would be  
2 providing a name, a phone number, an address that they  
3 would fill in, press yes, at which point the franchisor  
4 is protected. They have what I would assume to be --  
5 I'm not an attorney -- a legal receipt that would  
6 indicate that the user has in fact agreed to the terms  
7 that are specified by the franchisor.

8                   MS. HOWARD: Let me ask you: You're  
9 talking about something that the prospect would  
10 basically send back before they open the document or  
11 after?

12                   MR. GERDES: It would be actually before

1 MS. HOWARD: Would there be a way of taking  
2 that a step further by requiring almost a second  
3 feedback to the franchisor? What I'm thinking is that  
4 suppose a person agrees. I accept. I'll take it this  
5 way. They try to get into the document, and they  
6 can't. What if you put something actually embedded  
7 within the document at the very beginning or as like a  
8 sample page, see if you can read the next page.

9 You know, you send back to the franchisor I  
10 accept. And you open up the first page of the document.  
11 The document says, you know, can you read this? If you  
12 can, click yes. And then that goes back to the  
13 franchisor. And at that point the franchisor would know  
14 that, yes, they accepted it, and, yes, they in fact got  
15 something readable.

16 MR. GERDES: That becomes very much an  
17 issue of the types of programs that are used at the  
18 client or at the franchisee level. Certainly you can  
19 embed all kinds of executable code within a document  
20 that will actually go out and send some kind of  
21 receipt to a franchisor as long as that individual is  
22 still maintaining an internet connection or a session.  
23 Yeah, those things are very possible.

24 Another way to approach that would be to  
25 again -- and the idea actually that was proposed by



1 the solution provider, ISP, that was in New York was  
2 actually a very good one because at that point in time  
3 you always have access to a section of an internet  
4 site whereby that information is always readily  
5 available.

6           And in the event that it would cease to be  
7 available, certainly that could be addressed to the  
8 franchisor or could be noted by the prospective  
9 franchisee.

10           But, yes, with respect to your answer about  
11 the document itself, there's a couple answers. One  
12 is actually embedding a code within the document that  
13 allows it to send some kind of receipt back to the  
14 franchisor. Very doable. I believe the answer there  
15 is probably --

16           THE COURT REPORTER: Is probably?

17           MR. GERDES: -- OLE, O L E, but I'm not a  
18 code specialist, so I'm not going to go into that.

19           The other option would be to request some  
20 kind of answer from the client after the document has  
21 been downloaded that says was this document  
22 downloaded successfully?

23           And obviously if you have any kind of  
24 interruption in your internet connection and/or if  
25 there's been some kind of corrupt delivery of that

- 1 document, then of course you can just simply answer
- 2 no, at which point you can initiate another try or

1 we would call, loosely defined of course, E commerce  
2 as it relates to the delivery of transactions.

3           Of course as attorneys I'm sure you all can  
4 appreciate the requirement or need for verification if  
5 you're actually sending contracts or proposals back  
6 and forth between attorneys, between attorney offices,  
7 et cetera.

8           There are privately-held, owned and  
9 operated, third party companies that also currently do  
10 this type of receipt verification today. And  
11 basically what that means is in the event that a  
12 franchise system completely goes away and there is  
13 some kind of litigation that ensues thereafter, this  
14 third party company has terra bites, terra bites, and  
15 terra bites of storage space that actually logs the  
16 transaction long after the fact.

17           MR. TOPOROFF: Howard Bundy.

18           MR. BUNDY: I want to make a comment that  
19 you may want to address later, and if so, just cut me  
20 off. I'll make it real fast.

21           This last comment triggered something.  
22 Under current law, State and Federal, no prospective  
23 franchisee is permitted to sign a binding contract  
24 of any sort except for a receipt or under some State  
25 laws an agreement to maintain confidentiality of

1 additional information until after -- until ten days  
2 after they have received the offering circular.

3 I think one area the Commission should be  
4 looking at here in this context is what are the limits  
5 and parameters of that entry contract that is being  
6 discussed? I don't have an answer. It's something I  
7 think you should be looking at.

8 MR. TOPOROFF: Okay.

9 Mr. Jeffers.

10 MR. JEFFERS: Yeah, I would like to make  
11 two points. One is that we're spending a lot of time  
12 addressing some of the potential for error or voids in  
13 electronic disclosures essentially. And frankly a  
14 lot of what I'm hearing really doesn't go beyond  
15 potential for error that exists right now.

16 I mean, we work specifically with franchise  
17 companies as clients, and I'm sort of day to day  
18 involved in the trenches with the franchise market.

19 First of all, in the 14 years working with  
20 clients, I never allow franchise offering circulars to  
21 be mailed out, to be sent back by mail. It's always  
22 done at the first personal meeting.

23 And the reason is if you're familiar with the  
24 receipt, it doesn't just say that this acknowledges that  
25 you received a copy of the offering circular, period,

1 with a signature. It specifically lists those items in  
2 the offering circular that are supposed to have been  
3 included in the circular, including the financial  
4 statements, including any lease agreements or other  
5 documents that have to be signed even post signing of  
6 the franchise agreement.

7           And my point is that I've always considered  
8 it very important to make sure that all of my  
9 franchisee prospects have clearly understood all of  
10 the items that are in the document that they've been  
11 given, and we go through it.

12           And if you don't do that on a person basis  
13 -- on a face-to-face basis -- that's an intimidating  
14 document that they're not likely to understand. And  
15 so when they sign that receipt in my presence or in  
16 one of your marketing representative's presence, I'm  
17 then comfortable that they have really been properly  
18 disclosed, as opposed to just having been disclosed.

19           And in the same way with electronic  
20 documents, if there is -- by the example you gave  
21 earlier, you said that you gave me this disk. It  
22 didn't show. It didn't format. There would be no way

1 saying we have to acknowledge are in the paper  
2 document and to have -- or for that to have been  
3 considered a legitimate disclosure

4           So there was a deficiency there to start  
5 with. And that would have been the burden of  
6 the franchisor since it's going to be his  
7 responsibility if later on there's a claim. He's  
8 going to have to have demonstrated that he received  
9 that.

10           And the second point was that Roger  
11 mentioned some of the other government agencies and  
12 the U.S. Post Office because there was a lot of  
13 lawyers here. And I will mention this from the view  
14 that there are a lot of franchising people here,  
15 period.

16           I mean, there was at least -- I mean, I was  
17 just at a conference in --

18           THE COURT REPORTER: Whoa, Speed Racer. I  
19 was just at a conference in --

20           MR. JEFFERS: I was just at a conference in  
21 Minneapolis where another company was introduced to me  
22 that I wasn't familiar with that were Internet or  
23 something -- but there was a company in San Diego, IFX  
24 Synacor, that right now can set up a franchisor  
25 completely on a system internally with communication

1 capability with their existing franchisees that  
2 provides for absolute proof of delivery, signage,  
3 documents, and securities so that a franchisor can get  
4 one message, and the manager in the outlet can  
5 indicate that they received it.

6           That same technology can clearly be applied  
7 to identifying whether or not an offering circular by  
8 disk was legitimately disclosed and received because  
9 it's existing now for much more complicated data.  
10 They want proof of changes in the operation manuals  
11 and other things. They're selling this system now to  
12 franchisors.

13           So I don't think that the FTC necessarily  
14 has to be any more involved with establishing the  
15 parameters for proof than they already are with paper  
16 documents, which is that it's a clear format there,  
17 and the franchisor either complies or doesn't comply.

18           And I've always felt that many franchisors  
19 don't comply adequately because they allow for other  
20 than personal meetings for these disclosure documents  
21 to be given. That's not a requirement, other than it  
22 can be given as long as it's done ten days prior.  
23 I just don't operate any other way because I think  
24 it's that important that it's really clear.

25           So I think we really have some of that

1 covered right now, other than just the one point made  
2 earlier that we allow that as an additional form of  
3 disclosure, in addition to the traditional ways, that  
4 if the franchisor and the franchisee consent, they  
5 could receive it on electronic disk.

6           And that's something that I think covers  
7 really where we are for the next maybe couple years or  
8 at least two weeks.

9           MR. TOPOROFF: Well, that gets back to my  
10 initial point, and that is that the Commission isn't  
11 looking to prescribe very detailed, precise ways that  
12 franchisors have to use whatever technology is  
13 available.

14           What is does mean is that the Commission  
15 has any number of rules where compliance on the  
16 internet is an issue. And again you may be  
17 comfortable or any number of franchisors or their  
18 attorneys might be comfortable with these issues, but  
19 there's a whole host of others that aren't.

20           And I can tell you we get asked all the  
21 time for guidance on this subject. But to the extent  
22 that we are asked to provide guidance that is going to  
23 last for the next decade or so, again what we're  
24 interested in discussing at this point are very  
25 general, basic principles that the Commission could



1 use.

2 Roger.

3 MR. GERDES: No, I have nothing.

4 MR. TOPOROFF: I want to move on to another  
5 point, and this is a touchy one for us at the  
6 Commission, and that is access.

7 Certainly if a -- let me backtrack. There  
8 are many different ways that an internet disclosure  
9 may come about. It could be that a prospect is  
10 sitting in their study with a computer screen surfing  
11 away on the internet, comes across a particular  
12 franchisor who has a web site, and find there are  
13 different hyperlinks or whatever, and they could get  
14 in, apply to be become a franchisee, get a password  
15 or not, or maybe the disclosures are out there up  
16 front, and it's not to much of a problem for the

1           Now, in a situation like that, if a  
2 franchisee goes back and tries to find the web site or  
3 tries to find the disclosure document on the web site,  
4 they might not necessarily be able to do so. There's  
5 a concern that we have that a disclosure document be  
6 available at the web site for the period of time at  
7 least that the franchisee -- the prospective  
8 franchisee has to review -- otherwise would review a  
9 paper copy.

10           So, for example, if a prospective  
11 franchisee chooses to download, and there's proof that  
12 it was in fact downloaded, no problem. They have the  
13 paper copy themselves.

14           What happens if I don't want to download?  
15 What happens if I don't want to drag around with me  
16 stacks of paper? I want to be able to go to my  
17 brother-in-law, and I want to go to my accountant, and  
18 I want to go to my attorney.

19           If literally a disclosure document on the  
20 internet is a substitute for a paper copy, it needs to  
21 be available. It needs to be up there on the screen  
22 for at least the 14 days or whatever so that any time  
23 I want to click on it, I can go, and I can click on  
24 it.

25           So there's a question for us of how could a

1 franchisor -- well, two questions actually. One is  
2 what happens if there are updates or changes or other  
3 factors that -- to the disclosure document that if I'm  
4 a prospective franchisee, I click on today, that might  
5 not be the same disclosure document I click on  
6 tomorrow? There's a security issue here and/or a  
7 change issue at least.

8           And then the second one is I don't want  
9 a paper copy. Unless you're going to force people  
10 to have a paper copy, to download. If I don't want  
11 to download, if I want to be able to use my computer  
12 screen literally the same as I would a paper copy  
13 disclosure document, how are franchisors going to  
14 be able to prove that they had this document up on the

1 changed real time, which by definition means that you  
2 have greater accessibility to those changes. So  
3 those are just points to make.

4 MR. TOPOROFF: Let me give an example of  
5 what I mean by an update or a change. Let's say on  
6 January 1st -- well, let's scratch that. December  
7 30th of a particular year a franchisor's disclosure  
8 document has 100 individual pieces of litigation that  
9 are disclosed. But let's say its fiscal year is a  
10 calendar year. So on January 1st -- let's say those  
11 100 items of information occurred ten years ago.

12 So it could be on December 31st the  
13 disclosure document will reflect 100 pieces of  
14 litigation, but on January 2nd it won't. But the  
15 person who is getting the disclosure document at the  
16 end of December should have access at least to the  
17 disclosure document that they would have otherwise  
18 gotten if they had a paper copy, which would have had  
19 the 100 items of disclosure. Am I have wrong on this  
20 one?

21 And if so, if a prospective franchisee is  
22 entitled to a particular disclosure document or should  
23 have gotten that because that is the timeframe, then  
24 how are we going to be able to prove that a particular  
25 franchisor was -- had that disclosure document

1 available and enabled the prospective franchisee to  
2 have access to it during the key 14 day period that  
3 they have to review a disclosure document?

4 I'm going to ask Roger about this.

5 MR. GERDES: Well, there's two solutions  
6 but certainly one solution is to identify to the  
7 franchisee at that point in time that in order for  
8 them to have a record of the disclosure document as  
9 it's reflected on the internet site at that current  
10 point in time, that they have to agree -- give their  
11 consent to actually download a copy so that they have  
12 a copy for themselves.

13 If they waive that opportunity, then maybe  
14 the -- it's explicitly obvious that these documents  
15 are in fact legally subject to change. And if they  
16 consent not to download a copy for their records,  
17 then that's their problem. I don't know if that's a  
18 good answer or not.

19 But the second solution gets back to  
20 working with firms that actually provide some kind of  
21 verification of what was actually sent and received.

22 From my standpoint -- I have a colleague  
23 that is responsible for the legal industry, and we  
24 talked about this at considerable length. And we  
25 really believe that this is an answer to freeing up a

1 lot of the paper that takes place in the legal process  
2 today because the concern for verification of who sent  
3 what, when and who received what from whom -- and I  
4 think I got that all right -- is extremely important.

5           And it's no less important in the franchise  
6 space because there is a lot of legal matters that  
7 take place between a prospective franchisee,  
8 franchisee, and then of course the franchisor.

9           So there's kind of my view in terms of two  
10 ways to actually look at assaulting that dilemma which  
11 you noted, which is a very real dilemma. I understand  
12 the importance of that.

13           MR. TOPOROFF: Let me ask this: Should we  
14 basically say something along the following line: If a  
15 franchisor has its disclosure document on the  
16 internet, then it basically says to the prospective  
17 franchisee, look you have to download this, so if  
18 the prospective franchisee that is supposed to get the  
19 disclosure document on December 20th or whatever  
20 the magic date is, if it's available and it can be  
21 downloaded, then it really is the obligation -- and  
22 assuming there is proof of receipt and downloading and  
23 all that, but if the franchisor says you have to  
24 download this document, could we then say once that  
25 option is available, then the burden, if you will,

1 switches then to the franchisee to say that in fact  
2 they did download it?

3           Let me repeat that, so it's clear. If the  
4 franchisor has a web site that basically has access to  
5 a disclosure document, and they say here's our  
6 disclosure document, you download it for your records,  
7 okay, as long as they make that option available to  
8 download, then they have no further obligation to  
9 ensure that the disclosure document is there and the  
10 proper one as long as the franchisee could have  
11 downloaded? I mean is that an option?

12           Howard.

13           MR. BUNDY: I think the two letter answer  
14 is no, that simply giving the option doesn't work  
15 because that is in effect a waiver, which at least  
16 under all of our State franchise laws is void -- void  
17 at the beginning as if it had never occurred, or at  
18 least voidable at the option of the franchisee. That  
19 gives the franchisor little or no comfort and doesn't  
20 give the franchisee meaningful disclosure.

21           I'm afraid that we may be in one of those  
22 fringe areas where for at least the next two weeks  
23 until Microsoft can solve another one of our problems  
24 where a franchisor in order to derive any protection  
25 from having given the disclosure has to either require

1 a download, or if the prospective franchisee fails to  
2 download it, then do what Carl suggested and deliver  
3 a paper copy to them to cover yourself because the  
4 burden has got to stay on the franchisor to see to it  
5 that that prospective franchisee gets a meaningful  
6 disclosure.

7           And simply having it up for 15 milliseconds  
8 or whatever time it takes to read that document  
9 on-line is not meaningful disclosure. They need to be  
10 able to take the same exact document and show it  
11 to their lawyer, show it to their accountant, show it  
12 to their mother-in-law, who is probably the most  
13 competent advisor, and, you know, have it be  
14 consistent throughout; otherwise, you're chasing  
15 ghosts.

16           MR. TOPOROFF: Dennis Wieczorek.

17           MR. WIECZOREK: At the beginning of this  
18 discussion, Steve, you said maybe it is appropriate



1 the web site.

2           And does that mean now the period needs to  
3 go an extra day, and that franchisor needs to be aware  
4 that all of its prospective franchisees on the  
5 pipeline instead of being through on January 15,  
6 now they have to wait until January 16th? I think  
7 that's a crazy result and will cause all kinds of  
8 problems.

9           But I disagree with Howard that if a  
10 franchisor on its web site or some other medium says  
11 you should either download it right now and preserve a  
12 hard copy of this or call us up at this 800 number or  
13 ask us for a fax or ask us for a Federal Express, we  
14 urge you to do that, and the franchisor does that,  
15 that should be presumptive that the franchisee did  
16 have delivery of the disclosure document, and that  
17 should be enough.

18           If a franchisee chooses not to do it and  
19 the web site goes down a week later for a couple of  
20 days, tough luck. The franchisee chose not to get a

1 MR. TOPOROFF: Gary Duvall.

2 MR. DUVALL: In answer to your question on  
3 the burden, the burden is always on the franchisor.  
4 I think we all agree with that. But I don't agree  
5 with either what Dennis or Howard said because I  
6 think they ignored the solution that Roger mentioned.

7 One can receive a document such as an  
8 offering circular and be required to click on your  
9 consent that you have downloaded the document. And  
10 that's what franchisors will do to meet their burden  
11 of proof. There's a technology solution to this  
12 dilemma.

13 It will be the franchisor who bears the  
14 burden, and they'll easily be able to meet that burden  
15 by simply having an interactive electronic  
16 communication with the franchisee which will prove  
17 that the franchisee downloaded the document.

18 And as Dennis mentioned, there are options  
19 as well. Again it can be an interactive communication,  
20 and the franchisee, if they can't download will click on  
21 something that says I tried. I couldn't do it. Or if  
22 they won't download, then the franchisee will click on  
23 something that will say send it to me in hard copy. But  
24 there's an easy solution.

25 I just got a newsletter yesterday, for

1 example, and the newsletter was attached to an E mail,  
2 and there were three or four responses that I could  
3 make. Yes, I read the newsletter. It was great. No,  
4 I don't want to receive this newsletter anymore.  
5 These technology solutions are available and will  
6 allow the franchisor to easily meet its burden.

7 MR. TOPOROFF: Mr. Jeffers.

8 MR. JEFFERS: Two points. One is first  
9 of all I don't have any franchisor clients that either  
10 presently or are currently working --

11 THE COURT REPORTER: I'm sorry. You don't  
12 have any franchisor clients that --

13 MR. JEFFERS: -- who at the present time  
14 have their offering circular available as an  
15 electronic disk transmission. I do not have any  
16 clients.

17 And frankly until there was a body of  
18 case law and actual litigation on this matter that  
19 clearly established what the rule would be, in the  
20 foreseeable future even if I were working with franchise  
21 companies who had the availability as an option, I would  
22 still continue to provide a paper copy of the offering  
23 circular to any prospective franchisees that I was  
24 involved with in a transaction for the simple purpose of  
25 clarity and of some additional protection because of

1 the potential vulnerability of discrepancies in the  
2 information or improper disclosure claims by people like  
3 Howard on behalf of the client, which I think is  
4 reasonable if they have that opening. I'm not going to  
5 give them that opening.

6 But the point that Dennis was making was  
7 about the different options, and I do agree that there  
8 comes a point where some of the burden does have the  
9 shift from the franchisor to the franchisee. I mean,  
10 if the franchisor has made it an option, not saying,  
11 because this was the original point, that the only way  
12 we provide our disclosure document is through the  
13 internet -- that in my mind would be a ridiculous  
14 business decision. But as an option. And they have  
15 Federal Express. They have --

16 THE COURT REPORTER: I'm sorry. Because in  
17 your mind that would be a ridiculous business  
18 decision.

19 MR. JEFFERS: Yes, that would have been a  
20 ridiculous option for a franchisor to require that  
21 their document only be available on the internet to  
22 prospective franchisees.

23 But if it's an option that they're making  
24 available to prospective franchisees, and they clearly  
25 list all of the options that they, the franchisee, has

1 available to obtain this document, then I think at  
2 that point that there is a presumption there that the  
3 franchisee has to exercise some degree of sense and  
4 good judgment in determining what makes sense for him.

5           If you don't even have your computer yet,  
6 it doesn't make sense for you to check off the  
7 internet option to get the offering circular. And  
8 it's not the franchisor's responsibility at that stage  
9 to decide if that's the one you checked off that that  
10 was not appropriate and therefore was an improper  
11 disclosure.

12           But your last case, sort of, study that you  
13 mentioned before -- which I would like to address  
14 again, and I would like to get some comment on that  
15 because it's been bothering me for the last five  
16 minutes.

17           Your example was that if on December 31st,  
18 the fiscal year ended January 1st, and because of the  
19 that in the internet they could make the change,  
20 eliminate the 100 lawsuits because we now have passed  
21 the ten year point of view -- ten year period, but  
22 those who were receiving the document as a paper  
23 document would still have access to that information  
24 -- I mean, we do -- we file post-effective amendments  
25 to make changes in the circular.

1           If we're now at the point where there is a  
2 fiscal year reporting and there's a change in the  
3 circular, why would not the same document until they  
4 had either been able to file the changes in the  
5 document and prepare the new document -- if -- unless  
6 -- if it's a registration state particularly -- in  
7 other words, they would not be able to change the  
8 internet and update that document that's on the  
9 internet without having gone through the process of  
10 filing the changes and the renewal of their  
11 registration with new financial statements and  
12 -- otherwise that would also trigger a change in the  
13 paper document.

14           And until that was approved by the State,  
15 that internet document would have to be the same one  
16 that was on the paper unless they suspended their  
17 franchising until that was done.

18           MR. TOPOROFF: That's not true. That's not  
19 true because it's depending on how you have the web  
20 site and you offer the disclosures. For example, if  
21 you have a web site and the particular page that has  
22 the disclosures lists all the different states, and  
23 then there's an all state for non-registration states,  
24 maybe you can't fix it for the registration states,  
25 but maybe you could alter the disclosure document for

1 the other category.

2                   And if -- let's take it a step further.

3 If in order to get into a particular disclosure

4 document, you have to give a password, and you only

5 have access to a particular disclosure document, you

1 behoove us to think about some of these issues and  
2 come up with general principles. Again we're not  
3 dictating any particular format or any particular  
4 means, whether you use passwords, not use passwords.

5           What we want is to come up with general  
6 approaches so that people, franchisors and others,  
7 could say, okay, here we have general guidance, and we  
8 could go forward and use the internet and other  
9 electronic means.

10           MR. WIECZOREK: Steve, can I just respond  
11 to your example because I don't understand your  
12 example?

13           MR. TOPOROFF: Yes.

14           MR. WIECZOREK: If a franchisor is up and  
15 running throughout the United States, and there's a  
16 material change to its circular, it immediately can  
17 make the change to -- in the non-registration states  
18 and will do so in paper and on the internet.

19           Let's say for example in states like  
20 Illinois, Washington, et cetera, they're out of  
21 business and can't do anything, so their paper  
22 delivery is shut off and their internet site for  
23 Illinois, Washington, et cetera should also be shut  
24 off until they can get their document filed and  
25 approved by the state.



1           So it's the same scenario whether it's  
2 paper or computer commerce, that you're --

3           MR. TOPOROFF: The difference is --

4           MR. WIECZOREK: -- stopped in the state.

5           MR. TOPOROFF: Let's remove the  
6 registration states from the discussion because I  
7 agree with you for registration states that's not a  
8 problem.

9           If a prospective franchisee gets a hard  
10 copy disclosure document on December 20th, again back  
11 to my scenario, he or she walks home with that  
12 document. That document isn't going to change. They  
13 see listed there 100 pieces of litigation disclosed.  
14 Okay.

15           But if I don't -- if the internet

1 have a travel manual. It's put out by Holiday Inn or  
2 there's any number of ones that tells us flights,  
3 per diems, hotels, and so on. We have hard copies  
4 of those, and we also have internet copies available  
5 on our screen.

6 I don't have to go to the front office  
7 every time I want to look up what the per diem is in  
8 Dallas or Seattle or whatever city it might be. I  
9 literally can go into my screen, and it is there each  
10 and every time. I don't have to download it. I don't  
11 have to do anything.

12 So the concern is -- sure, if a disclosure  
13 document is put on the net, and the people download  
14 it, and you have proof it was downloaded, fine, we  
15 have no problem, putting aside proof of delivery  
16 issues and receipt.

17 But if a disclosure document is going to be  
18 like my travel guide instance where literally if I  
19 want it, it's going to be there any time I want it, it  
20 does raise issues whether the franchisor could go in  
21 and change it. And on day one, I might get one  
22 disclosure document, and when I go to see my financial  
23 planner or my lawyer, it could be a different  
24 disclosure document for the reasons that I stated  
25 before.

1           MR. WIECZOREK: I know Roger has to leave,  
2 but I still don't see the difference, Steve, because  
3 if there is an adverse event -- if 100 pieces of  
4 litigation are filed after the person sees the web  
5 site the first time, the franchisor has to ensure that  
6 the prospect sees a new disclosure with 100 pieces of  
7 new litigation a week later.

8           He has to say -- under the law now he would  
9 have to prove that that franchisee was redisclosed,  
10 whether it's paper, electronically, or otherwise. So  
11 really I don't see --

12           MR. TOPOROFF: Not under our rule. Under  
13 our rule there has to be --

14           THE COURT REPORTER: I'm sorry. You're  
15 both speaking at the same time.

16           Under our rule there has to be --

17           MR. TOPOROFF: -- an update if there's a  
18 material change at least on a quarterly basis. In  
19 theory a franchisor could drag that out to the end of  
20 that quarter, and they would still be in compliance  
21 with our rule; they could say, hey, I updated it;  
22 it was a material change, and I updated within the  
23 quarter, but yet avoids the circumstance that I  
24 mentioned before.

25           MR. WIECZOREK: Okay. Last comment, and

1 then I'll stop is that in the states you are required  
2 to make immediate redisclosure and -- after you do  
3 your filing, so I think as a practice most franchisors  
4 don't wait the 90 days to make their redisclosure.  
5 They do it immediately as soon as they can. That's  
6 all.

7 MR. TOPOROFF: Roger.

8 MR. GERDES: Taking a very non-technical  
9 sort of view, I don't see how this is very different  
10 from the paper world, much like, you know, security  
11 is an issue with respect to the sending and the  
12 receipt of mail, for instance.

13 If you hand somebody a disclosure document,  
14 nothing prevents acts of God, for instance, happening  
15 that would cause somebody to maybe catch that document  
16 on fire, it could fly out the cab door, the dog could  
17 eat it, the children take it to school, and it's lost  
18 forever, and you've lost that archive. That by  
19 definition means that that archive is lost forever.

20 MR. DUVALL: Or the franchisor asks for it  
21 back.

22 MR. GERDES: Exactly. In that instance  
23 there is nothing left for a prospective franchisee to  
24 hang their hat on so to speak. In the electronic  
25 realm there is always some kind of information

1 available.

2           Now, it may have changed, and there may be  
3 some kind of principle parameter that would be  
4 outlined by the Commission that would state you have  
5 to have, you know, because of this ten year rule  
6 -- and again I don't understand a lot of these things  
7 -- that you have to provide a prospective franchisee  
8 that has not downloaded a circular with the ability to  
9 go back six months or whatever the case may be.

10           Now, we all think about that and go, oh,  
11 gee, that's administrative nightmares racking up all  
12 over the place, and my response to that is no, it's  
13 not at all, because all that happens sort of magically  
14 server side such that, based upon somebody's profile,  
15 they can always receive a document based upon the  
16 initial date that instigated the first transaction  
17 between the franchisor and the franchisee.

18           Now, again that is contingent upon there  
19 being some kind of profile being established by the  
20 client, by the franchisee so that the server will  
21 understand what documents are required for that  
22 individual to see, which really kind of touches on the  
23 whole idea of personalization and of course is a big  
24 part of what Carl referenced before, which is basically  
25 an extranet, which is really a secure internet site

1 that is personalized for a select viewer.

2           So server side the issue of what somebody  
3 has received in the past versus what is available  
4 in the present can certainly be handled. I don't know  
5 if you pass principles or legislation or whatever the  
6 case maybe to mandate that, but certainly from a  
7 technology standpoint it's very, very doable, and it's  
8 much more practical and better suited for the  
9 franchisee and the franchisor than this hard copy that  
10 I hold before me because chances are I might drop  
11 this in the elevator and never see it again, at which  
12 point my archive is gone.

13           THE COURT REPORTER: I'm sorry. I'm about  
14 to run out of paper, and I need just a second.

15           (Discussion off the record.)

16           (Mr. Gerdes leaves the meeting.)

17           MR. TOPOROFF: Back on the record.

18           Judy.

19           MS. GITTERMAN: One comment that I have in  
20 regards to the problem of having the disclosure  
21 on-line for a 14 day period, it seems that you could  
22 just put it into an archive -- I think Roger was  
23 referring to that somewhat -- of six months, but it  
24 could just be a 14 day archive that the user can  
25 access for that period and that would be the same as

1 -- the same situation as if he had been given a paper  
2 document.

3           And it seems to me I would disagree with  
4 those people who have said it would be the  
5 franchisor's burden to force a paper document on the  
6 prospective franchisee if he refuses to download. I  
7 mean, we're talking about mutual consent here in the  
8 first place.

9           Only those parties who agree to internet  
10 disclosure are going to engage in that transaction.  
11 And once you have the consent and it's informed, you  
12 give the franchisee some sort of statement, preamble  
13 that we advise you at this time to download it on the  
14 first time that they click on it.

15           And if they don't do that, you shouldn't  
16 have to baby-sit them. And having it available in an  
17 archive would solve the problem also in case they  
18 didn't have access on that first day.

19           And then as far as your example, I really  
20 don't see the difference between the paper situation  
21 and the internet over the time period from December  
22 20th to January 2nd because the serendipity of a  
23 franchisee having the first face-to-face meeting and  
24 getting the disclosure on the 20th versus on the 2nd  
25 means franchisee A may get one disclosure statement,

1 and franchisee B gets another one. And I don't think  
2 that that's an unsolvable problem that is related to  
3 the internet.

4 MR. TOPOROFF: Any more?

5 Myra, did you have one question?

6 MS. HOWARD: Why don't you go to Mr. Bundy  
7 first.

8 MR. TOPOROFF: Howard.

9 MR. BUNDY: I had a couple of follow-ups on  
10 some things that had been said. Several people have  
11 indicated that the option to download or the option to  
12 create an archive is enough.

13 One of the problems I have with that is the  
14 real-world situation where the typical prospective  
15 franchisee often until a year after they've bought the  
16 franchise, unless they've consulted the right  
17 attorneys in between, don't understand why they're  
18 getting this book, this document, whether its  
19 electronic or otherwise, except for the fact that  
20 we've got that FTC or State cover page that kind of  
21 explains it.

22 And I'm very concerned about an electronic  
23 means of delivery -- I should say non-paper means of  
24 delivery that doesn't force the franchisee, if you  
25 will, to at least confront that much information which



1 is on the cover.

2           For example, when Microsoft hands out  
3 nearly free software, they print right on the CD  
4 and right on the jacket substantial information about  
5 it. But when you unload -- download that same  
6 software from the internet, you don't get the benefit

1 occasion a sweeping integration clause that says  
2 anything except what is in the franchise agreement  
3 itself, including the offering circular often, is out  
4 of here, you've lost the value of your disclosure  
5 again. So just another issue to raise for you.

6           And perhaps another issue that ought to  
7 come to the table here in light of this discussion is  
8 that maybe we should have a requirement that only  
9 sophisticated franchisors can use these alternative  
10 media, because I see a lot of temptation on the part  
11 of small franchisors particularly to slap that thing  
12 on the internet so it gets out there for broad  
13 distribution without any of the kinds of protection  
14 and documentation that Roger and the rest of us have  
15 talked about.

16           The people who are represented in this room  
17 are not the dangerous ones for the most part.

18           MS. KEZIOS: Wait a minute. Duvall is  
19 sitting there.

20           MR. BUNDY: I don't mean to defame anybody  
21 by saying that, but the people who are out there  
22 failing to give adequate disclosure either through  
23 ignorance or deliberate deceit don't have a place at

1 those.

2           There's a concept in Admiralty Law that I  
3 think has some marginal applicability here where a  
4 sailor, a seaman, is deemed as a matter of law to be a  
5 ward of the court, in need of protection of the court,  
6 in need of protection of the government. It's a  
7 matter of law. It's presumed. Virtually  
8 irrebuttable. You know, to some extent, prospective  
9 franchisees are in that same boat. Pun intended.

10           MR. TOPOROFF: Okay.

11           MR. BUNDY: Thank you.

12           MR. TOPOROFF: Mr. Jeffers.

13           MR. JEFFERS: I would only add to your  
14 comment though, to soften it a bit, it's my impression  
15 that there are franchisors out there just as there are  
16 in any business who have a deliberate purpose of  
17 deceit and attempt to use loopholes for the basic  
18 purpose of personal gain or fraud. And that's a level  
19 that there aren't seminars to address.

1 is no pattern there of that.

2           And for those franchisors, and that's I  
3 think the bulk of them, this kind of a format I think  
4 can be helpful because they will respond and do  
5 respond. And that's where I think it's important  
6 that the FTC be clear, be consistent, but not go so  
7 far as to be overwhelming in taking on areas that the  
8 most brilliant minds who are available can't come to  
9 complete agreement on.

10           And so for the FTC to simply lay out  
11 specific guidelines that have to be followed, it  
12 makes it very difficult. And I would only ask that  
13 you allow that maybe everybody in this room is of good  
14 will and good intent in that area and not for the  
15 most part.

16           MR. TOPOROFF: Moving along.

17           MR. BUNDY: I certainly concur with that.

18           MR. TOPOROFF: Okay. One second.

19           MS. HOWARD: Yeah. I just have a few  
20 things I would like to bring up. Following up on what  
21 Judy had mentioned about responsibility, it doesn't  
22 seem to me or I'm not sure that I've heard a consensus  
23 about whether or not it should be the franchisor's  
24 responsibility to prove that they have a document,  
25 say, on the net for a certain period of time. Is

1 there any sort of agreement on that issue, or is that  
2 still up for grabs?

3 Gary.

4 MR. DUVALL: I think the rule should be the  
5 same as it is for a paper document, that is -- and I  
6 don't think you need a special view for the internet.  
7 Just as a franchisor has to disclose an offering  
8 circular and leave it in the franchisee's hands for  
9 ten business days --

10 THE COURT REPORTER: I'm sorry. I can  
11 barely hear you.

12 MR. DUVALL: -- that would be true whether  
13 it's an electronic period or a paper period.

14 MS. HOWARD: And that raises the question:  
15 How differently do we need to treat, if at all, an  
16 internet version versus a paper copy? I mean, you  
17 know this is --

18 MR. DUVALL: Well, to use Steve's example,  
19 if indeed a franchisor was able to change the internet  
20 version of an offering circular on January 2nd, at a  
21 minimum what would be required under current law would  
22 be that that new version have proof of delivery and that  
23 that new version be available to the franchisee over the  
24 internet for another ten business days. I think  
25 that rule takes care of the problem.

1 MS. HOWARD: Is there agreement as to that?

2 No.

3 Dennis.

4 MR. WIECZOREK: I go back to the --  
5 the issue regarding an amendment, a material change in  
6 the offering is absolutely accurate. I don't disagree  
7 with that at all.

8 But if there are technical problems and a  
9 server -- you know, most of these internet sites are  
10 through third party entities that have servers in Guam  
11 or Toga or Pogo [sic] or wherever the heck that is.

12 And if the server goes down for a day or  
13 two and a franchisee theoretically didn't have access  
14 during that day or two period, what does that mean,  
15 and how do we deal with that issue, and does that  
16 automatically extend the 10 business days to 12  
17 business days because of that?

18 And I would hate to get into that issue  
19 because Howard will make hay with that because he'll  
20 find out that the internet site was shut down for a  
21 couple of days for technical reasons. So I think it  
22 would be preferable, although I know there is  
23 disagreement about this, to have the downloading  
24 possibility, the mailing possibility available to the  
25 franchisee.

1           And if the site shuts down for technical or  
2 other reasons during that ten business day period --  
3 and keep in mind, you know, you have -- if you're a  
4 large franchisor, you have potentially scores or  
5 hundreds of people in the pipeline with time periods  
6 ending, starting constantly.

7           And that could cause a big problem to say  
8 in the rule that if you utilize the internet as your  
9 disclosure site, that it must be up and running for  
10 the full ten business days applicable to any  
11 franchisee.

12           And I would say a proxy for that would be  
13 to put in an option or shift the burden anyway if the  
14 franchisee is told download this and proceed.

15           MR. TOPOROFF: Well, that still -- putting  
16 aside Dennis's suggestion, which is actually one that

1 way of guidance. Again these are formal requirements.

2           But there is nonetheless a question from  
3 our perspective as law enforcers. How are franchisors  
4 going to prove that a prospect had the disclosures  
5 available on-line for the given period of time? And I  
6 don't know that we really answered that.

7           MS. KEZIOS: Roger answered that. He said  
8 -- and he also answered Dennis's problem with it being  
9 an administrative burden for franchisors who have got  
10 hundreds of franchisees in the pipeline. He said that  
11 administratively it's not a burden because there's  
12 enough room out there to put those documents.

13           And, second, he said that whenever a --  
14 it's possible when you get a document that they can go  
15 in and find out from your computer that -- you leave a  
16 trail when you're engaged in electronic communication,  
17 and there are companies that can tell you exactly the  
18 day that the document was downloaded.

19           MR. TOPOROFF: So is the problem solved as  
20 long as the franchisor maintains a copy -- each copy I  
21 suppose of its disclosure document for a given period  
22 of time and at the same time allow access to  
23 prospective franchisees who are entitled to a specific  
24 version?

25           Martin.



1           MR. CORDELL: Well, I think the burden is  
2 always on the franchisor -- the burden is on the  
3 franchisor to prove delivery. So actually I can't  
4 even conceive of your hypothetical in which a  
5 franchisor would simply disallow a franchisee to  
6 come in and not verify or have some way to force the  
7 franchisee to download that document or create some  
8 trail that the franchisor can use to substantiate  
9 the person has in fact received the document.

10           MR. TOPOROFF: Okay. Again I keep getting  
11 back to this issue of we know that franchisors may do  
12 that, and I don't think that that's the concern for  
13 most franchisors.

14           It really is a law enforcement issue, and  
15 that is as regulators, as potential law enforcers, if  
16 we want to go out -- if we find there's a pattern and  
17 a practice in a particular franchise system that  
18 prospective franchisees just do not have access to  
19 disclosures on-line, how do we prove that?

20           MR. CORDELL: Well --

21           MR. TOPOROFF: And if there are fixes,  
22 that's fine if the franchisor uses those fixes that  
23 Roger mentioned.

24           So in those instances where a franchisor  
25 does leave a trail or uses a third party or does

1 whatever it wants to do to ensure that the disclosures  
2 are read, then that's fine.

3           But what happens in those circumstances  
4 where that isn't the case? Do we just say that they  
5 violated the rule, and therefore they should be  
6 subject to civil penalty action?

7           MR. CORDELL: The one option is to require  
8 that they keep a record, just like they're required  
9 now to keep acknowledgements of receipts. They'll  
10 have to keep an acknowledgement in some form, and  
11 it has to be a form that is clearly understandable to  
12 law enforcement just as it would be to attorneys who  
13 -- you know, assuming they're going to be -- they will  
14 have discovery by plaintiff's attorneys eventually,  
15 but they will have to -- yes, they will be forced to  
16 provide proof that they've done whatever it is that  
17 they said they've done. Again I don't really see  
18 that being a problem, especially when they are really  
19 easy technical solutions already.

20           MR. TOPOROFF: Howard.

21           MR. BUNDY: Steve, I think it's more  
22 important from the franchisee's point of view to  
23 maintain the burden of proof where it is, that it's  
24 the franchisor's burden to do it.

25           THE COURT REPORTER: I'm sorry. I lost my

1 train of thought there.

2           MR. BUNDY: It's more important to maintain  
3 the burden of proof as being on the franchisor to  
4 prove all of the relevant facts, including that for a  
5 period of at least 10 business days, 14 calendar days,  
6 whatever the number is, that document was available  
7 24 hours a day or 23 and a half hours a day on -- at  
8 some source if it's not downloaded in an unchanged  
9 format.

10           We don't care how they do that as long as  
11 they bear the burden of it. And, you know, to the  
12 extent that I'm advising franchisors, I'm going to say  
13 -- at this stage of development in technology, I'm  
14 going to say maintain a paper trial.

15           But if somebody chooses to take that chance  
16 and wants to give me as a franchisee lawyer a fun shot  
17 at it with my computer expert sitting over there, you  
18 know, that's their risk to take.

19           Now, from the regulatory side, I think it's  
20 the same thing. It's the burden of the franchisor to  
21 show that they maintained that unaltered document  
22 available to the franchisee, or that in the  
23 alternative they -- the franchisee in fact downloaded,  
24 or in the alternative the franchisee in fact received  
25 it in another medium.

1           The focus has to be on whose burden of  
2 proof it is. And if you're in doing an investigation  
3 today as I understand it, they have to prove to you  
4 that they complied.

5           MR. TOPOROFF: Right, but it still misses  
6 the point. I mean, we can talk all day long about  
7 whose burden it is. And I agree.

8           The next question is when I get an advisory  
9 opinion request that says I understand it's my burden,  
10 now how do I satisfy it, that is the concern. I mean,  
11 I agree with you that -- whose burden it is. The  
12 Franchise Rule says the franchisor shall furnish the  
13 disclosure document. I'm not arguing with that.

14           But the question really boils down to when  
15 we advise, when we come out with updated interpretive  
16 guides or whatever, what information should we impart  
17 to the franchisor?

18           One option is to say, hey, this is  
19 technical. You speak to your people, and you deal  
20 with it. As long as you come up with a fix, we're  
21 happy. That is an option. That seems to be what I'm  
22 hearing.

23           MR. BUNDY: That is the best option.

24           MR. TOPOROFF: Dennis.

25           MR. WIECZOREK: Some of the sense of

1 concern here I think goes to the -- this may be a very  
2 silly simple issue, but it seems like a lot of the  
3 internet sites require the prospect to put in his or  
4 her name and at the beginning an address. And that  
5 sort of indicates that, well, they started the  
6 process, but did they go through the whole document?

7           And maybe there needs to be an additional  
8 level of security that there is a check off, sign off  
9 at the beginning of the process and at the end of the  
10 document even on the site, so that in theory the  
11 person at least has scrolled through 100 pages of  
12 documentation and has said at the end, yes, I received  
13 it. I've read it. Check it off. That's that.

14           Maybe that's adequate for proof of delivery  
15 under the rule rather than requiring an absolute  
16 maintenance of the document for 14 days throughout  
17 that period, because literally that's what happens  
18 today with a paper document.

19           The person gets the document, probably  
20 looks at it, and reads through it, and the receipt is  
21 at the end. That hopefully inclines them to at least  
22 turn pages. They may not read, but they will turn  
23 pages. Maybe that's good enough. Maybe that's an  
24 option.

25           MR. TOPOROFF: Judy.

1                   MS. GITTERMAN: I think that just having  
2 the franchisor provide the information box at the  
3 beginning of the disclosure statement -- and I'm not  
4 talking about someone just signing on the web page and  
5 putting their name in that they're kind of perusing  
6 it, but if somebody is actually getting the disclosure  
7 that is applicable to them, that the franchisor have a  
8 record of their visiting that site and opening the  
9 disclosure document as was mentioned before, similar  
10 to the license agreement that you always see at the  
11 beginning of using software.

12                   Going beyond that I think is really  
13 dangerous because not only do you have problems of the  
14 server being down, but if you require a franchisor to  
15 prove that he's had the document on there for a  
16 certain period of time, I mean, you can get into all  
17 sorts of things at the other end, on the franchisee's  
18 end.

19                   Let's say he uses American On Line, and he  
20 can't get through, or Netscape, and there's a problem  
21 with getting on Netscape. I think it's just much  
22 too subjective.

23                   Once the franchisor offers the opportunity  
24 to use the internet as a means of disclosure and the  
25 franchisee signs in at that document and is given also

1 the information that they're advised to download, I  
2 think that that should be all that is necessary for  
3 the franchisor to satisfy his burden.

4           Because even if you give an option of,  
5 okay, if you don't download, you have to ask us to  
6 mail you a copy or fax you a copy, how many people  
7 have fax machines that you get something out of the  
8 fax machine, it comes out all gibberish because there  
9 is some problem there, yet the person at the sender  
10 end can get a confirmation that says all ten pages  
11 have been sent, and they have no idea that the  
12 recipient hasn't received it.

13           So I think it's really going too far to go  
14 beyond that objective point that the franchisor can  
15 prove that he offered it, he gave the warning that we  
16 advise you to download it or ask us for a copy, he  
17 keeps a record of when that particular individual did  
18 sign on, and makes it available for 14 days to --  
19 making his best effort to make it available for 14  
20 days, but because of the server or because of the user  
21 they can't access it, you just don't want to get into  
22 it at that level.

23           MR. TOPOROFF: Howard.

24           THE COURT REPORTER: I'm sorry. I'm  
25 getting very tired. Are we going to go to lunch soon?

1 MR. TOPOROFF: We're going to break soon.

2 THE COURT REPORTER: Speak slowly, Howard.

3 MR. BUNDY: I'll try to keep it short.

4 I'm still troubled by something, and

5 forgive me if I'm coming full circle a little bit.

6 The current rule requires delivery of a thing that can  
7 be clearly identified, and assuming no act of God or  
8 slip in the elevator or fire occurs, leaves a document  
9 in the hands of that prospective franchisee, which I  
10 have seen and reviewed as much as 30 or 40 years  
11 after the fact. Not a UFOC, you know, but disclosure  
12 documents.

13 And now we're talking about a situation  
14 where at the whim of the party who is supposed to give  
15 the disclosure to the franchisee, the entire document  
16 or some material portion of that document can be spun  
17 off into outer space with no way to prove, you know,  
18 15 years down the road just before that 3 year broad  
19 statute of limitations runs out that in fact they  
20 failed to disclose that the president was a convicted  
21 felon or, you know, whatever the issue was because  
22 now that's buried in subsequently-changed electronic  
23 documents.

24 I'm very concerned about taking away not  
25 only the regulator's ability to monitor what actually



1 formed the basis of the mutual consent that resulted  
2 in the contract but also the prospective franchisee  
3 and his attorney down the road when he often lands in

1 be addressed or rejected.

2           The comment is that it is my opinion that  
3 what we're really talking about is the internet as an  
4 additional way to provide the offering circular to  
5 prospective franchisees. As an alternative, period.

6           On that basis it would be my recommendation  
7 that the Commission consider simply continuing to  
8 require the same paper receipt, acknowledgment of  
9 receipt for delivery of the offering circular to  
10 prospective franchisees that we have now, except that  
11 it also provides that this acknowledges that the  
12 franchisee has received a copy of the offering  
13 circular either in printed text form or by way of

1 suggest that that is an excellent recommendation. I  
2 feel the same way. And as a franchisor, from a risk  
3 management standpoint, we keep our paper documents for  
4 years on end.

5           And I think that if we would consistently  
6 keep the copies on disk, it certainly takes up a lot  
7 less space, but do that for our own risk management as  
8 well, so that it can be reviewed and surfaced if  
9 needed.

10           MR. TOPOROFF: Okay. We're going to take a  
11 break.

12           (Luncheon recess at 12:40 p.m.)

13

14

15

16

17

18

19

20

21

22

23

24

25



1 issues in much greater details. So today's discussion  
2 is going to be focused strictly on a disclosure fix.  
3                   So the first item is encroachment. And

1 place of what the current rule says, which basically  
2 would be no we don't offer an exclusive territory?

3           So does anybody have any thoughts on  
4 whether the Item 12 disclosure could or should be  
5 modified, and if so, how?

6           Howard Bundy.

7           MR. BUNDY: Steve, I think the quick answer  
8 to your question is yes, we could do a better job. Do  
9 I have a specific set of language I would suggest? I  
10 don't have that yet.

11           Let me throw another wrinkle into your  
12 question though because I've encountered it recently.  
13 We've got encroachment through additional outlets. We  
14 have historic issues of --

15           THE COURT REPORTER: I'm sorry, Mr. Bundy.  
16 I'm having a hard time hearing you over this fan.

1 pre-lunch issue, we have run into cases involving  
2 encroachment through use of electronic media. Oh,  
3 yes.

4 MR. TOPOROFF: Can you give an example of  
5 that because I have no clue what you're talking about?

6 MR. BUNDY: I'm trying to avoid use of  
7 names. A services franchise in which the franchisor  
8 provides directly through the internet a list of  
9 non-franchisee affiliates who have paid an advertising  
10 fee of some sort nominally to have competitive  
11 services advertised on the franchisor's web page.  
12 That was the one that we just ran into.

13 But I can see many permutations of that,  
14 including a franchisor client of mine who is selling  
15 product over -- through the internet off his web page  
16 -- the same web page that lists all of his franchisees  
17 -- to customers within the franchisee's exclusive  
18 territory.

19 MR. TOPOROFF: Okay. I think I understand.

20 MR. BUNDY: Now, I would tell you  
21 preemptively, in case we've got any of the plaintiff's  
22 attorneys around here, I anticipated the problem and  
23 drafted around it in that case. Full disclosure is  
24 better than not.

25 But I think you need to broaden the scope

1 of your inquiry as to what constitutes encroachment to  
2 at least include those things. And does Item 12  
3 adequately address it? No. But I don't have an  
4 answer.

5 MR. TOPOROFF: Martin.

6 MR. CORDELL: Well, kind of on the same  
7 vein as Howard, my point was also going to be that  
8 really the problem may not necessarily be one of  
9 encroachment, but what we're really talking about is  
10 alternative methods of distribution. And the problem  
11 is dilution of the franchisee's market or impact on  
12 the franchisee's market share.

13 And at least the only kind of off of the  
14 top of my head solution would be is to have some type  
15 of risk disclosure, which hopefully the franchisor  
16 is going to be disclosing anyway, that they are  
17 involved in alternative methods of distribution that  
18 may impact the franchisee's market share.

19 MR. TOPOROFF: Well, let me ask you: Isn't



1 that I think I brought up where a franchisor says,  
2 yes, our territory -- your territory -- our policy --  
3 they don't have it in the agreement. It's our policy  
4 is one for every 35,000 population.

5           What they don't tell you is they're known  
6 -- after you put your unit up, develop it, break even,  
7 and begin to become profitable, their policy is  
8 they're going to come in and put another unit in  
9 there, which will siphon sales off.

10           So it's not disclosed that we may -- and  
11 the language needs to be somehow -- you know, our

1                   MR. TOPOROFF: In item one would that --  
2 if those disclosures were made there, would that  
3 take care of that problem in terms of disclosure?

4                   Howard Bundy.

5                   MR. BUNDY: Steve, in an effort to answer  
6 that, I think the tendency of franchisors, and it's a  
7 natural tendency, is to disclose in very vague and  
8 general terms, because frankly that's as far as  
9 they've thought about it, that we may possibly  
10 some time in the future maybe use some alternative  
11 means of distribution. We reserve the right to do  
12 that.

13                   And particularly in the post Burger King  
14 cases, the Sheck cases, many, many franchisors are  
15 drafting that kind of language. In fact I've seen  
16 circulars now and contracts that say we reserve the  
17 right to put a new unit in right next to you, to take  
18 your customers away through the internet, and so  
19 forth.

20                   Because it's not immediate, because the  
21 salesman sits there in reality and says, well, we've  
22 never done that, but we just reserve the right to --  
23 you know, I'm not sure we can solve the problem with  
24 specific language. You know, I would like to find a  
25 solution because it is a very real problem.

1           MR. TOPOROFF: Okay. Are there any  
2 thoughts on a specific language or at least an  
3 approach in how the disclosures could be improved to  
4 address those issues that Howard identified.

5           MS. KEZIOS: Steve, are you suggesting that  
6 they be put in Item 1 as a competitive -- as a risk?

7           MR. TOPOROFF: Well, there are two items  
8 that I could think of. One -- and maybe there are  
9 more. Item 1 which requires the franchisor to  
10 disclose information about the competition. And then  
11 there's Item 12 that talks about territories.

12           And it seems that we're really talking  
13 about two different issues. There's competition  
14 from other franchisees, and then there's competition  
15 from the franchisor itself.

16           And I'm not necessarily suggesting that  
17 that information be in one item over another. The  
18 question is: No. 1, should it be covered in either of  
19 those items at all? And, No. 2, if it is, then what  
20 should the language look like?

21           Susan.

22           MS. KEZIOS: In New York you were talking  
23 about perhaps -- and maybe we're going to get to it  
24 later, but you were talking about maybe combining the  
25 FTC cover page with the State cover page, and then

1 what do we do with the risk factors? And maybe we're  
2 coming up with a solution.

3           But going back to some of those comments  
4 that we made in New York and putting -- but not  
5 burying this. For the members of the AFA, American  
6 Franchisee Association, this issue is paramount. I

1 It's such a dynamic environment that franchising  
2 exists in that I think that what we're attempting to  
3 do here is somewhat determine the future, and  
4 sometimes you can't do that with the dynamics the way  
5 they are.

6           So I think in the terms of Item 1 and Item  
7 2, there might be some clarification that can take  
8 place. But as far as getting too specific, I think  
9 it's really challenging to be able to do that and  
10 make it work for both the franchisee and the  
11 franchisor to their benefit.

12           MR. TOPOROFF: I think there are three  
13 aspects to this. One is what the franchisor's current  
14 policy is. The next is just a general warning of what  
15 might occur. And then there's post-sale changes in  
16 corporate policy.

17           Changes -- post-sale changes in corporate  
18 policy really do not raise a disclosure issue. It  
19 might raise an unfairness issue, but it doesn't  
20 necessarily raise a pre-sale disclosure issue.

21           So I think what we're really talking about  
22 are, one, some kind of requirement that franchisors  
23 disclose what their current policy may be. And then,  
24 two, again some kind of warning that what might happen  
25 in the future, not necessarily specific to that

1 franchise system but just generally broadly what may  
2 happen in franchising that might impact upon them.

3           So I think that that -- your point is very  
4 well taken, but I think it's a little bit narrower.

5           Susan, do you have a comment?

6           MS. KEZIOS: The only comment I would like  
7 to make is that if you put language in to identify the  
8 possibility of encroachment as a risk factor, that  
9 it not be buried somewhere in the document; that  
10 it be positioned where a franchisee might most likely  
11 be able to see it, maybe on the cover page, but  
12 definitely in bold type. It should not be allowed  
13 to be buried within, you know, a 50 page franchise  
14 agreement.

15           MR. TOPOROFF: Okay. Well, we're going to  
16 move on. What I was going to say before is we're not  
17 going to beat this to death. I think the record  
18 reflects what people's concerns are. And I would  
19 advise anyone who has thoughts on specific language  
20 that could be used to think about it and supplement

1 the need for adding a requirement that a policy be  
2 described because I think more franchisors would  
3 interpret Item 12 as it currently exists to require  
4 disclosure of that policy anyway.

5 MR. TOPOROFF: Okay. Another issue that  
6 franchisees have brought to our attention is  
7 restrictions on purchases or sourcing. And my  
8 understanding is that the current Item 8 addresses  
9 sourcing issues and related disclosures.

10 So my general question is whether Item --  
11 the current Item 8 is sufficient to give prospective  
12 franchisees information about their purchase  
13 obligations?

14 Does anyone -- Dennis Wieczorek.

15 MR. WIECZOREK: Item 8 is more than  
16 adequate to describe a franchisee's sourcing  
17 restrictions. In fact if there was anything in the  
18 new UFOC that significantly expanded the prior  
19 disclosure obligations it was in Item 8.

20 A franchisee can determine in Item 8 what  
21 items are subject to restrictions, what the  
22 franchisor's volume of sales of those restricted  
23 purchases are, and whether the franchisor is getting  
24 any rebates from suppliers and the actual dollar  
25 amount of those rebates. So there is extensive

1 disclosure now.

2 MR. TOPOROFF: Susan Kezios.

3 MS. KEZIOS: This is Item 8 from the new  
4 UFOC which the FTC has or has not adopted?

5 MR. TOPOROFF: Well, that is the proposal.  
6 This comes in a broader context. The broader context  
7 is that the Commission is contemplating changing our  
8 rule to match -- or to be molded after the current  
9 UFOC. So when we talk about is the current Item 8  
10 sufficient, it's in that light.

11 MS. KEZIOS: You're talking about --

12 MR. TOPOROFF: -- the new UFOC Item 8.

13 Does anybody have any concerns on that?

14 (No audible response.)

15 MR. TOPOROFF: No? If not, we're going to  
16 move on.

17 Susan Kezios in her comments raised an  
18 issue whether the term renewal is a misnomer because  
19 there are two different -- really two different types  
20 of events that might be classified as a renewal but in  
21 fact may not be.

22 One is a simple extension. And I think the  
23 best analogy perhaps is if somebody is renting an  
24 apartment, the lease ends, they still get the same  
25 apartment perhaps at the same rent, and they just



1 sign, and it's the identical concept being transferred  
2 over.

3           The other concept is not a renewal as such  
4 but perhaps a total renegotiate of a contract, and so  
5 at the end of the day what a franchisee might get  
6 could be substantially and materially different than  
7 what the franchisee just ended.

8           So the question there is whether the use of  
9 the term renewal alone in Item 17 is possibly  
10 misleading or not and whether that needs some kind of  
11 fix?

12           Susan Kezios.

13           MS. KEZIOS: It is misleading. It needs to  
14 be fixed. It needs to be called a rewrite, a  
15 relicense, renegotiate, something. And also upon  
16 renewal, the franchisor should be disclosing -- should  
17 be giving a new disclosure document to that existing  
18 franchisee if they are indeed renewing. And I don't  
19 know that they are doing that, at least not in a lot  
20 of the situations that we see.

21           MR. TOPOROFF: Under our rule if it is a  
22 renewal and there's different terms and conditions,  
23 material changes, then there has to be a disclosure  
24 document.

25           Howard Bundy.

1           MR. BUNDY: This is an area that's been  
2 troubling for a long time because, you know -- and I  
3 haven't read Susan's comments, so I'm at some risk of  
4 either disagreeing with her or being redundant.

5           I think it's important somehow in the  
6 circular to communicate to the prospective franchisee  
7 that what we now call renewal probably will not be  
8 what the word renewal commonly means in the English  
9 language.

10           And perhaps we need to have the franchisor  
11 disclose that there will not be a renewal in the sense  
12 of an extension of the same contract, but we may in  
13 our sole discretion offer you an entirely different  
14 contract.

15           If that's what the franchisor intends,  
16 which most of them I think do, then let's make it  
17 clear so that folks can understand what it is they're  
18 getting into.

19           Can we do that as part of a rule making? I  
20 don't know whether it's meaningful there. But that  
21 distinction needs to be clearly drawn for the investor  
22 before they put their money in.

23           It comes as a very serious shock to people  
24 who come to me presale, and I explain to them that  
25 they are agreeing that three, five, ten years from now

1 the franchisor is reserving the right to double the  
2 royalties, add a 10 percent advertising fee, limit  
3 them to only using products manufactured by the  
4 franchisor, on and on and on because you're signing a  
5 blank check.

6           You know, and the people who don't come and  
7 hear that before they buy never come to understand  
8 that they are in fact signing a blank check some  
9 time down the road -- or in the alternative they lose  
10 their investment.

11           MR. TOPOROFF: Dennis Wieczorek.

12           MR. WIECZOREK: Our practice in drafting  
13 documents is to refer to it as an expiration and the  
14 execution of a successor agreement, which simply means  
15 that when you get to the end of the term, you sign a  
16 new contract.

17           The Item 17 of the UFOC describes in the  
18 requirements that you must disclose provisions on  
19 renewal or extension of the term and requirements for  
20 a franchisee to renew or extend.

21           And if you look at the sample answer, and  
22 this is not unlike what any franchisor would do,  
23 you'll say -- and I'm looking at the sample answer 17  
24 in the UFOC. And in that item it says if you are in  
25 good standing you can add additional term equal to the

1 renewal term of the lease ten years max.

2           And then the next item says what do you  
3 need to do to do that? Then it says sign new  
4 agreement, pay a fee, remodel, and sign release. So  
5 the disclosures are there.

6           If the summary is accurately done, the  
7 disclosure will say this is how you renew. Whatever  
8 renewal constitutes. You're going to have to sign a  
9 new agreement. You're going to have to do certain  
10 things.

11           So I think the structure of Item 17 covers  
12 this adequately, and I don't see that there's a big  
13 problem out there with franchisor mislabeling or  
14 trying to pull the wool over people's eyes saying,  
15 well, you're renewing. You keep your old document.

1 compete. So they're under enormous pressure to sign  
2 whatever it is that is put down in front of them.

3 But the word renewal again implies to  
4 someone that you're -- it's merely an extension. As  
5 in your analogy, it's merely an extension. We're  
6 extending this lease. Well, we're not.

7 Dennis, you say you call it an expiration  
8 when you write them for your clients. It's an  
9 expiration, and you sign a successor agreement. Maybe  
10 that's the word, successor agreement, where it's clear  
11 it is not simply renewing what you already have as the  
12 terms and conditions.

13 You're entering into a whole new agreement,  
14 and guess what? I get to pick the decision. I being  
15 the franchisor, not you being the franchisee. And if  
16 both parties are sharing in this enterprise called a  
17 franchise, both parties really should in the renewal  
18 have input into it, but currently they are not.

19 And that brings me to another point. It  
20 goes back to just the practice of offering franchises  
21 for sale. And I think I've said this. I don't know  
22 if I wrote it in my remarks or not. I think I did.

23 That the analogy that when you buy a  
24 franchise you're building equity in yourself much like  
25 when you buy a home you're building equity in

1 yourself, that is often the first fraud, if you will,  
2 that's put in the mind of somebody as their buying a  
3 franchise.

4 Which plays into this concept that at the  
5 end I'm going to renew this because I'm thinking I own  
6 this, when in fact it's more analogous to renting an  
7 apartment. You've got it for a set period of time,  
8 and you're going to get a different contract put down  
9 in front of you.

10 So I think the language needs to be very  
11 clear. This contract is going to expire. Then if you  
12 and I agree, we're going to enter into -- and if  
13 you're not in default, we're going to enter into a  
14 whole new agreement.

15 MR. TOPOROFF: Okay. Any other comments on  
16 this particular point?

17 (No audible response.)

18 MR. TOPOROFF: Okay. The next concern that  
19 franchisees have brought to our attention is post-term  
20 covenants not to compete. Again Item 17 addresses  
21 that. Again I ask is the Item 17 sufficient to put  
22 prospective franchisees on notice that there might be  
23 covenants not to compete?

24 Dennis Wiczorek.

25 MR. WIECZOREK: My answer is going to be

1 the same in that Item 17 is very clear, and the  
2 summary is supposed to indicate the very -- a very  
3 summarized version of what the non-compete covers.

4           Now, if we go back historically before the  
5 new UFOC, the old UFOC required these same disclosures  
6 except what franchisors did to cover themselves was  
7 regurgitate the terms of the contract here at  
8 length, so that Item 17 used to be 20 pages long, and  
9 you would see the non-compete laid out in full flower.

10           The idea on the part of NASAA, and the  
11 advisory committee also concurred with this I think,  
12 was that this table that is Item 17 now, which is  
13 about two or three pages long, is a better, more  
14 readable way of conveying information to the  
15 franchisees. So that's why this table is used, and  
16 that's why the summary is there, to describe the  
17 non-compete.

18           MR. TOPOROFF: Dennis, if a franchisor has  
19 franchisees enter into covenants not to compete, is  
20 that part of their contract that could be disclosed  
21 beforehand, or is it an attachment? Is it part of the  
22 materials that a prospective franchisee would get  
23 before they sign the disclosure?

24           MR. WIECZOREK: Absolutely. The franchisor  
25 cannot ever, and I think Howard would support me on

1 this, establish a non-compete by policy or by fiat.  
2 The contract is the only way to get it done, and even  
3 then it's difficult to enforce because courts don't  
4 like non-competes.

5 MR. TOPOROFF: Howard Bundy.

6 MR. BUNDY: I'm going to go out on a limb  
7 and agree with Dennis that the new UFOC handling of  
8 non-competes is vastly superior to the old methods.  
9 It doesn't mean it can't be improved.

10 The area where I see the non-compete  
11 disclosure in need of improvement, and there may be  
12 others, but this one is fresh in my mind, is in the  
13 area of the interaction between the fact that the --  
14 and it's usually disclosed -- that the franchisee has  
15 no right whatsoever to terminate this contract for any  
16 reason.

17 A five or ten year term of the contract,  
18 and then a two to five year non-compete after the fact  
19 really means that if something happens, if that  
20 franchisee leaves the system in year one but the



1 don't like putting franchisees in the position where  
2 they have to hire a lawyer to find out whether they  
3 can -- whether they're subject to enforcement of this  
4 thing. The coercion is often too great.

5           So if we could find a way to more clearly  
6 highlight the interlinked nature of the various Item  
7 17 subitems, I think it would be helpful to a lot of  
8 franchisees.

9           MR. TOPOROFF: Is that a consumer education  
10 issue as opposed to a disclosure issue?

11           MR. BUNDY: It could be.

12           MR. TOPOROFF: Martin, do you have any  
13 thoughts on this?

14           MR. CORDELL: Well, where the disclosure --  
15 the covenants not to compete are particularly  
16 important is where there is service-oriented  
17 franchisees that --

18           THE COURT REPORTER: I'm sorry. Is where  
19 there is --

20           MR. CORDELL: You have service franchisees  
21 who are involved in a service business in which they  
22 may have some particularized skill. And in those  
23 cases it actually might be -- it might be worth  
24 considering requiring, you know, risk factor, you  
25 know, some special risk factor disclosure.

1           That doesn't take really though -- my  
2 concern is that it really doesn't take care of the  
3 substantive problem because, as Dennis pointed out,  
4 Item 17 requires disclosure of the covenants. The  
5 covenants are always laid out in the agreement. So  
6 certainly any franchisee or their counsel that is  
7 going through the agreements should be cognizant of  
8 the fact that that's a very critical term.

9           MR. TOPOROFF: Susan.

10           MS. KEZIOS: Perhaps it needs to be laid  
11 out in a manner that indicates to the potential  
12 franchisee, especially if they have a skill or a  
13 service they're providing, that the franchisor may be  
14 allowed to confiscate all or part of your business  
15 at the end of its term, because to me that post-term  
16 covenant not to compete is a device to ace the  
17 franchisee out of that ownership of the local  
18 business, the local good will, the local telephone  
19 number.

20           So the importance of it to a current  
21 franchisee is not laid out in the disclosure document  
22 in a manner which is going to make it important to a  
23 prospective franchisee. Because when you're becoming  
24 a franchisee, you're not thinking about getting out on  
25 the back end. I don't care how clear the covenant not

1 to compete is.

2           It's not the importance of it that -- you  
3 actually may not be able to work after this. And  
4 especially in some of the service businesses where you  
5 have a service and you convert and become a franchisee  
6 in that chain, and you still have to abide by the  
7 covenant not to compete post term. So you've got  
8 some serious -- it's a big risk factor.

9           MR. TOPOROFF: Martin.

10           MR. CORDELL: And that's why I made the  
11 point it might be worth considering a risk factor for  
12 service franchise businesses. But I would like to  
13 make a comment about whether that is a disclosure  
14 issue or a consumer education issue. And actually I  
15 think it's both.

16           And I know one of the things we talked  
17 about when we did the last -- the revised UFOC is  
18 whether we actually could refer to some other outside  
19 document, have the UFOC refer to some other outside  
20 document so that consumers could get additional  
21 information or disclosure. Maybe a list of questions  
22 to ask similar to the brochure that the FTC puts out.  
23 So that may be something worth considering.

24           And certainly it would involve a lot of  
25 work because you're talking about lots of different

1 types of industries. But there are certain types of  
2 businesses -- or just the FTC brochure in general, if  
3 there is disclosure on the cover page that suggested  
4 that they might want to refer to the FTC consumer  
5 brochure, that might be helpful.

6           And then that FTC brochure, it could be  
7 updated fairly easily, fairly readily as these issues  
8 come up to identify certain key points that  
9 franchisees might want to make further inquiries about  
10 or just warn them about certain trouble areas.

11           I'm not sure that we can craft anything in  
12 terms of the disclosure item because the disclosure  
13 document is going to take care of this particular  
14 problem.

15           MR. TOPOROFF: Okay. Moving on. Another  
16 set of concerns that franchisees brought to our  
17 attention I'll call procedural devices, and those are  
18 choice of law and choice of venue and arbitration.

19           And again it is my understanding that those  
20 items are addressed in two different ways in the  
21 current UFOC. One is the risk factors on the cover  
22 page address venue and choice of law I believe. And  
23 also those items are addressed in Item 17.

24           So my question is whether the combination  
25 of the cover page, which is pretty explicit when it

1 comes to choice of law and venue I believe, and the  
2 Item 17 together are sufficient to put prospective  
3 franchisees on notice of when the franchisor uses  
4 these particular -- or requires these particular  
5 devices. Any thoughts?

6 Dennis Wieczorek.

7 MR. WIECZOREK: Yes, they are sufficient.

8 MR. TOPOROFF: Mr. Jeffers.

9 MR. JEFFERS: I do believe they are  
10 adequate because they haven't come up enough times to  
11 say that -- in dealing with the franchisees in these  
12 transactions this is not an area where they seem to  
13 feel that they are unaware of the consequences of the  
14 franchisor's requirements.

15 MR. TOPOROFF: Martin.

16 MR. CORDELL: Actually I have the opposite  
17 sense, that they really aren't aware that there are  
18 going to be these consequences. On the other hand, I  
19 don't have a fix.

20 This is a fairly typical problem, and I  
21 know a number of Howard's clients have had this  
22 problem, or his firm has had this problem, that they  
23 don't realize until they have had a dispute that  
24 they've got to go to New Jersey or California or  
25 Florida. But quit frankly I don't have an answer on

1 it.

2 MR. TOPOROFF: Mr. Jeffers.

3 MR. JEFFERS: Actually it comes up -- in my  
4 cases it comes up quite a bit in where -- in fact it  
5 comes up so often, that oftentimes when franchisees  
6 that I'm dealing with and their lawyers have had a  
7 chance to review the contracts, that's very often one  
8 of the most consistent items in their response  
9 letters, that they want to address the requirement  
10 that the franchisor -- that the franchisor's locale  
11 has to be the jurisdiction for bringing suits, or in  
12 the case of most registration states where the  
13 franchisee is allowed to bring the action there. I  
14 mean, it is a common occurrence that it comes up.

15 MR. TOPOROFF: But, Mr. Jeffers, do you  
16 think the disclosures the way they are now are  
17 sufficient to put the --

18 MR. JEFFERS: Yes, I think it's sufficient,  
19 because it's sufficient enough for them to understand  
20 whether they like it or not, and then they come back  
21 to me with their response. So they're not saying they  
22 don't understand it. They're saying they don't like  
23 it or they -- they accept it.

24 MR. TOPOROFF: Martin.

25 MR. CORDELL: Well, I actually had a

1 question for Carl in terms of when these franchisees  
2 ask for a change, what percentage of those contracts  
3 are changed to require venue to be in the home state  
4 of the franchisee?

5 MR. JEFFERS: Well, in my case it's very  
6 few because in most of the cases, the venue has been  
7 required to be adjusted for the franchisee's benefit  
8 because of the State laws, State registrations.  
9 That's what most of the situations are that I'm  
10 dealing with.

11 MR. TOPOROFF: Howard Bundy.

12 MR. BUNDY: I typically advise any  
13 franchisee who is serious about signing a franchise  
14 agreement containing a foreign venue or choice of law  
15 clause that that is a serious enough problem that on  
16 that basis alone they should not invest in that  
17 particular franchise and look at other alternatives.

18 I go further and say that this may be  
19 deceptive in that Item 6 and 7, if those are the  
20 budget items, don't disclose that you really need to  
21 have a cash reserve for legal fees down the road  
22 because if you have even a minor dispute with a  
23 franchisor, you will be required to spend tens of  
24 thousands of dollars to go resolve that, or you have  
25 no alternative but to give in.

1           I tell that long story to drive home the  
2 point that this is an extremely important, crucial  
3 issue to franchisees, and it's something that  
4 particularly those prospective franchisees who are not  
5 represented by counsel who deals with these issues  
6 every day simply don't get. They don't understand  
7 even the current disclosure.

8           The current disclosure is way better than  
9 anything we've had in the past, but I think we could  
10 add a sentence or two that would make it very clear  
11 that it will probably cost you so much to get issues



1 I'll try not to take too long. In answer to that, we  
2 see two groups of franchisees. We see those that are  
3 prospective franchisees who come to us before they  
4 buy, and we counsel them. Those people have counsel.

5 MR. JEFFERS: Correct.

6 MR. BUNDY: The ones that I worry about are  
7 the 85 or 90 percent who take their legal advice  
8 from the franchise salesman and never consult any  
9 counsel or consult counsel that doesn't know this  
10 stuff. And they need something that is in plain  
11 enough, clear enough English that it drives the point  
12 home about the risk of the investment.

13 If you read a securities prospectus, you  
14 will find the kind of language I'm talking about in  
15 terms of the risk of those things. We should just  
16 look to that for some guidance in terms of the  
17 sentences and phrases that we should be using.

18 MR. JEFFERS: Well, since that is on the  
19 record, I would also like to add that it's my personal  
20 opinion that it's probably somewhere less than 25  
21 percent of all franchisees today who execute franchise  
22 agreements that do so without any review by any  
23 outside counsel. I do not think that the number would  
24 anywhere approach like 80 to 85 percent.

25 MR. TOPOROFF: Okay. Any other thoughts on

1 this specific issue? Again the issue on the table is  
2 whether the cover sheet plus Item 17 are sufficient to  
3 provide disclosure for again procedural devices.

4 Judy.

5 MS. GITTERMAN: Shouldn't there also be  
6 some statement -- as Carl mentioned, there are State  
7 laws that invalidate the choice of law and the venue  
8 provisions so that the franchisee who sees it on the  
9 cover sheet or in that item doesn't take that as the  
10 be all and end all?

11 MR. TOPOROFF: Okay. We're going to move  
12 on. The next -- we're not going to move on.

13 Susan Kezios.

14 MS. KEZIOS: When you were also just  
15 talking procedural devices, were you talking  
16 integration clauses at all or --

17 MR. TOPOROFF: Not at this point. We're --

18 MS. KEZIOS: Oh, not at --

19 THE COURT REPORTER: I'm sorry. You're  
20 both talking at the same time.

21 MR. TOPOROFF: We're talking about choice  
22 of law, venue, and arbitration.

23 Dennis.

24 MR. WIECZOREK: Item 17 does require  
25 disclosure of integration clauses, so it's there.

1                   MS. KEZIOS: I know that. That was going  
2 to be my point.

3                   MR. TOPOROFF: I was not going to raise the  
4 issue of disclosure of integration clauses, but that  
5 one that franchisees have brought to our attention,  
6 so I will ask whether the current Item 17 is  
7 sufficient to put prospective franchisees on notice  
8 that they may be subject or their contract will have  
9 an integration clause?

10                   Susan Kezios.

11                   MS. KEZIOS: No. The reason is because  
12 some franchisors use the integration clause as a  
13 device to say whatever they want during the sales  
14 process and then have the franchisees sign a contract

1 MR. TOPOROFF: Martin.

2 MR. CORDELL: Actually I'll defer to Carl.

3 MR. JEFFERS: First thing I'm thinking is  
4 I need to --

5 THE COURT REPORTER: I'm sorry. I can't  
6 hear you, Mr. Jeffers.

7 MR. JEFFERS: It's probably not important.  
8 The point is that, you know, Susan just makes the  
9 point that -- you said you get a franchisee there to  
10 sign a document which has an integration clause that  
11 says there hasn't been anything that we represented  
12 outside of the four corners of this document. And  
13 then she acknowledges that and of course we know that

1 wasn't included or covered by this. And I make a  
2 specific point of following the items verbatim to make  
3 sure that we don't in fact provide outside  
4 information.

5           But what I'm concerned about is that at a  
6 certain point though -- at a certain point there ought  
7 to be a conference for franchisees to say to them,  
8 you know, you have to accept some responsibility. I  
9 mean, it's perfectly legitimate for a franchisor to  
10 establish some sort of documentary basis for saying  
11 that we have followed the law. We have complied with  
12 it. And we have not given them any information that  
13 we were not supposed to.

14           And at a certain point a franchisee should  
15 be able to and be held accountable for if he says yes,  
16 that's correct, I agree with that, then that should be  
17 legitimate. And he shouldn't be able to then two  
18 weeks later or two months later say, no, because  
19 his lawyer now tells him, no, you weren't in fact  
20 given that information.

21           And if he's just doing it on his own, then  
22 at some point there is a business judgment concern  
23 here that I think goes beyond what the FTC is doing.  
24 I'm not saying it's right. I'm just saying I'm  
25 thinking it may be going beyond what you can do at

1 the FTC level, at the government level to make sure  
2 that these things are covered.

3 I'm thinking about franchisors who are  
4 in good faith attempting to comply. And I know that  
5 with clients that I work with and what we handle in  
6 the marketing and sales area, we make sure that that  
7 information, that body of information they're  
8 getting is within the parameters and is within that  
9 document.

10 And I in fact want confirmation of that  
11 from those franchisees when we're ready to execute the  
12 agreement, that in fact nothing beyond that has been  
13 represented.

14 But I'm just amazed that -- I can't imagine  
15 the franchisees that I deal with that I would have  
16 been able to convince them to sign this if in fact I  
17 had given them other information. And that's just  
18 baffling to me. And so I just want to make that  
19 comment, that I think that it's very clear as it is.

20 MR. TOPOROFF: Martin.

21 MR. CORDELL: I only wish that all our  
22 franchise brokers were as honest as Carl, but that is  
23 clearly not the case as many of our enforcement actions  
24 show.

25 What happens is that the salesmen do make

1 all kinds of various misrepresentations. But I do  
2 agree with Carl that the cure is not in the disclosure  
3 document. The cure really is having the judges not  
4 let the franchisors hide behind these integration  
5 clauses where it's clear that the franchisees have  
6 received earnings claims not within Item 19.

7 MR. TOPOROFF: Okay. We have one more item  
8 that fits into the general category of franchisee  
9 concerns, this is something that was raised in New  
10 York, and that is whether the disclosure document in  
11 Item 20 should be modified to require the disclosure  
12 of a trademark-specific franchisee association.

13 And we talked about how that could be  
14 defined and all, and I asked for the comments, and no  
15 one submitted any comments on that particular point.  
16 So we're going to iron this out today hopefully.

17 So what I would propose -- and again this  
18 fits into the broad category of a general proposal  
19 -- is that Item 20 be modified to have something like  
20 the following: The franchisor must disclose the name,  
21 address, and telephone number of any national  
22 franchisor sponsored advisory counsel or independent  
23 franchisee association.

24 Would that do it? I know in New York  
25 people raised the concern that there are small groups

1 or factions that come and go and they're not  
2 necessarily accountable and people don't know who they  
3 are or who's in leadership, and I think that that is a  
4 valid concern.

5 But at least to the extent that there is a  
6 franchisor sponsored advisory counsel or independent  
7 franchisee association, should that information be  
8 disclosed?

9 Susan Kezios.

10 MS. KEZIOS: Yes.

11 MR. BUNDY: What is the address that should  
12 go in there?

13 MS. KEZIOS: 53 West Jackson.

14 MR. TOPOROFF: Martin.

15 MR. CORDELL: Well, I would agree. I think  
16 that would be extremely useful information. And this  
17 is the first time I've actually heard this issue, so  
18 I'm talking off the top of my head. But I know one of  
19 the problems for prospective franchisees in trying to  
20 obtain information from other existing franchisees is  
21 it's difficult sometimes to get information.

22 And I think the trade association would be  
23 much more -- or could be a much more ready source of  
24 information as opposed to individual franchisees who  
25 have to take time out of their businesses to share



1 information with the prospective franchisee.

2           The one -- I would also like to make a  
3 point -- I don't know that I made it earlier -- is  
4 that in terms of making any changes to the UFOC,  
5 again I would like to emphasize that I would like to  
6 see the Commission try to synchronize any change in  
7 the UFOC with NASAA to the extent possible.

8           MR. TOPOROFF: Dennis Wieczorek.

9           MR. WIECZOREK: The only problem that I  
10 have with the disclosure is the same one that was  
11 raised in New York, and that is if there's a  
12 franchisor sponsored advisory counsel, not a problem.  
13 The franchisor will know about it. If there is a KFC  
14 franchisee association known to the franchisor, well  
15 represented, not a problem.

16           But there are a lot of franchisors who have  
17 small groups. And the definition of national is  
18 somewhat key here. And substantial representation is  
19 the key also. If there is a franchisor that has 3,000  
20 franchisees, and they have a group of 10 franchisees  
21 who happen to be national because one is in California  
22 and one is in New York, should that be required to be  
23 disclosed?

24           A franchisor representative, a field rep  
25 may know that this organization exists. That

1 information may or may not be transmitted to the  
2 headquarters people so that they would know.

3           So it's really a question of what problem a  
4 franchisor might run into if they don't necessarily  
5 have the information or if it's such a small group or  
6 the splinter group that they won't have any means of  
7 ascertaining that it exists.

8           MR. TOPOROFF: Again to clarify that the  
9 proposal on the table is strictly national groups,  
10 either a national advisory counsel, which, as I  
11 understand the way they work, the franchisor would  
12 certainly know of its existence, and if there is an  
13 independent franchisee group, and again a national  
14 franchisee group, let's say will add another factor  
15 into this, that the franchisor is aware of, whether  
16 that should be disclosed, and will that solve some of  
17 the problems?

18           Dennis.

19           MR. WIECZOREK: Well, the first question is  
20 what problem is it that we're talking about. And if  
21 the problem is does the franchisor -- excuse me, if  
22 does the prospective franchisee have some other  
23 resources to talk to, if you're trying to address that  
24 concern, I guess I can understand some basis for this  
25 kind of a requirement.

1           So if we define the universe properly, I  
2 guess I can't think of a good basis to object to this  
3 other than again making sure that the NASAA folks and  
4 the FTC are operating on the same wavelength here.

5           MR. TOPOROFF: Gary Duvall.

6           MR. DUVALL: I have the same concerns from  
7 a franchisor prospective, and I think it can be solved  
8 by drafting. As I wrote down what you were suggesting,  
9 it did not have the qualifications that were just  
10 discussed, and it needs to.

11           And in addition to the problem that Dennis  
12 mentioned with franchisee associations that the  
13 franchisor may not be aware of and franchisee  
14 associations that are extremely small, I've had a  
15 number of situations where franchisors are faced with  
16 multiple franchise organizations.

17           And in fact I would say that that's  
18 probably the majority of the cases. The majority of

1 disclosed would be a franchisor sponsored or  
2 recognized association. Clearly I think that would be  
3 acceptable to most franchisors.

4           If they are actually bargaining with a  
5 franchisee association, almost no matter how small  
6 they are, I think they could be reasonably asked to  
7 disclose that.

8           MR. TOPOROFF: Can I just interrupt you one  
9 second?

10          MR. DUVALL: Yes.

11          MR. TOPOROFF: Just so that the record is  
12 clear, could you just repeat what you said as the  
13 language so that we have that clear.

14          MR. DUVALL: I think it would be acceptable  
15 to most franchisors if they were required to disclose  
16 franchisor sponsored or recognized associations. I  
17 don't think using the word national association is  
18 helpful or appropriate.

19          There are franchisors who are regional and  
20 who have recognized franchisee associations that  
21 recognize -- that perhaps, let's say, represent nearly  
22 all of their franchisees, and they should have an  
23 obligation to disclose that association. So I don't  
24 think the concept of national helps, but I think the  
25 concept of whether they are recognized does.

1           Another concept that might help is whether  
2 the association represents a majority of the  
3 franchisees. That also is critical I think. So I  
4 think you would have to work with the language is the  
5 problem.

6           MR. TOPOROFF: Howard Bundy.

7           MR. BUNDY: I think we have to look at this  
8 a little differently. Franchisees are not national.  
9 Franchisees are local. They're going to have one,  
10 two, a dozen locations normally in one state.

11           It's as important to them if there is a  
12 local association -- it's more important if there's a  
13 local association that they can contact than if there  
14 is some one in New York that purports to be national.

15           So I would propose that assuming we agree  
16 that the disclosure would be useful, which I think it  
17 would be because it gives the franchisees a source  
18 of some people that they can talk to -- prospective  
19 franchisees -- who are actually in the business, a  
20 source of identifying former franchisees who have left  
21 the system and various other factors, I would propose  
22 that the disclosure require that they disclose any  
23 franchisee associations known to them which are  
24 formally organized. In other words, they have a  
25 corporation. They have a formal structure of some

1 sort. We could get into the details of that.

2           And, secondly, I think it's very, very  
3 important that they disclose as to each association  
4 whether that is a captive association that's  
5 effectively controlled by the franchisor.

6           Some of you may have seen the old IFA  
7 document that -- it's a handbook for franchisors on  
8 how to set up a franchise advisory counsel in such a  
9 way as to essentially eliminate association activity  
10 by franchisees -- or preempt it I should say more than  
11 eliminate.

12           So I think it's important if we do require  
13 disclosure of association, that we go that second step  
14 and say whether they're truly independent.

15           MR. TOPOROFF: Judy.

16           MS. GITTERMAN: An alternative might be to  
17 deal with this issue whether the franchisor knows all  
18 of the associations and which ones are substantial  
19 and which regional are fly by night and which ones  
20 are going to be around, maybe you could just have a  
21 disclosure statement to the effect of as far as any  
22 that the franchisor knows that are sponsored by them,  
23 you can put them by name, but also say that they can  
24 contact the franchisor for, at that particular time,  
25 the names of franchisee associations so that you're

1 not limited in the document to identifying them.

2 MR. TOPOROFF: Susan.

3 MS. KEZIOS: I would not agree with what  
4 Judy just said or even some of what Gary said about --  
5 I would absolutely stay away from allowing the  
6 franchisor to determine who they're going to recognize  
7 and who they're not going to recognize and whether  
8 they're going to put that association in the document  
9 because the franchisors, if they determine they're not  
10 going to recognize the association, they don't have to  
11 put them in the document.

12 I don't care if the association is  
13 regional, local, or national. The associations, if  
14 there's 3 or 33, need to be listed in the document,  
15 whether they're franchisor sponsored or independent  
16 franchisee associations.

17 So maybe the language needs to be something  
18 to the effect that it's franchisor sponsored advisory  
19 councils or independent regional or national  
20 franchisee associations.

21 The other concern I have is this notion of  
22 substantial representation. If you've got 3,000  
23 franchisees, and 30 of them have gotten together, to  
24 me that's substantial representation. You should be  
25 listening to what they have to say, or you may find

1 yourself on the end of a nasty lawsuit.

2           And the reason that it's important to keep  
3 -- to put these associations in there and to allow  
4 prospective associations to talk to an association  
5 versus talking to individual franchisees is the  
6 association has institutional memory. They have a  
7 collective memory of what has been going on  
8 historically in the franchise system that one or  
9 another individual franchisees may or may not have.

10           The franchisor usually has a collective  
11 institutional memory, but when we're trying -- in my  
12 way of thinking I'm trying to balance the power here a  
13 little bit, and this would certainly assist with some  
14 of that.

15           MR. TOPOROFF: We're going to hear from  
16 Judy.

17           MS. GITTERMAN: Just one comment. I think  
18 looking ahead at the possibilities of liability, it  
19 would be difficult for the franchisor to have to  
20 guarantee that they've listed all the names of all  
21 the associations because there may be just some that  
22 they don't know about.

23           MR. TOPOROFF: We're going to hear from Mr.  
24 Jeffers.

25           MR. JEFFERS: Mine is more of a question



1 than a comment because in fact I -- this was not an  
2 area that I addressed in my comments that I submitted  
3 because I somehow passed over it, so maybe you can  
4 update me, and it might be of some benefit to some  
5 others as well.

6           Is this a result of a problem that -- I  
7 mean, I understand what Susan's motivation is, and I  
8 can see. But what was the problem?

9           Was the problem that the franchisees were  
10 complaining that franchisors were not disclosing the  
11 existence of any franchisee associations, period, out  
12 there, or that they were not disclosing organizations  
13 or associations of their own franchisees?

14           And if that -- my question is two parts.  
15 If the answer to either one of those, whichever one  
16 it is, if it's not any, are you suggesting that  
17 franchisors have a responsibility then to provide to  
18 prospective franchisees the name of all franchisee  
19 associations, period, that exist in the country?

20           Because I certainly recognize that it's  
21 justifiable if I'm a franchisor and 40 or 50 of my  
22 franchisees have organized, I think that makes sense  
23 that I should let my prospective franchisees know  
24 about that.

25           But if you're telling me that I need to let

1 a prospective franchisee know about all of the  
2 franchisee associations, period, that exist out there,  
3 that that's something well beyond what I think that I  
4 would be willing to agree to.

5           And that's why I'm asking for that  
6 clarification. What was the nature of the problem,  
7 and is that in fact the way the answer is going?

8           MR. TOPOROFF: This is not an issue that  
9 the Commission raised on its own. You will not find  
10 anything about this in the ANPR. This was an issue

1 follows that prospective franchisees should have  
2 access to franchisees to learn as much from them as  
3 possible.

4           There are a number of ways of doing that.  
5 One way is to obviously contact franchisees that are  
6 listed in the Item 20. And another possibility is  
7 that prospective franchisees contact a franchisee  
8 association because by contacting the association that  
9 might short-circuit the process and perhaps a  
10 prospective franchisee could learn a lot more quicker  
11 by going to an association than calling up any number  
12 of franchisees over the phone. That may or may not be  
13 true. I don't know. The way I look at it is it's  
14 just another source of information.

15           But I don't want to beat this one to death  
16 either, and we really do need to move on. So unless  
17 somebody has a specific concern or suggestion, I would  
18 really prefer to move on at this point.

19           MR. DUVALL: I guess I would like to say  
20 something. Sorry.

21           MR. TOPOROFF: Okay. Gary Duvall.

22           MR. DUVALL: Very quickly. Another issue  
23 with that disclosure might be that Item 20 is the  
24 wrong place for it. In Item 11 franchisors are  
25 already required to disclose advertising co-ops, and

1 there is a discussion in the guidelines -- UFOC  
2 guidelines about advertising advisory councils.

3 Another possible place would be Item 8 with  
4 respect to purchasing co-ops, which are again already  
5 mentioned.

6 And finally if the purchasing type co-ops  
7 and advisory councils and the advertising ones are not  
8 sufficient to cover it, perhaps what should be  
9 considered is a disclosure in Item 20 that franchisees  
10 should contact -- prospective franchisees should  
11 contact the franchisees listed -- that are required to  
12 be listed already and inform themselves as to whether  
13 there are independent franchisee associations, in  
14 other words, give them direction and information such  
15 that they can discover that themselves.

16 MR. TOPOROFF: Okay. We're going to move  
17 on. We're going to take a break in a few minutes, but  
18 before we break I want to just set the context for  
19 what we're going to be talking about next, and that is  
20 the earnings disclosures. Dennis and Susan are  
21 familiar with this, but others around the table are  
22 not.

23 We are not going to debate the merits of  
24 whether the Commission should mandate earnings  
25 disclosures. That is not on the table. Okay? What

1 is on the table is the ANPR's proposal that  
2 franchisors revise Item 19 to have certain preambles  
3 and disclosures.

4           In New York we talked about it generally,  
5 and now we're going to talk about specific proposals  
6 that staff, Myra, me, Keith Anderson, and others have  
7 come up with. We might not accept this proposal. We  
8 might reject it. Let alone I have no idea what the  
9 Commission or the Bureau's view might be. This is  
10 strictly a proposal to help us move the project along.

11           We're going to take a break. I would  
12 appreciate it if you look through the handout, because  
13 when we get back we're going to go through with a fine  
14 tooth comb. And hopefully at the end of the  
15 discussion, we'll be able to modify this.

16           It is my goal to walk out of here with  
17 this proposal in hand in the best shape that it can be  
18 understanding that it's a proposal, understanding  
19 that other people have very different views on the  
20 subject of earnings.

21           So with that, let's take -- it's about ten  
22 to 3:00. Let's meet at three o'clock, at three  
23 o'clock sharp.

24           (Short recess.)

25           MR. TOPOROFF: We're back on the record.

1           And the next item we're going to address is  
2 the earnings disclosures. And let me give again a  
3 little context to this. What this proposal is is  
4 basically three parts.

5           One is disclosure that all franchisors  
6 would have to take in their Item 19 of the disclosure  
7 document. The second part is a disclosure that  
8 franchisors who do make earnings disclosures would  
9 include. And the third part is if a franchisor  
10 chooses not to make earnings disclosures, they would  
11 include that particular part.

12           So let's look at the first proposal which  
13 is on the sheet of the handout -- the first page of  
14 the handout, what's marked proposal. And I'm going  
15 to go through it somewhat line by line and ask for any  
16 comments.

17           But before I do that, let me explain what  
18 this is designed to address. Basically there are  
19 three goals in our proposal. One is to make it clear  
20 that franchisors can disseminate earnings information  
21 because there is some confusion about that. Second is  
22 to inform prospective franchisees that they should not  
23 accept earnings information at face value but should  
24 ask for written substantiation. And the third is to  
25 warn prospective franchisees not to rely on

1 unauthorized earnings representations.

2           So again we discussed this somewhat in New  
3 York, and I'm picking up the ball now to move this  
4 along. So basically what I'm going to do is go  
5 through this sentence by sentence and ask for  
6 feedback.

7           And the first sentence of this proposal  
8 would be: The FTC's Franchise Rule permits a  
9 franchisor to supply you with information about actual  
10 or potential sales, income, or profits of its  
11 franchise and/or company-owned outlets.

12           On that sentence, are there any problems,  
13 concerns, or suggestions for improvement?

14           Dennis Wieczorek.

15           MR. WIECZOREK: Well, I don't have a  
16 problem with the concept except the statement that  
17 we're talking about sales, income, or profits because  
18 a franchisor may well disclose things that are in  
19 addition to that or may actually be in lieu of that.

20           In other words, there may be expense  
21 information that is provided. There may be -- we talk  
22 about this constantly -- room occupancy rates, room  
23 rates, et cetera. So at least from a linguistic  
24 standpoint, we should probably focus on sales, income,  
25 profits, or other financial performance information.

1 MR. TOPOROFF: Okay. Howard Bundy.

2 MR. BUNDY: Thank you. Since we're  
3 wordsmithing, the and/or combination I think is  
4 somewhat dangerous, perhaps antiquated, and could  
5 leave too much of a sense that you can do either or,  
6 and you can pick the best of them.

7 MR. TOPOROFF: What would be your solution?

8 MR. BUNDY: I would substitute the word  
9 and.

10 MR. TOPOROFF: Just and?

11 MR. BUNDY: Just the word and for and/or.  
12 And I agree with Dennis on the need to maybe rework  
13 the language of what can be disclosed. Perhaps  
14 inserting or other financial performance information  
15 is sufficient.



1           I like the all-encompassing nature of that  
2 definition.  If we're going to define earnings claim,  
3 rather than defining it as the result that you can  
4 derive from the information, which is what I think  
5 your language here does, I would define it as any  
6 information which -- from which you can derive that  
7 result.

8           MR. TOPOROFF:  Gary Duvall.

9           MR. DUVALL:  Also in the way of

1                   MR. JEFFERS: Yes, I have a question  
2 related to Howard's suggestion of eliminating and/or  
3 and just making it and. From the FTC perspective, if  
4 the wording were such that it read or profits of its  
5 franchised and company-owned outlets, if a company  
6 decided then that it was going to provide only

1 address that substantive suggestion because what he's  
2 saying is that he doesn't want -- essentially I think  
3 what he's saying is he doesn't want the companies to  
4 be able to select either company-owned or just  
5 franchises to provide that information.

6 MR. TOPOROFF: Well, I'll tell you what we  
7 have in mind, and that is what the rule currently  
8 allows, and that is again company owned, franchisee  
9 owned, or both. So I don't think that that's going to  
10 change. It's a question of the language to get there.  
11 But let's move on. The comments that you've given are  
12 very helpful.

13 The second part is provided that the  
14 franchisor has a reasonable basis for the information.

15 Any problems or suggestions with that part?

16 Howard.

17 MR. BUNDY: I would ride on Gary's coat  
18 tails for a minute and suggest that the language be  
19 modified to that we/us syndrome rather than otherwise.  
20 And I think the franchisee needs to be told at that  
21 point that they have a right to that substantiating  
22 information.

23 MR. TOPOROFF: That's coming up.

24 MR. BUNDY: Okay. I missed it. Sorry.

25 MR. TOPOROFF: Any other thoughts on that

1 specific language?

2 (No audible response.)

3 MR. TOPOROFF: No? We can move on.

4 And is able to substantiate the figures it  
5 provides you.

6 Is there any concern with the language and  
7 is able to substantiate the figures it provides you?

8 Howard.

9 MR. BUNDY: Substitute information for  
10 figures.

11 MR. TOPOROFF: Okay. Now, I have a  
12 question on this, and that is: Does the term  
13 substantiate really mean anything to a prospective  
14 franchisee that is picking up a disclosure document?

15 I think we're all comfortable with the term  
16 substantiate because it's a legal concept, those who are  
17 familiar with disclosure are familiar with the term, but  
18 could there be a better word for substantiate like the  
19 franchisor is able to prove its figures or demonstrate  
20 how it derived these figures? Is that a difference that  
21 makes a difference, or are we worried about nothing?  
22 Any thoughts on the subject, again the use of the term  
23 substantiate?

24 Dennis.

25 MR. WIECZOREK: Worried about nothing.

1 MR. TOPOROFF: Judy.

2 MS. GITTERMAN: I like substantiate better  
3 than prove. Any time you get into prove, you're  
4 asking for trouble I think.

5 MR. TOPOROFF: So just as a general point  
6 is there any problem with the word substantiate?

7 MR. TOPOROFF: Gary Duvall.

8 MR. DUVALL: Actually it just occurred to  
9 me that if the FTC adopts the UFOC guidelines, this  
10 isn't entirely consistent.

11 MR. TOPOROFF: That's a completely separate  
12 issue, because this may be an item where there's not  
13 going to be uniformity. If the --

14 MR. DUVALL: Actually let me preface my  
15 remarks differently then, because I like the UFOC  
16 guidelines in this regard. I think that the FTC  
17 should consider adding a statement here that is  
18 consistent with those. And the UFOC guidelines  
19 require that a franchisor states its material  
20 assumptions for any earnings claim. So I think that  
21 should be in here as well. That is separate from  
22 substantiate.

23 MR. TOPOROFF: That is a separate area. Of  
24 course if a franchisor puts in an earnings claim, they  
25 have to be able to substantiate it. It has to have a

1 reasonable basis. There have to be the assumptions or  
2 a basis for which the claims are made. Those parts  
3 are not going to change.

4 MR. DUVALL: But you've listed two of those  
5 parts here and dropped the third one. There are  
6 three parts to what a franchisor has to do. This  
7 clause lists two of the three, and I think the third  
8 should be listed as well.

9 MR. TOPOROFF: Okay. Any other comments on  
10 the language so far?

11 (No audible response.)

12 MR. TOPOROFF: Moving on. If a franchisor  
13 chooses to supply this type of information, it must  
14 do so here in Item 19 of its disclosure document.

15 Let me give some background on this. This  
16 is to address a concern that David Kaufmann and others  
17 raised in New York. If you don't refer to the Item  
18 19 itself, it could imply that franchisors could make  
19 earnings claims in some other way outside of the text  
20 of the disclosures, which is obviously wrong.

21 So there needs to be some kind of language  
22 that makes it very clear that if a franchisor is going  
23 to have disclosures, that they need to be in this item  
24 in the disclosure document. So that's what this  
25 language is seeking to address.

1           Any comments on this particular language,  
2 again if a franchisor chooses to supply this type of  
3 information, he must do so here in Item 19 of this  
4 disclosure document?

5           (No audible response.)

6           MR. TOPOROFF: None? Okay. Move on.

7           MR. BUNDY: The same grammatical changes.

8           MR. TOPOROFF: Fine. Let's just take it as  
9 a given that the grammatical changes are noted for the  
10 record, and we'll address those.

11          Dennis.

12          MR. WIECZOREK: Let me ask a related  
13 question. Is this a -- is this language used like the  
14 cover -- the FTC cover page language? Is this a  
15 statement by the FTC, or is this a statement by the  
16 franchisor?

17          MR. TOPOROFF: This is a statement by the  
18 franchisor. This would be a preamble that would be in  
19 all Item 19 disclosures.

20          MR. WIECZOREK: Okay.

21          MR. TOPOROFF: The next part do not rely on  
22 any representation about sales, income, or profits  
23 unless the franchisor: (1) sets forth financial  
24 information below -- now, let's not get into the same  
25 issue that we talked about before of sales, income,

1 or profit. We could change that to be consistent.

2           Assuming it's consistent with what we've  
3 described before, again the basic concept, do not rely  
4 on any representation about earnings information, call  
5 it what you will, unless the franchisor: (1) sets  
6 forth financial information below.

7           Is there any concern on that language?

8 Again it's basically following the sentence that  
9 immediately came before emphasizing again that the



1 difference between if a franchisor chooses to, it has  
2 to be in Item 19, and don't rely. One is a statement  
3 of the law. The other is a warning.

4 MR. DUVALL: I agree, but I think that you  
5 could combine those two sentences into one though. In  
6 other words, the preceding sentence could begin with  
7 -- could be turned around and begin with do not rely  
8 on this type of information and continue on to say  
9 unless it is set forth in Item 19 of this disclosure  
10 document.

11 MR. TOPOROFF: Good point. Okay.

12 Anybody else on this point?

13 MR. CASILLAS: Steve, I was going to say  
14 that the potential word should be added here.

15 MR. TOPOROFF: Meaning? I'm sorry.

16 MR. CASILLAS: Do not rely on any  
17 representations about potential sales, income --

18 MR. TOPOROFF: Sure. Okay.

19 Now I have a question.

20 MS. KEZIOS: Actual or potential sales?

21 MR. TOPOROFF: Actual or potential.

22 Now I have a question. The use of the word  
23 rely, does that open up a door that could cut against  
24 franchisees? If we use the term don't rely on this,  
25 does that basically arm a franchisor down the road

1 with a defense?

2           We told you the Federal Trade Commission  
3 told us that we had to tell you not to rely on  
4 unauthorized -- or statements made outside of the  
5 disclosure document. Would that switch the burden so  
6 to speak, or would franchisees ultimately be put in a  
7 disadvantaged position? On one hand it's a warning,  
8 but it really cuts -- potentially cuts against  
9 franchisees in the long term.

10           I think that this is a problem. What's on  
11 the table right now is: Is there a fix? Is there  
12 another verb other than rely -- because I think rely  
13 is a loaded term, is there another verb or other way  
14 to phrase this that we get the same message across but  
15 not disadvantage franchisees?

16           Howard Bundy.

17           MR. BUNDY: The solution is real simple.  
18 You should disregard.

19           MS. KEZIOS: Yes.

20           MR. BUNDY: Any time you put a word like  
21 rely in there -- and I've been sitting here puzzling  
22 over it until you phrased the question, and then all  
23 of the sudden I came up with the obviously perfect  
24 solution. It's late in the day, Guys.

25           MR. DUVALL: The ever humble Howard.

1                   MR. BUNDY: But the word rely, A, it  
2 doesn't mean the same thing to a prospective  
3 franchisee or my stepkids that it does to me. They  
4 see it as being -- I'm sorry.

5                   MR. TOPOROFF: The record will reflect that  
6 Howard Bundy is now laughing.

7                   MR. BUNDY: The record will not reflect  
8 what caused me to.

9                   MR. WIECZOREK: It says humble Howard  
10 Bundy.

11                   MR. TOPOROFF: Howard was talking about.

12                   MR. BUNDY: I lost my train of thought.

13                   MR. TOPOROFF: I think we got the message.  
14                   The last part of the item is -- well, we  
15 have to backtrack a little -- you should disregard  
16 unless the franchisor sets up financial information  
17 below, and granted we might collapse this with the  
18 sentence before, but also offers to make written  
19 substantiation available to you.

20                   Is there a problem or any suggestions with

51 DY 18NDve

MR4 vs wiausenDY an me t 3 )) ōk ã

1 the Item 19, has that general preamble in there, now  
2 there are two possibilities that follow. The  
3 franchisor makes earnings disclosures, or they don't.

4           On the assumption that they make earnings  
5 disclosures, we suggest the following based upon the  
6 instructions to the current Item 19, and that is we  
7 have elected to provide you with the following  
8 earnings information.

9           And again earnings information we could  
10 tinker with. Written substantiation of the data  
11 used in preparing this earnings information will be  
12 made available to you upon reasonable request.

13           Any problem with that? And then obviously  
14 what would follow is the actual text of any earnings  
15 disclosure -- any earnings claim.

16           Howard Bundy.

17           MR. BUNDY: You got ahead of me because I  
18 wasn't ready to leave the last paragraph. May I  
19 go back and revisit something that I think we should  
20 consider?

21           MR. TOPOROFF: Yes, you may.

22           MR. BUNDY: And the reason I think it  
23 should go in the prior paragraph is that it would  
24 require all franchisors to state that preamble.  
25 And I think it needs to say something to the effect of

1 if you receive financial performance information, so  
2 that we understand what I'm talking about, that is not  
3 contained in or consistent with this requirement, you  
4 should call A or B with phone numbers.

5 MR. TOPOROFF: We're getting there. We're  
6 getting there.

7 MR. BUNDY: Am I missing a page?

8 MR. TOPOROFF: It's in the next one.

9 So obviously if --

10 MS. KEZIOS: It's on the next page at the  
11 bottom.

12 MR. TOPOROFF: At the bottom of the next  
13 page.

14 So if you are going to make the earnings  
15 claim, you set it forth at that point. Okay?

16 Howard, you look troubled.

17 MR. BUNDY: I still am troubled because the  
18 stuff on the next page only applies if you're doing  
19 the negative disclosure. I'm concerned that it should  
20 apply equally to all disclosures, not just the  
21 negative, because what I see -- just to give you an  
22 example to get us all on the same page, a negative  
23 disclosure or a proper earnings claim in the document  
24 buried on page 33 juxtaposed against a five color  
25 separation glossy brochure that has much more exciting

1 earnings claims in it, and in that situation I think  
2 we need to tell that franchisee here are some numbers  
3 you should call if that happened.

4 MR. TOPOROFF: Okay. Gary Duvall.

5 MR. DUVALL: I think the place to tell them  
6 that is right up front; don't you, like right in the  
7 FTC cover page rather than buried in Item 19?

8 MR. BUNDY: No. No, I like Item 19. It's  
9 already in the FTC cover page.

10 MR. TOPOROFF: Given Howard's concerns  
11 that perhaps there should be that additional  
12 disclosure for all franchisors up front, let's still  
13 look at this particular language, again if the  
14 franchisor makes earnings disclosures, should it say  
15 we have elected to provide you with the following  
16 earnings information. Written substantiation of the  
17 data used in preparing this earnings information will  
18 be made available to you upon reasonable request.

19 Dennis.

20 MR. WIECZOREK: Just a quick comment. The  
21 substantiation stuff is starting to repeat itself too  
22 many times, so either the substantiation language  
23 should be edited out of the prior paragraph or -- if  
24 the idea here is to be quick, to the point, punchy,  
25 let's clean up some of that, because there is no

1 reason to say we will substantiate, we will  
2 substantiate, we will substantiate.

3 MR. TOPOROFF: Okay. Moving on. If the  
4 franchisor does not make earnings disclosures, then we  
5 have the following. The first sentence, this  
6 franchisor chooses not to make any representations  
7 about sales, income, or profits. And let's take for  
8 argument sake that we'll revise the language so it  
9 will be consistent with what we said before. We also  
10 do not authorize our representatives to make any such  
11 representations either orally or in writing.

12 Are there any problems, suggestions,  
13 concerns about that language?

14 Martin Cordell.

15 MR. CORDELL: I have one comment. I  
16 believe it was Brett Lowell who made a proposal adding  
17 a little bit stronger language, cautionary language  
18 regarding franchisors who did not make earnings  
19 claims. And I don't have that language with me now,  
20 but I will certainly get a copy of it and forward it  
21 on to you.

22 But basically the point is what it does say  
23 is that -- it warns franchisees that the fact that the  
24 franchisor is not making earnings claims, that perhaps  
25 there is some deficiency or some weakness in the

1 franchise program that should caution franchisees to  
2 either make further inquiries or perhaps stay away.

3 MR. TOPOROFF: Second sentence reads if any of  
4 our representatives makes such earnings representations  
5 to you, please notify us by contacting, and then  
6 obviously the name and the address of the person to be  
7 notified.

8 Are there any concerns, suggestions about  
9 that?

10 (No audible response.)

11 MR. TOPOROFF: None.

12 The second step is you should also notify  
13 the Federal Trade Commission and appropriate State  
14 authorities.

15 Howard Bundy.

16 MR. BUNDY: Addresses and telephone  
17 numbers. Essential.

18 MR. TOPOROFF: The problem with that, with  
19 addresses and telephone numbers of the Federal Trade  
20 Commission and State authorities -- well, now that I  
21 said it, I realize it might not be a problem.

22 My initial concern was if we put in a  
23 specific telephone number, for example, for the  
24 Federal Trade Commission, that number may change over  
25 time. And we would have to go through a whole



1 rulemaking process to update that. It seems  
2 ridiculous. On the other hand, we could just  
3 put in current address, telephone number, whatever,  
4 close paren, and that might work.

5           MR. BUNDY: As published in the CCH  
6 Business Franchise Guide.

7           MR. TOPOROFF: Dennis.

8           MR. WIECZOREK: I think that's silly. The  
9 phone numbers will change. If someone looks in the  
10 phone book under Federal Trade Commission -- it may be  
11 preferable for a franchisee in Seattle to call a  
12 regional office. I don't know that there is any  
13 reason for them to call Washington.

14           And the State list is already in an

1 just go through it, and you can offer whatever  
2 comments you have on this particular proposal.

3           This franchisor does not make any  
4 representations concerning the financial performance  
5 of its company-owned or franchised outlets. We also  
6 do not authorize our employees or representatives to  
7 make any financial performance information to  
8 prospective franchisees either orally or in writing.  
9 If you receive any financial performance information,  
10 you should report it to the franchisors's management,  
11 the Federal Trade Commission, and the applicable  
12 State agencies listed in Exhibit, blank, attached to  
13 this offering circular.

14           As a general proposition, is this language  
15 better? Worse? Something that we should look at?  
16 Any particular comment?

17           MR. JEFFERS: I actually prefer it simply  
18 because I believe that it's more neutral in its

1 least damaging and so forth.

2           And the second statement simply says this  
3 franchisor does not make any representations, and  
4 that's a statement of fact. And based on that, the  
5 prospective franchisee can make his judgment from  
6 there on. And all of the rest of the information  
7 there is essentially the same as in proposal one.

8           So if there were a choice, my preference  
9 just for that reason would be proposal two.

10           MR. TOPOROFF: Gary Duvall.

11           MR. DUVALL: I think proposal two is  
12 superior in every respect from proposal one in all the  
13 changes. I agree I would like to eliminate the word  
14 chooses. I think financial performance information is  
15 more accurate than sales, income, or profit as to what  
16 the rule requires. And I like referring to the  
17 exhibit for the applicable State agencies.

18           MR. TOPOROFF: Howard Bundy.

19           MR. BUNDY: I like the word chooses.

20           MR. TOPOROFF: Martin Cordell.

21           MR. CORDELL: Well, I would concur with  
22 some of the wording changes suggested by Jeff and  
23 Gary, but I do think in terms of readability that  
24 proposal one, just the format, is much more readable.

25           MR. TOPOROFF: Okay. Let me address the

1 issue of the word chooses. That was very intentional  
2 here for a reason.

3           Clearly under the rule the franchisor may  
4 or may not make earnings representations. I don't  
5 think that there's any debate about that. But in many  
6 respects part of the reason for having these preambles  
7 and disclosures is to put some pressure, if you will,  
8 or to let market forces work to encourage franchisors  
9 to make earnings information available voluntarily.

10           If it's neutral, I don't think it gets  
11 across that message. If the message however is one of  
12 choice, then prospective franchisees arguably could go  
13 to the franchisor and say, hey, you know, we would  
14 really like this kind of information.

15           The franchisor may still say no, and  
16 perhaps there are very legitimate reasons. But again  
17 using a market approach, if we want franchisors to  
18 consider the effect of its choice, then it seems to me  
19 at least as a proposal that franchisees should at  
20 least know that in fact it is a choice.

21           Mr. Jeffers.

22           MR. JEFFERS: Well, philosophically I don't  
23 think the FTC should essentially be involved now in

1 some 19 years ago when the rule was taken into effect.

2           This is the one area that is the most  
3 consistent problem in franchises and marketing and  
4 abuses. It is this area. I mean, it is the one area  
5 where we said, well, if the franchisor says no to the  
6 earnings request, the franchisees could come back and  
7 say but we want that.

8           But they do that now anyway. I mean,  
9 franchisees want this information. And the reason why  
10 I think it makes sense for the FTC to use neutral  
11 language is simply because one of the reasons that  
12 franchisors are concerned about this is that I know  
13 franchisees will use any information that they can  
14 receive as a yard stick to measure their performance  
15 down the road no matter how guarded and how much you  
16 qualify it.

17           And if there is more than just enough  
18 encouragement by any other agencies, then they'll now  
19 have a field day because they'll almost be able to  
20 elicit the FTC as a friend of the court in terms of  
21 saying the franchisor gave me this earnings claim  
22 information, and my store didn't live up to those  
23 numbers, and as a result I now want to hold them  
24 accountable.

25           And that's the real reason why franchisors

1 are reluctant to give the information, because of the  
2 potential legal liability, and not because they have a  
3 problem with franchisees being able to do a pro forma.

4           So I still feel that the FTC doesn't need  
5 to go further and say we want to make sure that it's  
6 not an easy choice, that we want to make it clear that  
7 they're choosing not to, and we want to force them to  
8 do that.

9           There's a lot of pressure already. And  
10 when we're finishing addressing this, I want to  
11 address that as a separate point. But I just think at  
12 this point the FTC is well served to be neutral  
13 because the ramifications of these changes will be  
14 significant, even without using the language the  
15 franchisor chooses.

16           And I think that would be adequate to get  
17 the information that you want out there and at the  
18 same time without making it a problem for those  
19 franchisors who in good faith decide not to get  
20 involved with this because they're making also a  
21 business judgment that they don't want the potential  
22 liability.

23           And frankly there are a lot of franchisees  
24 out there who would love to have information now which  
25 they will discount, and say don't worry I know there

1 is no basis for this. I know that I can't rely on it  
2 and all of that. They'll acknowledge all of the  
3 safeguards that we're talking about until they open  
4 their store, and it doesn't meet those projections.

5           And then in that case they want to go  
6 back and call out every one of those same items of  
7 information to use against the franchisor. And I'm in  
8 the middle of that all the time.

9           So it's one of the most important areas  
10 that I wanted to comment on because I'm dealing with  
11 franchisees every single day who want that  
12 information. All I'm saying is fine. I think that  
13 this is a very positive step.

14           But you don't have to go so far as to make  
15 it really almost a badge of guilt for those  
16 franchisors who may decide for good reasons of  
17 judgment, and they may be so advised by their  
18 attorneys or counsel, that it's still not the best  
19 idea because of the potential liability.

20           MR. TOPOROFF: We're going to hear from  
21 Judy and then Susan, and then we need to move on.

22           MS. GITTERMAN: I don't think you need to  
23 have the wording chooses as stated in this first  
24 proposal because you have that in your first page  
25 in the preamble that you say is going to -- all the

1 franchisors are going to have. It already says if a  
2 franchisor chooses to supply this type of information,  
3 it must do so here.

4           And the other thing I like better about the  
5 second proposal is that it refers to applicable State  
6 agencies listed in the exhibit; whereas, it would be  
7 very ambiguous and confusing from the first one as  
8 to who the appropriate State authorities are.

9           MR. TOPOROFF: Well taken.

10           Susan.

11           MS. KEZIOS: I like the choose because it  
12 is a voluntary disclosure. What has gotten  
13 franchisors and some franchisees in trouble in the  
14 past has been the fact during the sales process -- not  
15 during your sales process but during the sales  
16 process, many franchise sales people will say we're  
17 prohibited by law from giving you this information,  
18 when in fact that is untrue. They have chosen not to  
19 volunteer the information. So it should be disclosed.  
20 That's full and complete disclosure. We've chosen not  
21 to give this information for whatever reason.

22           MR. TOPOROFF: Okay. We're going to move  
23 on, but before we do I just want to ask the  
24 stenographer, do you need a break?

25           THE COURT REPORTER: Let's move on.



1 MR. TOPOROFF: We're going to move on.

2 Again one of the items that we're  
3 considering is revising the Franchise Rule to be more  
4 in line or to be modeled after the UFOC. That does  
5 not necessarily mean accepting the UFOC verbatim.  
6 It means looking at it critically and seeing if there  
7 are areas that could be improved like we did before.

8 One major item -- we touched on some  
9 aspects of Item 20, but there are many others that  
10 raise issues for us. One second.

11 (Discussion off the record.)

12 MR. TOPOROFF: Before we go on though --  
13 Mr. Jeffers.

14 MR. JEFFERS: Just a question. Let's  
15 assume that those changes we're talking about do take  
16 place, what would be your ballpark estimate of when  
17 in fact -- with all of the processes that have to take  
18 place, when in fact this would be part of the ongoing  
19 -- would be in fact effective?

20 MR. TOPOROFF: That's somewhat Susan's  
21 preliminary question early this morning. I really  
22 can't hazard a guess. To make a long story short,  
23 we go back to the Commission. We make recommendations  
24 to the Commission. The Commission considers it.

25 The next stage would be the publication of

1 a proposed rule. And possibly along with that  
2 proposed revised interpretive guides. And that is a  
3 long process.

4 And so I cannot hazard a guess really when  
5 this -- at the end of the day when this will all be  
6 wrapped up, and we'll have an enforceable new rule.

7 MS. KEZIOS: We were placing bets at lunch  
8 on when it might happen.

9 MR. TOPOROFF: Well, I have no opinion on  
10 that.

11 Now, moving along, on Item 20 there's a  
12 preliminary matter that Myra and I want to resolve  
13 because this is not clear to us, and that is Item 20  
14 talks about the disclosure of outlets. Does it  
15 literally mean the disclosure of outlets, or are we  
16 talking about the disclosure of franchisees?

17 Let me give you an example. It could very  
18 well be that one franchisee or a group of franchisees,  
19 a handful of franchisees, own 100 outlets. If what  
20 you have to disclose is literally outlets in a state,  
21 it could very well be that you disclose the 100  
22 different locations, but in terms of franchisees it  
23 boils down to let's say four or five in some  
24 instances.

25 So if a prospective franchisee wants to

1 talk to existing franchisees, 100 outlets doesn't  
2 necessarily give them a lot to go on if the way the  
3 UFOC is interpreted literally means outlets.

4           So this is by way of clarification. To  
5 those people who draft UFOCs for Item 20, does it  
6 literally mean outlets, or are we talking about  
7 franchisees?

8           Dennis Wieczorek.

9           MR. WIECZOREK: It absolutely means  
10 outlets, and it was intentionally drafted to mean  
11 outlets because the issue arose primarily from  
12 franchisee turnover. And if a franchisor could state  
13 in Item 20 that it had one turnover event of one  
14 franchisee who happened to control 100 outlets, that  
15 would not be an appropriate disclosure.

16           So the focus was on outlets -- the focus  
17 was on listing those outlets and listing the owner of  
18 those outlets. That could be one franchisee that owns  
19 100 outlets, but, nevertheless, the -- this was  
20 extensively discussed at new UFOC drafting time, and  
21 the clear decision by the NASAA committee and  
22 supported by the advisory committee was the focus  
23 on outlets.

24           MR. TOPOROFF: Okay. Howard.

25           MR. BUNDY: It may be the only time I ever

1 get to say it, but Dennis is absolutely right.

2           Now, what mitigates your concern I believe  
3 is in most cases where there is one franchisee who  
4 controls 100 outlets, you will see the same name  
5 sprinkled throughout the listing, particularly if  
6 they're geographically contiguous.

7           If they're spread out all over the country,  
8 it sometimes does break it up. But normally when  
9 you're looking through a circular, you will see the  
10 same name jump out at you time and time again.

11           MR. TOPOROFF: Okay.

12           MS. HOWARD: I just have a question.  
13 Dennis, you said it was based on the fact that what  
14 the goal was was to look at turnover. So does that  
15 mean that Item 20b that just asks for names and

1 had 100 outlets closed 50 of them, that list would  
2 show 50 outlet addresses and 50 of the same name of  
3 closed outlets.

4 MS. HOWARD: Well, here's why I ask,  
5 because -- Steve touched on this already. If in Item  
6 20b the goal is to give prospective franchisees a list  
7 of people that they can contact to get information from,  
8 and the rule is, you know, you have to list all of them  
9 in the state, and then if it's not 100, you have to  
10 start listing them from surrounding states, if we are  
11 just talking outlets, you could have, you know,  
12 conceivably in the state one franchisee who owns 150  
13 outlets, and that's it, so when you're trying to contact  
14 franchisees to get information, you in fact have one  
15 person to contact?

16 MR. WIECZOREK: To respond, that's  
17 absolutely right. I would say that most franchisors  
18 as a matter of practice -- it's too much of a pain in  
19 the neck to subdivide the country into many circulars,  
20 so most franchisors will do a national list. It's  
21 simple. It's easy. Their lawyers don't get crazy  
22 with them.

23 There are some, however, very large  
24 companies because they have so many and because  
25 they're concerned about competitive information

1 floating around, they will divide it into regions, and  
2 they'll do it regionally. But that's fairly rare.  
3 That's is very, very much in the minority. Almost all  
4 the lists are national.

5 MS. HOWARD: So this is really more a  
6 theoretical problem than a real problem?

7 MR. WIECZOREK: Yes. And what is  
8 interesting about it is keep in mind that if a  
9 franchisor chooses to list the 100 in the state, for  
10 example, I believe, and I'm confirming that in the  
11 UFOC, that the list of closed outlets has to be  
12 national.

13 So, I mean, it would be sort of a marketing  
14 negative to sit there and put 100 in the state, and  
15 then have 300 that closed across the United States  
16 last year. So that's another reason why franchisors  
17 tend to use national data, because it shows a thriving  
18 healthy system, and it doesn't show a disaster  
19 because there are so many closed outlets but --

20 MS. HOWARD: Howard.

21 MR. BUNDY: I would submit that the current  
22 language in the rule and the problem -- the hypothetical  
23 or theoretical problem that you perceived is more of a  
24 factor of the fact that in 1978 we really didn't have a  
25 good computerized word processing system that could spit

1 this out in an instance.

2 Today it is much easier to give all of that  
3 than part in almost all cases. So I think it would be  
4 very easy to close the gap by just saying that you  
5 will provide a list of all, at least in the United  
6 States.

7 MS. HOWARD: Okay. That was going to be my  
8 next question. Is there a problem with that?

9 MR. BUNDY: In practice we do it anyway.  
10 Why not just do it.

11 MS. HOWARD: Dennis.

12 MR. WIECZOREK: Well, I'm not standing up  
13 for any particular company, but NASAA decided that  
14 there was a reason for allowing segmented disclosure.  
15 And I don't see that there is any compelling reason to  
16 put in a national list.

17 There are some companies that don't do it  
18 because they view the UFOC as an institutionalized  
19 leakage of information that they rather people don't  
20 have. And that -- frankly UFOCs are great sources of  
21 information for the competition.

22 So their intention is that -- give you an  
23 example. In the real estate business, real estate  
24 brokers are constantly being harassed, I'll use the  
25 word in quotes, by other franchisors to switch. So

1 you'll have a Century 21 being talked to by Remax and  
2 by others, and they really don't like to have a broad  
3 national list used because of that competitive issue.  
4 And I don't see any compelling reason -- Howard may  
5 disagree -- to require national information

6 MS. HOWARD: Okay. Moving on.

7 MR. TOPOROFF: In New York we discussed how  
8 Item 20 might be revised to get around the double  
9 accounting issue. By that I mean, if you're not  
10 familiar with it, the concern is when you talk about



1 hits first, that's how you count it. And, therefore,  
2 each and every outlet would be counted for once.

3           When we got back to the office and tried to  
4 do that, create a hierarchy, it didn't exactly work  
5 out well because we realized right from the beginning  
6 that we're really talking about two completely  
7 different concepts. There is what happens to the  
8 franchisees and what happens to the franchised  
9 outlets, and they are not the same.

10           Again, a single franchisee can go out of  
11 business, retire, and go home, and that might reflect  
12 many more terminations in the actual disclosure  
13 document.

14           So we thought that perhaps a way to fix  
15 Item 20, this double accounting issue, is to really  
16 split it into two, talk about franchisee statistics  
17 and then talk about franchised outlets statistics.

18           And the proposal that we're coming up with,  
19 which will be on the table after I describe it, is to  
20 say okay -- and it's the handout that you have -- it's  
21 to say okay, for a period of three years -- now, for  
22 argument's sake let's just use one year for clarity,  
23 but it would be for three years.

24           At the beginning of the fiscal year list  
25 how many -- by number, not by name -- how many

1 franchisees you have. So let's say it's 100. And  
2 then at the end of that fiscal year, tell us what  
3 happened to these folks: Are they in business, in  
4 the same kind of business; were they terminated;  
5 cancelled; whatever the factors might be. Okay. So  
6 that gives us a snapshot for that calendar year -- or

1 is not going to be able to perceive the difference  
2 between those two sets of events and is also not  
3 going to really distinguish in his or her mind which  
4 event is something he should focus on or not focus on.

5           And there's a franchisor difficulty here  
6 also, and that is there are lots of franchisees out  
7 there that are, let's say, partnerships where a  
8 franchisee is Mr. X and Mr. Y as to outlet No. 1, and  
9 as to outlet No. 2, it's Mr. Y and Ms. Z.

10           And if there's a change in one of those, is  
11 that a diminishing number of franchisees? Is the  
12 corporation the franchisee? Is the principle owner of  
13 the corporation the franchisee?

14           I think it's a big mistake to talk about  
15 franchisee turnover because franchisee is a very  
16 undefined, indefinable term from an entity standpoint  
17 and from an ownership standpoint.

18           So I don't see any benefit to the  
19 franchisee because the franchisee should be concerned  
20 about the locations, the franchises, how many have  
21 changed hands, how many have closed, how many new ones  
22 are there.

23           I don't think a franchisee should have a  
24 whole lot of concern about whether a franchisee  
25 changed over or turned over or ownership -- majority

1 ownership moved, et cetera. And I think it leads to  
2 unnecessary complications and difficulty with very  
3 little disclosure benefit.

4 MR. TOPOROFF: Howard Bundy.

5 MR. BUNDY: I think I respectfully disagree  
6 with my colleague to the left here. He's usually on  
7 the right. Franchisors -- all of us who write  
8 franchise agreements and circulars spend usually  
9 about pages 16 and 17 defining what these various --  
10 how these various entities will be affected and how  
11 they will be defined within the contract. It usually  
12 says that any change of more than majority ownership  
13 in any entity is a change in the franchisee and  
14 requires franchisor approval.

15 I would suggest that we could impose the  
16 franchisors own definitions on the franchisor and, you  
17 know, require them to live with that definition in  
18 terms of Item 20.

19 I think it would be useful to a prospective

1                    Either measure without the other can be  
2 inherently deceptive because it can either look like  
3 you have a bigger turnover than you have or a less

1 complex it is and it's become. This is deceptively --  
2 this proposal is deceptively similar -- or deceptively  
3 simple because the proposal is to disclose this on  
4 a state-by-state basis I believe -- is that correct?

5 MR. TOPOROFF: Yes.

6 MR. DUVALL: -- as the existing UFOC is,  
7 and so it cannot be put in this linear format that we  
8 see in front of us.

9 Rather there would have to be a chart which  
10 divides each of these seven items, and I'm looking at  
11 seven items per outlet, into 50 subitems, 50  
12 subcategories.

13 The chart as it is now does that by having  
14 three numbers in each box in the chart with slashes  
15 dividing the numbers. I've been told by franchisors  
16 and franchisees that it's virtually impossible to  
17 understand that on first glance, that they require  
18 a lawyer or a translator to understand it, and this  
19 would make it twice as bad as it is now, twice as  
20 long, twice as complicated.

21 If you look at the -- your proposal on the  
22 outlet turnover, I think that's a really good  
23 proposal. And I also note in response to Howard  
24 Bundy's comment that Item 1 does disclose to  
25 prospective franchisees transfers of ownerships.

1           There are seven items here. They overlap a  
2 great deal with the proposal for franchisee status.  
3 Of the two, the one the franchisees should be most  
4 interested in is outlet turnover for all the reasons  
5 that Dennis mentioned. It's the key information.

6           And so in terms of tradeoff between  
7 complexity and what could become a full employment act  
8 for franchise lawyers and getting the necessary  
9 information to franchisees, I think just staying  
10 with the outlet turnover proposal is the way.

11           MR. TOPOROFF: Judy.

12           MS. GITTERMAN: I think that there is one  
13 problem that would result if you continue to only  
14 disclose outlets, and that involves seasonal type of  
15 franchisees. There are some franchise agreements  
16 where the franchisor allows the franchisee to open  
17 units on a seasonal basis, for instance, a rent a  
18 car type of situation during the more heavily traveled  
19 months.

20           And in that situation a franchisee can open

1 problem, but I think if you only disclose outlets,  
2 that is a problem.

3 MR. TOPOROFF: Dennis.

4 MR. WIECZOREK: Let me just add to what I  
5 said earlier, and that is that your proposal is -- has  
6 short falls also in that if you focus on outlet  
7 turnover, there -- I just mentioned this to Howard,  
8 there is nothing in here about terminations,  
9 non-renewals, closed for other reasons. So you've got  
10 to multiply these categories even further, and there  
11 is quite a bit of redundancy in the outlet turnover  
12 chart anyway.

13 And in the franchisee turnover category,  
14 we're talking about franchisees being terminated, and  
15 that's really into accurate because outlets are  
16 terminated, franchise agreements are terminated. And  
17 I think that data is also not necessarily clear or  
18 appropriate for the --

19 MR. TOPOROFF: Dennis, let me ask you a  
20 question. If you have a franchisee that owns ten  
21 outlets, do you mean to tell me that a franchisor  
22 might terminate five of them, but the franchisee  
23 continues to operate the other five?

24 MR. WIECZOREK: Absolutely.

25 MR. JEFFERS: It does happen.



1 MR. WIECZOREK: It happens all the time.

2 MR. JEFFERS: It could be for failure to  
3 meet development schedules, failure to maintain  
4 exclusive territories, if there are locations where  
5 the revenues were such that the franchisee wanted out,  
6 and the franchisor might have taken preemptive action  
7 to terminate the agreement so that they would have  
8 their option in place knowing that the franchisee  
9 was planning to terminate. There are certainly  
10 situations where a franchisee who has multiple units  
11 might have some agreements terminated without all of  
12 them being terminated.

13 MR. TOPOROFF: Okay. Thanks.

14 MR. WIECZOREK: Let me follow up because I  
15 was in the middle. NASAA is working on this, and  
16 there are proposals that I think you've seen, Steve,  
17 but I think there are proposals that are being  
18 discussed now that would deal with double counting and  
19 some of the appropriate hierarchical issues.

20 And I think the direction that at least in  
21 theory NASAA is talking about is moving some of the  
22 information into different categories so that the  
23 truly adverse information, terminations, non-renewals,  
24 abandonment closures are grouped and totalled so  
25 that a prospective franchisee -- again this is only on

1 an outlet basis -- the prospective franchisee can see  
2 the truly negative data combined together.

3           There would be a separate disclosure of  
4 transfers, and there would be an entirely separate  
5 disclosure of reacquisition of units by the company and  
6 operation of those units by the company.

7           And then on the hierarchical issue, I  
8 think -- although it happens to be one that I  
9 proposed, I think that at our last meeting, which  
10 there weren't any FTC representatives there, I think  
11 we conferred at the end that it would be better to  
12 focus on a chronological hierarchy, and that is if a  
13 franchisor issued a termination letter and the outlet  
14 then closed a week or two later, that you would focus  
15 on which event occurred first, so that the termination  
16 would be -- it would be characterized as a termination  
17 in that situation. If there is a termination followed

1 event reported for each closure, change-over, et  
2 cetera. And that would be one way to handle it.

3 MR. TOPOROFF: That's interesting. I  
4 hadn't thought of that, so I appreciate that comment.

5 I'm going to make a comment, and I hope  
6 that it is not taken in a negative way because it's  
7 not intended to. It's more by way of timing.

8 Susan asked early in the morning what's the  
9 process here for developing a rule, and I explained  
10 some of the concerns and factors that go into it.

11 At the same time today at many different  
12 points it was raised that NASAA is working on a  
13 particular proposal. And certainly I am interested --  
14 I won't speak for the Commission, but I am interested  
15 in knowing what NASAA has developed.

16 But there's a real timing issue here. If  
17 people point fingers at the Commission, that we take  
18 too long and we're not moving this, well, I hate to  
19 tell you, NASAA creeps along at a snail's pace as  
20 well.

21 And I think Martin would agree with that,  
22 as would anyone who participates in the NASAA  
23 meetings, that very little gets done any particular  
24 meeting. It goes at a very small pace, which is fine.

25 But to say that the Federal Trade Commission

1 should put things on hold until NASAA develops specific  
2 proposals really isn't going to work well. I think a  
3 better approach is the Federal Trade Commission needs to  
4 come up with its proposals. Where we can iron them out  
5 with NASAA in advance, fine.

6           Bear in mind that there already will be a  
7 notice and comment period on the Notice of Proposed  
8 Rulemaking, so there will be opportunities, but I  
9 cannot just go to the Commission and say, hands off  
10 until NASAA comes back with something because that  
11 something could be years down the road.

12           So we need to move and come up with  
13 proposals. Where we can iron them out with NASAA,  
14 we intend to do so. But the flip side is also true.  
15 There is nothing wrong with NASAA at the end of the  
16 day saying, well, look what the Federal Trade  
17 Commission did to update its rule. Perhaps we could  
18 change the UFOC guidelines to match what the FTC has  
19 done.

20           So I don't want that to be taken in the  
21 wrong way, but it gets a little tiresome after a while  
22 to constantly hear about the Federal Trade Commission  
23 should coordinate and have better uniformity with  
24 NASAA. It really is on a timing issue.

25           If NASAA was on a fast track and had

1 proposals and things were going to be done by next  
2 year, that would be one thing. But, as I understand,  
3 and I participate in these meetings, it generally  
4 doesn't work that way.

5           What I would like to do, because it would  
6 be helpful to us is two things. One is to discuss  
7 Dennis's proposal that we focus on the chronology of  
8 events. And for purposes of this argument, we're  
9 going to focus on outlets as opposed to franchisees.  
10 Would that work? Are there potential problems with  
11 that? And I don't want to beat it to death.

12           The second point is: If we are going to  
13 develop a hierarchy of events, can we? And let's put  
14 some thought into that and figure out what events, if  
15 they occur, are more important than others.

16           So on Dennis's proposal of when it comes  
17 to outlets, we count once whatever the first immediate  
18 triggering event is, would that work? Are there any  
19 concerns?

20           Howard.

21           THE COURT REPORTER: I'm sorry, but I'm  
22 going to need to add paper soon. So when we get to a  
23 good stopping point, I --

24           MR. TOPOROFF: Well, after Howard's  
25 comments.

1                   MR. BUNDY:  If you run out of paper, just  
2 let me know.

3                   I love the superficial simplicity of  
4 Dennis's proposal.  I like the fact that we would only  
5 be counting one event, and I like the idea that the  
6 first event to occur is the one that gets counted.

7                   My problem is from representing both sides  
8 in these wonderful situations that you can have at  
9 least three different kinds of letters go out from the  
10 franchisor.  You can have the nice, clean letter that  
11 says you are hereby terminated unless you cure this  
12 problem within three days.

13                   You can have the letter that says at the  
14 other extreme that well, we don't -- you're in breach  
15 of the contract, and it's the same breach for the  
16 eighteenth time in the last six months, and if you  
17 don't deal with this immediately, we're going to do  
18 something.  That's a little harder to pin down as to  
19 what the event was -- what the precipitous event was  
20 that caused -- that should be disclosed.

21                   Is it really the franchisee quitting  
22 because that's a precipitous event?  There was no  
23 termination.  And in fact there's a practice of some  
24 franchisors to never terminate a franchise because  
25 then you don't have to disclose it as a termination.

1           So although on the surface it is nice and I  
2 like it, I think we need to figure out how to -- I  
3 mean, if we're going to do it, how to characterize  
4 that precipitous event that results in disclosure.

5           Is it just a letter? Is it the franchisee  
6 responding to just a letter that, you know, accuses  
7 them of breach and quitting. Does that get reported  
8 as a termination or a quit?

9           I find it very troubling because of the  
10 multiplicity of ways that you can write that letter.  
11 And when we write them -- we all write them for -- to  
12 address the specific factual circumstances at that  
13 moment.

14           And it may be that you kind of hope that  
15 that franchisee will jump back on the ship, and it may  
16 be that you're hoping that he or she will be the one  
17 to pull the plug so that it doesn't trigger certain  
18 rights or responsibilities, or that it does trigger  
19 certain rights or responsibilities. So it's not a  
20 clear-cut chronological sequence of events that you  
21 can identify.

22           MR. TOPOROFF: We're going to take a break.

23           (Short recess.)

24           MR. TOPOROFF: Back on the record.

25           All right. This is an area where I just

1 don't think that we're going to get anywhere near  
2 consensus today. And to ask people to go through a  
3 mental exercise in trying to think of hierarchies and  
4 all, I don't know if that's a real productive use of  
5 our time. I understand and I appreciate that NASAA is  
6 working on the issue.



1 we would appreciate having their comments as soon as  
2 possible. In fact the comment period ends at the end  
3 of the year, so that just leaves about shy of two  
4 months.

5           Short of that if proposals don't come in,  
6 we could do one of two things. We could ignore the  
7 issue all together, and the rule will just not change,  
8 and it will be -- from the Federal Trade Commission's  
9 perspective, the rule will be what the rule is now.

10           Or we can get proposals again for change.  
11 Or in the absence of proposals, Myra and I and others,  
12 like we drafted this proposal here, could put our  
13 heads together and try to come up with something  
14 that's narrow, simple, easy perhaps to -- for  
15 franchisors to comply with as well as franchisees to  
16 read.

17           So at this point, I'm basically putting it  
18 back into all your courts to come up with something,  
19 or again we'll leave it as is, or Myra and I will come  
20 up -- and others will come up with some kind of other  
21 proposal.

22           And again bear in mind that even if we do  
23 come up with some kind of proposal, it is not carved  
24 in stone. It will be put out for comment again.  
25 Perhaps by that time, NASAA will have some kind of

1 proposal. So there is a built-in time mechanism here.  
2 So everyone shouldn't fret too much on this particular  
3 issue.

4           But we are going to move on. The last  
5 major issue that we're going to handle is again gag  
6 orders. We are not going to rehash the merits of gag  
7 orders. They've been discussed at length in New York.  
8 And in many of the comments that we've received,  
9 people have brought to our attention that gag orders  
10 are a good idea, bad idea.

11           What we're going to do is the following:  
12 Basically answer two questions. One, how prevalent is  
13 the use of gag orders? And on that one, I'm glad that  
14 Howard Bundy is here, Gary Duvall, Martin Cordell, and  
15 some others who do work in this area, and they can  
16 share their experiences with us. And then, No. 2,  
17 which Myra is going to lead the discussion on,  
18 possible fixes.

19           So I'm going to start off -- I would like  
20 to ask Howard Bundy a preliminary question, and that  
21 is: In your practice generally, how pervasive would  
22 you say the use of gag orders by franchisors is?  
23 And let me just add a caveat there, what we mean by  
24 gag orders.

25           We are not talking about post-settlement --

1 post-litigation settlements. Those already have to be  
2 disclosed in the UFOC as is. We are also not talking  
3 about agreements that protect trade secrets or  
4 proprietary information. That's not what we're  
5 addressing.

6           We're addressing something very narrow, and  
7 that is contractual provisions in the franchise  
8 agreement itself or post-signing of the franchise  
9 agreement some kind of contract settlement, call it  
10 whatever you want, that basically forbids franchisees  
11 from discussing their personal experience with  
12 prospective franchisees or anyone else for that  
13 matter, anyone. It could include the press, it could  
14 include the Federal Trade Commission, or others.

15           So what we're talking about by gag orders  
16 will be very, very narrow. Something that prohibits  
17 again existing franchisees from discussing their  
18 experience. And that is all that we are talking about  
19 for purposes of this discussion.

20           Howard, I would be very interested in  
21 knowing in your practice how often you come across  
22 this, that prospective -- that franchisees may have  
23 signed some kind of order like this that prohibits  
24 them from speaking about their experience to  
25 prospects or others.

1 MR. BUNDY: Am I under oath here?

2 MR. TOPOROFF: No, you're not under oath.

3 And you could pass.

4 MR. BUNDY: I won't duck the question.

5 It's a good, legitimate question. I don't see very  
6 many of them in my practice. I'm trying to think of  
7 how many I have in fact seen to date, but it's -- you  
8 could list them on the fingers of one hand.

9 The -- what I do understand from attending  
10 the ABA forum and reading the literature is that a  
11 large number of franchisors are at least being advised  
12 to include such provisions in their contracts. But  
13 they haven't trickled down to my desk yet in any  
14 serious numbers. And frankly the ones that have are  
15 so inartfully drafted that I don't find myself very  
16 concerned about them yet.

17 In concept I do find myself -- I am very  
18 concerned about them. On the other hand -- let me  
19 give you the other side of the picture. I represent a  
20 large number of franchisees. And one of the things I  
21 have to ask myself and counsel clients about is when  
22 that prospective franchisee calls you and asks you a  
23 series of questions, what do you say?

24 And I'll tell you what I tell every  
25 prospective franchisee -- every franchisee with whom

1 this issue arises, and that is give your name, rank,  
2 and serial number and refer them back to the  
3 franchisor for everything else.

4           And the reason for that is any information  
5 that you give is given knowingly in connection with an  
6 offer or sale of a franchise. And if you touch it,  
7 you become a person who offered or sold a franchise  
8 under the Washington Act at least and under many of  
9 the other State statutes and become potentially liable  
10 for any claims or damages arising out of your  
11 behavior.

12           And at the same time you become a potential  
13 target for the franchisor. And I've only seen one  
14 case where it actually came up in a defamation claim  
15 if you tell the truth about the -- the truth as you  
16 perceive it about the franchisor. So my consistent  
17 advice is name, rank, and serial number and refer  
18 them back to the franchisor for everything else.

19           MR. TOPOROFF: Martin, I want to ask you in  
20 your practice, do you come across franchisees that may  
21 have signed or are under some kind of gag order  
22 provision?

23           MR. CORDELL: I can only think of one  
24 instance in which we've run across that. Typically  
25 where we've run into problems are post-litigation

1 settlements. So I really haven't perceived that to  
2 be a problem for us yet.

3 MR. TOPOROFF: Anybody have comments on the  
4 prevalence, not the wisdom or the merits of it, but  
5 just on the prevalence of how often gag orders are  
6 used? Any thoughts?

7 MR. TOPOROFF: Gary Duvall.

8 MR. DUVALL: I object a bit to the term gag  
9 order. I understand what you're referring to, but I  
10 think that whenever two parties have entered into a  
11 contract, particularly one that results in dispute,  
12 it's appropriate to have mutual releases, it's  
13 appropriate to have mutual covenants not to disclose  
14 confidential information, and it's occasionally  
15 appropriate to have mutual covenants not to defame one  
16 another or to criticize one another.

17 That happens in my practice as frequently in  
18 the franchise context as it does in the non-franchise  
19 context. For example, license relationships, employment  
20 relationships, any other ongoing relationship that is  
21 ended by a contract, will have the kinds of provisions  
22 that you're discussing.

23 And I don't think they're a matter of  
24 concern. I think they are -- they occur, so they're  
25 -- I'm not sure that they occur in the majority --

1 it's probably less than the majority of cases that  
2 they occur, and I think they're not a serious concern  
3 for the number of reasons that I spoke of.

4           MR. JEFFERS: The only point that I would  
5 add would be essentially the point that I made in my  
6 series of comments, which was that the net effect of  
7 gag orders as relates to your concern about prospective  
8 franchisees not getting adequate information because of  
9 them -- and I think that's the main crux of it, because  
10 otherwise I think they're an absolute central part of  
11 doing business. But the net effect of that is somewhat  
12 mitigated by the fact that the potential franchisees who  
13 call or contact existing franchisees or terminated  
14 franchisees who are under gag order restrictions will  
15 find that enough of a red flag, particularly if there is  
16 more than one or if the franchisee is very adamant,  
17 because they can imply in their phone that I had a  
18 problem, I had a settlement, but I'm not at liberty to  
19 discuss it because I could violate the agreement.

20           They will then go to back the franchisor.  
21 Prospective franchisees will not let that be the end  
22 of that concern, and they'll just accept that and say,  
23 okay, well, thanks for your time.

24           They will want the franchisor to address  
25 what's been happening with these kinds of situations

1 so that there will be an opportunity and really there  
2 will be a requirement by the franchisor to adequately  
3 address that concern by the prospective franchisee in  
4 order for him to consummate that sale.

5           And so I think that in the end some of the  
6 concern is going to be taken care of by the fact that  
7 the prospective franchisees will not just accept the  
8 franchisee telling them there is a gag order in place.  
9 I can't talk to you. And then they go on with  
10 everything else as if it were normal. They will then  
11 go back and want more explanation.

12           MR. TOPOROFF: Gary Duvall.

13           MR. DUVALL: I agree with that. And that  
14 reminded me. One of the reasons they're not as  
15 prevalent as they might be is that very reason, that  
16 the franchisor doesn't want its former franchisees  
17 telling prospective franchisees that they have a gag  
18 order. They can't talk.

19           So normally franchisors will ask the  
20 franchisees to agree to some restrictions on what they  
21 say when there's some concern or claim that the  
22 franchisee has either interfered with contractual  
23 relations or has defamed the franchisor.

24           And for that reason -- they're generally  
25 narrowly drafted as well. They usually address an



1 existing problem. The ones I've drafted do that, and  
2 the ones I've seen do that. They address a particular  
3 behavior on behalf of -- that has occurred with a  
4 former franchisee, and they prohibit that behavior.

5 MR. TOPOROFF: Susan Kezios.

6 MS. KEZIOS: The use of gag orders is  
7 almost 100 percent in some franchise systems,  
8 apparently not in many of those that you are dealing  
9 with. They are used primarily when a franchisee is  
10 out-going and the franchisor wants to keep that  
11 franchisee quiet, or that franchisee was perhaps  
12 politically incorrect or unpopular according to the  
13 franchisor system.

14 So the use of gag orders, No. 1, circumvent  
15 the FTC Rule and the various State laws by exactly  
16 what you're talking about now. You call up to the  
17 franchisee, and he says I can't talk to you because  
18 I'm under this gag order.

19 To a lot of people it's repugnant. It's  
20 denying the franchisee freedom of speech. I mean,  
21 this did actually happen to you. I mean, you were  
22 actually a franchisee. Whether you're talking  
23 positively or negatively about this system, you're  
24 freedom of speech should not be curtailed, and you  
25 should not be able to not be able to make comments.

1           And the other thing that I think is a real  
2 disclosure issue is the fact that if you leave the  
3 system -- what's not disclosed when you're buying a  
4 franchise is the fact that when you leave the system,  
5 you may in fact have to sign a gag order.

6           That's not put -- I have not seen that in  
7 anybody's offering circular, that you may in fact have  
8 to sign something like that, so in fact it becomes a  
9 disclosure issue.

10           MR. TOPOROFF: Mr. Jeffers.

11           MR. JEFFERS: I would make two comments on  
12 that point, Susan. The first is that to the extent  
13 that you say you might have to sign a gag order and  
14 therefore it's a disclosure issue, gag orders are not  
15 sort of preforeseen events. They become part of the  
16 negotiated settlement.

17           And that's -- any commercial business  
18 transactions with regard to dispute could ultimately  
19 be subject to -- one of the conditions upon which they  
20 settle is that there's a gag order.

21           I don't think a franchisor has to be  
22 required up front to say that if I have a problem with  
23 you ten years from now, that there may be a gag order  
24 as part of that settlement because that in and of  
25 itself is not really fair to the franchisor in the

1 sense that he's got to be able to announce ahead of  
2 time all of the proposed conditions of the gag order  
3 itself.

4           The other point is that Susan's position is  
5 very much an advocacy position defending franchisees.  
6 Well, the fact is that in most cases where there is a  
7 gag order situation, that is one of the only concessions  
8 in fact that the franchisor does have some ability to  
9 get in return for all the other things they're going to  
10 give to the franchisee as part of the settlement.

1 that's the only -- that's one of the few things he can  
2 give up, and it's not a material concession in order  
3 to get the other things that he is getting from the  
4 franchisor when they do settle the dispute.

5 MR. TOPOROFF: We're going to hear from  
6 Susan and then Martin, and then we're going to move  
7 on.

8 So Susan.

9 MS. KEZIOS: To respond a little bit to  
10 what Carl said, I find it to be the opposite, that the  
11 franchisor is using that gag rule or confidentiality  
12 clause as a hammer over the franchisee's head. And if  
13 the franchisee wants to get their equity out -- you  
14 know, if they're coming with some kind of a settlement  
15 between the franchisor and the franchisee, in order  
16 for the franchisee to feel like they're getting their  
17 equity, their investment out, they are pressured.  
18 They are forced to sign saying that they won't talk  
19 about their experience with anyone.

20 So I find it almost the opposite. A list  
21 of demands is given to the current franchisee. You  
22 want out. We don't want you. You don't want us. You  
23 want out. Press hard. There's three copies. You're  
24 not going to talk about this to anyone.

25 So in order to get your equity out, you

1 have to sign something like that. It's not exactly  
2 the franchisee --

3 THE COURT REPORTER: I'm sorry. I didn't  
4 hear you.

5 MS. KEZIOS: A franchisee is not exactly  
6 able to freely negotiate or bargain to get out of the  
7 transaction.

8 And there's very -- I can only think of  
9 only one chain out of all the two or three thousand  
10 where franchisees who left the system really wanted to  
11 hurt or defame the franchisor afterward.

12 But most franchisees when they leave the  
13 franchise system, they're trying to get out. They're  
14 trying to get away as fast as they can. And they want  
15 to get on with their lives.

16 I find it very unusual that a franchisee is  
17 going to continue to work to try to defame a former  
18 franchisor after they're out of the franchise.

19 MR. JEFFERS: You really do?

20 MS. KEZIOS: Yeah. There's only one chain  
21 in particular where these franchisees have it in  
22 for the franchisor.

23 MR. TOPOROFF: Martin.

24 MR. CORDELL: Well, I don't have a problem  
25 with orders that prevent franchisees from disclosing

1 trade secrets and things of that nature. On the other  
2 hand, the policy behind the disclosure document is to  
3 provide full and fair disclosure. And to the extent  
4 that gag orders prevent that, from a policy standpoint  
5 I think we really need to take a look at that.

6 MR. TOPOROFF: Okay. We're going to move  
7 on, and that is Myra is going to lead a short  
8 discussion on possible fixes to the problem.

9 So Myra -- now, again we're not talking  
10 about the merits. We're talking about potential fixes  
11 for gag orders, confidentiality agreements, call them  
12 what you want.

13 Myra.

14 MS. HOWARD: I'm just going to start by  
15 building on what Martin left us with, which is that  
16 the purpose of the disclosure document is disclosure.  
17 And if, for instance, the list of franchisees in Item  
18 20 includes out of the 100 franchisees 50 that are  
19 under gag orders, for instance, is that an important  
20 piece of information that prospective franchisees  
21 should have? If the number is two, should prospective  
22 franchisees know this?

23 So I guess the question on the table is:  
24 Should this be an item of disclosure, whether or not  
25 current or former franchisees are under gag orders,

1 and if so, for instance, how many are?

2 Gary.

3 MR. DUVALL: No, it should not be an item  
4 of disclosure, and the reason is that there is a  
5 trade-off in policies here between disclosure, which  
6 is of course very important, and the policy leading to  
7 the settlement of disagreements.

8 A franchisee who enters into a contract  
9 with a franchisor to not disclose confidential  
10 information is presumably receiving consideration for  
11 that. It may be a mutual promise to not disclose  
12 information or a mutual promise not to defame one  
13 another, or it could be money. It could be a lot of  
14 things.

15 So if you require the disclosure of  
16 confidentiality agreements, you will discourage  
17 settlement of disputes, and you will prevent  
18 franchisees from getting consideration from those --  
19 for those agreements. And that is more important than  
20 whatever benefit -- disclosure benefit is received.

21 MS. HOWARD: Martin.

22 MR. CORDELL: Well, I guess I will take a  
23 different tack here. I think that's a good idea.  
24 I've not heard that -- actually considered that idea  
25 before.

1                   And I think in Item 20 since there's  
2 already disclosure of the franchisees required, it  
3 takes very little to add another column for  
4 franchisees under gag orders. And I like that idea  
5 for a couple other reasons as well.

6                   As I'm sitting here thinking, it would  
7 actually save the franchisee the time and trouble of  
8 contacting 50 franchisees who are under gag order.  
9 So in terms of being more efficient for the  
10 franchisee, that would be helpful.

11                   I'm less concerned about franchisees defaming  
12 franchisors. And typically I think franchisees --  
13 prospective franchisees when they go to talk to  
14 franchisors, former, existing franchisees, they really  
15 are looking for factual information on the operations of  
16 the business; the earnings, cost, and that sort of  
17 thing, and they're not going to be interested in trade  
18 secrets because they're going to get that information  
19 later anyway.

20                   And the defamation issue, I think it's kind  
21 of a non-issue because a former franchisee would be  
22 very foolish to defame a former franchisor. And they  
23 can do that whether they're under the gag order or  
24 not.

25                   MS. HOWARD: Howard.



1                   MR. BUNDY: I think it would be very useful  
2 to add a category of disclosure somewhere, perhaps in  
3 Item 20, that disclosed either the number or  
4 percentage of those subject to gag orders. In a  
5 perfect world I would have a list of those that are  
6 subject to it, so I didn't have to make all those  
7 extra 75 calls. But I could live with or without  
8 that. It's more important to disclose the fact that  
9 they do exist.

10                   And I guess I'm concerned from a policy  
11 point that there ought to be some threshold before  
12 the obligation to disclose kicks in. An isolated  
13 incident should not brand you -- give you the brand of  
14 being a gag order -- or that's a pretty -- that's like  
15 a 666 or something on your forehead. I mean, it's not  
16 a pretty picture. So, you know, there ought to be  
17 some threshold of, you know, how many would be -- of  
18 your former franchisees have been subject to this.

19                   I don't think it should ever be unlawful  
20 for people to enter into those; although, frankly we  
21 find that by guiding our prospective franchisee  
22 clients to ask a couple of questions that probably  
23 don't violate it -- we simply ask are you subject  
24 to an agreement not to; are you happy with the outcome  
25 of the underlying dispute; I'm happy; I've got a

1 smile on my face, or can't say -- you know, you learn  
2 a lot that way.

3           So gag orders frankly are pretty  
4 ineffective ways of keeping prospective franchisees  
5 from gaining the information that they want. That  
6 doesn't change the fact that I tell my franchisee  
7 clients don't talk to those people for the reasons  
8 I've talked about.

9           MS. HOWARD: Judy.

10           MS. GITTERMAN: I think that in order to  
11 encourage settlement of dispute without the necessity  
12 of going to litigation, there should not be disclosure  
13 of which franchisees are under gag orders because you  
14 should have an incentive to settle without going to  
15 court.

16           I mean, you said that you have to disclose  
17 litigation settlements. But many times that's the  
18 whole purpose that parties want to engage in  
19 alternative dispute resolution or some type of  
20 informal settlement process, so that it doesn't have  
21 to become something that is publicized.

22           And then there is the big question mark of  
23 what does it mean. It may be something particular to  
24 that franchisee which really is of no interest to the  
25 prospective franchisee and having the label of a gag

1 order just probably would be a disincentive to  
2 smoothing out relationships.

3 MS. HOWARD: Carl.

4 MR. JEFFERS: Yeah, actually Howard started  
5 on the track that I would go further down, which is  
6 that -- as sort of a compromise area with where Susan  
7 is or where others that felt there was no need -- I  
8 start with your original opening study -- or scenario  
9 rather.

10 If a system has 100 franchisees total, and  
11 50 of them are under gag orders, I think that is of  
12 material enough significant information that  
13 franchisees -- prospective franchisees ought to have  
14 it available to them. That says a lot to me about  
15 something going on in that system.

16 If they have 100 franchisees, and 2 of them  
17 are under gag orders, I don't think that's the kind of  
18 thing that ought to be just automatically required to  
19 be disclosed.

20 And I think that there is perhaps -- if you  
21 want to do something in this area, because I would be  
22 comfortable if you didn't, but if you wanted to do  
23 something in this area and decided to do something, I  
24 would ask you to consider a threshold, that if  
25 somewhere between 20 or 30 percent of your franchisees



1 briefly, and then we need to push on.

2           MR. DUVALL: One other aspect that would  
3 lead me to believe this is a mistake is that in a  
4 mediation, it is typical that the parties will enter  
5 into a confidentiality agreement with respect to the  
6 mediation. That is it's not only typical, but it's  
7 really an essential part of a successful mediation.

8           So any required disclosure will discourage  
9 mediation unless it carves out the requirement to  
10 mediate. Franchisors and franchisees have been  
11 embracing mediation in greater numbers. It's been a  
12 successful way of reducing conflict, reducing  
13 litigation, reducing legal fees, and patching  
14 relationships. And this proposal could adversely  
15 affect the choice of mediation as an ADR technique.

16           MS. HOWARD: If we just for a moment take  
17 as a proposition that this is important information  
18 franchisees should be able -- that they should be able  
19 to discover quickly and easily, what about the idea of  
20 under Item 20b where the names and addresses are  
21 listed, similar to what Martin suggests, which was to  
22 have a column whether or not a franchisee is under a  
23 gag order, what if there's an asterisk next to each  
24 person's name where that individual is under a gag  
25 order?

1 Susan.

2 MS. KEZIOS: We're not talking about  
3 litigation settlements? We're talking about mediation  
4 settlements?

5 MR. TOPOROFF: Depends when the mediation  
6 occurs.

7 MR. DUVALL: I believe we are. That's what  
8 I thought.

9 MR. TOPOROFF: Are you talking about post --

10 MR. DUVALL: I think the word gag order is  
11 getting in the way. We're talking about confidentiality  
12 agreements. That's what we're talking about. That is  
13 an essential part of the mediation.

14 MR. TOPOROFF: If we're talking about  
15 post-complaint settlements, mediation, or what have  
16 you, that's off the table. That's not what we're  
17 talking --

18 MR. DUVALL: We're not talking about --

19 THE COURT REPORTER: I'm sorry. You're  
20 both talking at the same time.

21 MR. TOPOROFF: We're talking about  
22 instances where there has not been any complaint filed  
23 in court.

24 MR. DUVALL: Right.

25 MR. TOPOROFF: So if you want to mediate a

1 dispute -- there are two different ways to mediate.  
2 There are many different times when a dispute might be  
3 mediated, pre-filing of the complaint or after a  
4 complaint is filed, and it goes to arbitration or  
5 something where the parties might want to settle on  
6 their own. We're not talking about those. We're  
7 talking about where there has not been a complaint filed  
8 in the court.

9           So getting back to Myra's proposal -- again  
10 there are basically two proposals. One, we already  
11 discussed number and percentage. And the comments  
12 that came back were perhaps we should also consider  
13 some kind of threshold.

14           But the other is if you have the list in  
15 Item 20 of the names and addresses and telephone  
16 numbers of existing franchisees and terminated  
17 franchisees for that matter, should there be -- or  
18 would it be beneficial to have the franchisor just put  
19 a little asterisk next to the name with some kind of  
20 indication saying those that are under the asterisk  
21 have signed gag orders basically signaling two things.

22           One, that the company uses gag orders,  
23 confidentiality agreements, call them whatever you  
24 want. And, No. 2, perhaps signaling that you don't  
25 want to call these people because you're going to

1 waste your time.

2 MS. KEZIOS: Yes to the asterisk. Yes to  
3 columns. No to threshold. Whether there's 2 or 222  
4 franchisees that are under gag orders, that ought to  
5 be listed because I would not trust the franchisor's  
6 side of the fence because then I've got to rely on the  
7 franchisor's side of the fence to tell the truth.

8 And they could always say forever and ever  
9 and ever we never hit the threshold. We don't have  
10 20 percent of our former franchisees. So how is  
11 anyone going to know whether that's true or not? So  
12 whether it's 1 or 2 or 100 or 102, the asterisk needs  
13 to be put in.

14 MS. HOWARD: Howard.

15 MR. BUNDY: I'm troubled by something here.



1 portion of Item 20 that deals with now former  
2 franchisees to give a more meaningful figure, because  
3 the fact that 1 out of 100 of 1996's formal franchisees  
4 had a gag order does not really fairly present the  
5 picture if you have 80 out 100 in 1995, and those have  
6 washed off the table.

7           You don't get a very good picture of a  
8 trend in any economic analysis if all you're looking  
9 at is one fiscal year or one 10 or 15 week period.  
10 You need at least -- in my view you need five years.  
11 I would acquiesce to three years because that seems to  
12 be the standard that we've all adopted. And from  
13 that, then you can see a trend.

14           And from the franchisor's point of view,  
15 perhaps you do have to disclose that 85 out of 100 in  
16 '95 were, and that only 1 or 2 in '96 were. That  
17 leaves the obvious implication that, hey, this  
18 franchisor used to be a bad actor, and now they're a  
19 good actor.

20           And you can present it that way in a lot of  
21 respects. And so I think it can cut both ways. But I  
22 think you need more data than what is now being  
23 disclosed. And you do need the differentiation, for  
24 example the asterisk thing, to indicate it, which  
25 raises a peripheral point which becomes relevant

1 here. I was just going to hold this, and do it on  
2 comment, but I'll go ahead and throw it out because it  
3 does relate to this.

4           The issue of the manner of presentation of  
5 that list of former franchisees. I'm finding more and  
6 more franchisors who simply give a 300 page, or 30  
7 page more commonly, list of all of their franchisees  
8 in alphabetical order or by state or by city with no  
9 indication of which of those are the former  
10 franchisees. They simply bury them in there along  
11 with everybody else.

12           So in order to find out who the 233 former  
13 franchisees are, you have to call 3,000 franchisees.  
14 I reviewed one of those the night before last. And  
15 that client wound up not buying largely because of my  
16 criticism of that fact.

17           MS. HOWARD: Dennis.

18           MR. WIECZOREK: I'll say it very quickly.  
19 This is a solution in search a problem; that there is  
20 very little data that indicates that this is a  
21 problem. You know, the only person here that I've  
22 heard so far that says it is a problem to a great  
23 degree is Susan.

24           And, you know, I don't want to ballyhoo our  
25 firm and what we do, but in my experience over 20

1 years, I haven't done one of these. And I don't know  
2 of anybody in the firm who's ever done something like  
3 this. That's No. 1.

4           No. 2, I think that the solution is worse  
5 than the disease here because you're talking about  
6 asterisks and notations that are going to go on a  
7 list. That is on the former franchisee list? Is  
8 it going to go in the table that shows the numbers?  
9 And that of the ten people who were terminated last  
10 year, you're going to have to asterisk and say three  
11 of these people are subject to gag orders?

12           Then you have a tabular list of all the  
13 former franchisees. Do you asterisk those? What about  
14 the existing franchisees? There are people that enter  
15 into -- who in theory enter into these things that are  
16 still franchisees. Are we going to asterisk them and  
17 also note that?

18           It's easy for the FTC to say this because

1 to put these asterisks and notations in our offering  
2 circulars. So I don't really -- No. 1, I don't see  
3 the problem. I'm still bewildered as to where this  
4 problem is coming from.

5           And, No. 2, the only solution that I would  
6 even consider would be a sentence in Item 20 saying  
7 some of the franchisees may have entered into  
8 confidentiality agreements which will not allow them  
9 to speak to you, period.

10           And let people make the calls, and they'll  
11 hit those people. And they'll get turned off or  
12 turned on or whatever they're going to do. That's it.  
13 I don't buy this asterisk and notations. It's going  
14 to drive us crazy. We have enough of a problem  
15 keeping the circulars in good shape as it is. This  
16 makes it much worse. And I don't think it's a  
17 problem.

18           MS. HOWARD: Any final comments here?

19           MS. KEZIOS: But if your firm does not do  
20 prgrgrgÜ0 0n turnle.is them.pe ir

1 I hear talk. I see no evidence that this is  
2 occurring.

3 MR. TOPOROFF: Well, that cuts both ways on  
4 a number of scores. We don't have empirical evidence  
5 on a number of things, in particular issues that are  
6 near and dear to franchisor's hearts also.

7 When franchisors talk about international  
8 sales, we didn't have facts and figures on those  
9 either. So it really cuts both ways. But I don't  
10 want to get into that.

11 Anyway, it is five o'clock. I'm pooped.  
12 I'm sure everybody else is.

13 MS. KEZIOS: Is that on the record?

14 MR. TOPOROFF: It's on the record, and I  
15 don't mind it being on the record because it's a fact.  
16 We don't have time to entertain other thoughts on  
17 other issues. It is late in the day. However, again,

1 if you will for the mike, we'll be happy to discuss  
2 any issues at length.

3           So with that I really want to thank  
4 everyone for taking the time to be here. It was very,  
5 very productive from our perspective. We know that  
6 this was costly in terms of flying here or taking off  
7 time from work, so we do greatly appreciate it.

8           I also want to thank the stenographer who  
9 is doing an excellent job. A round of applause. It's  
10 in the record.

11           MS. HOWARD: Well, I would just like to  
12 mention as a reminder, our final workshop will be on  
13 business opportunities in Washington D.C. November  
14 20th and 21st. If anyone is interested in attending,  
15 let us know.

16           MR. TOPOROFF: And with that -- Howard.

17           MR. BUNDY: I think it would be appropriate  
18 for us to thank you guys for coming to Seattle. It  
19 hasn't happened often, and we're glad to have you  
20 here and have the opportunity to meet with you here.

21           MR. TOPOROFF: Thank you, we appreciate  
22 that. And with that, the meeting is closed.

23           (Meeting adjourned at 5:05 p.m.)

24           (Meeting concluded at 12:00 p.m.)

25

1 C E R T I F I C A T I O N O F R E P O R T E R

2 DOCKET/FILE NUMBER: R-511003

3 CASE TITLE: FRANCHISE RULE

4 MEETING DATE: NOVEMBER 7, 1997

5

6 I HEREBY CERTIFY that the transcript contained  
7 herein is a full and accurate transcript of the notes  
8 taken by me at the hearing on the above cause before  
9 the FEDERAL TRADE COMMISSION to the best of my  
10 knowledge and belief.

11

DATED: NOVEMBER 17, 1997

12

13

14

MARGARET BUSTOS, CSR

15

16

17

18

19

SARA J. VANCE, Proofreader

20

21

22

23

24

25