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FEDERAL TRADE COMMISSION

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In the matter of:                    )  
  ) Matter No. R-511003  
FRANCHISE RULE                        )  
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Friday, November 7, 1997

Federal Trade Commission SRO  
915 Second Avenue, Room 2886  
Seattle, Washington

The above-entitled matter came on for meeting,  
pursuant to notice, at 9:16 a.m.

1 APPEARANCES:

2

3 ON BEHALF OF THE FEDERAL TRADE COMMISSION:

4

5 STEVEN TOPOROFF, ESQUIRE

6 MYRA HOWARD, ESQUIRE

7 Federal Trade Commission

8 Bureau of Consumer Protection

9 6th & Pennsylvania Avenue N.W.

10 Washington, D.C. 20580

11 (202) 326-3135

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P R O C E E D I N G S

2

MR. TOPOROFF: We're on the record.

1 have a feeling that if they understood where I'm  
2 sitting today, I would have a serious problem on my  
3 hands.

4 I don't have the financial resources that  
5 they do to withstand a protracted legal battle, and  
6 that is fast where it's headed in our particular  
7 situation.

8 But I would like to back up for a minute  
9 and just tell you that I've had a franchise since  
10 1985. I've done well with it. I did well with my  
11 franchisor up until about three or four years ago.

12 The business changed in the United States.  
13 The temporary service industry, which by the way is  
14 what my franchise is, changed in the United States,  
15 and it became much more competitive. A lot of  
16 mergers, a lot of low margin business is being done,  
17 thus creating a problem for myself and the other  
18 licensees that are part of the system in that we  
19 give such a large share of money to our franchisor that  
20 we can no longer be competitive.

21 And what has happened is that the  
22 franchisor -- through his choice or their choice and  
23 through the choice of the existing franchisees, the  
24 whole system has shrunk. It used to be 80, 100  
25 franchises. It's less than 20 now. People have

1 gotten out because of the problems. The franchisor  
2 has elected to boot some people out. But the whole  
3 point of this is it just shrunk.

4           It's not what I bought into. I bought into  
5 a franchise in 1985 that was growing, vital. The  
6 president of the company talked about little incubators  
7 all over the United States, being franchisees. And fast  
8 -- we had a lot of crib deaths so to speak. But, anyway  
9 -- excuse me for that, but it just changed and changed  
10 and changed.

11           The service level -- due to the fact that  
12 we don't have -- the franchisor does not necessarily

1 which has had a serious impact upon all of us  
2 franchisees in our system, and that is that the  
3 franchisor elected to sell the company, and the deal  
4 will close within the next couple of weeks. That's  
5 happening right now as we speak.

6           And the company they sold to has offices in  
7 many of the franchise areas. For instance, I am  
8 headquartered in Portland, Oregon. There was a joint  
9 venture by this new franchisor -- well, soon to be my  
10 new franchisor, and they have elected to -- they  
11 entered the joint venture the 1st of October, and  
12 they've gone ahead and opened another two stores  
13 within five miles of my office in Portland, Oregon.  
14 Same situation exists here in Seattle. There are  
15 other cities and states that have a similar situation.

16           So now I've got a situation where the  
17 franchisor that I had has sold out to a much larger  
18 company who is operating against me. And it's, you  
19 know, incredible for me to comprehend that there is  
20 any way that can be right.

21           My licensing agreement with my franchisor  
22 said they can't operate against me or operate in my  
23 same territory. I have a protected territory.  
24 However, it's the position of these people, the  
25 acquirer and our franchisor, that since this larger

1 company is acquiring my franchisor, that it's not a  
2 problem because my licensing agreement is with my  
3 existing franchisor and not with the new franchisor.  
4 And I just take great exception to that.

5 I'm going to have two offices within five  
6 miles. These people are going to know everything  
7 there is to know about my business if they choose to  
8 because they can go to the departments that process  
9 those kind of things and learn that stuff.

10 During discovery in buying the company,  
11 there's no doubt about it, they've learned about my  
12 business in Portland and about the whole system. They  
13 will be competing against me and taking away temporary  
14 employees, consulting, and contracts that I might  
15 otherwise use in my area to make a living.

16 And I'll be basically funding indirectly  
17 this office that they just opened to get it off the  
18 ground. And I've raised issue with both franchisors,  
19 current franchisor and the new franchisor. I have  
20 personally written letters. My attorney has. And  
21 again their response has been most recently that we  
22 don't see any problem. We can open in your territory,  
23 and that's not an issue. And I believe it is.

24 So there's just many problems, and I think  
25 this last thing I touched on is a terrible problem. I

1 mentioned to Steve earlier that we're -- I don't have  
2 the money -- I don't have two or three million dollars  
3 to fund a legal battle with these people. They have  
4 the money. They have lots of money. Getting into  
5 litigation with them, which is unfortunately where I  
6 think I'm going to have to go, is going to about  
7 destroy me. It could destroy my business.

8           There are other licensees -- I wish that  
9 one had chosen to be here, but he's faced with losing  
10 his business because his own franchisor is competing  
11 with the same major client as his. They currently  
12 are. So he's got a serious problem on his hands there.

13           It's gotten so far that the office involved  
14 has called his office to talk about the contract when  
15 it comes up for bid, and that is just absolutely not  
16 right. You know, they're competing against each  
17 other.

18           Let me clarify one of the problems with the  
19 competition, and that is that we pay a royalty to our  
20 franchisor so they make a profit off of our business.  
21 Okay. Well, if they don't have that royalty built  
22 into their bill rate, they can charge less money.  
23 Just the percentage that they make in the profit they  
24 can charge for less money because its going directly  
25 to them. You see, it's cut out of their picture.



1           So of course they're going to think it's  
2 okay to offer more money. They're going to make more  
3 money. That kind of kicks it off.

4           Can I go off the record for a moment?

5           MR. TOPOROFF: We're going to take a break.

6           (Discussion off the record.)

7           MR. DOE: I'm ready to go back on the  
8 record.

9           I know the purpose of this meeting today is  
10 not to resolve my individual problems that I have,  
11 but I would like to raise the issue that it's a  
12 wonderful thing to look ahead at what is going to  
13 happen to other franchisees in the future; however,  
14 there are thousands of us out there in the United  
15 States that have so many problems that are vestiges of  
16 years gone by.

17           And I have a real problem -- or I guess  
18 what I'm trying to say is I wish the FTC would take a  
19 long, hard look at the existing franchises and some of  
20 these contracts.

21           There is no end to my contract. If I can  
22 -- I can buy out of this thing, but it's going to cost  
23 me money that I don't have. I would have to spend 4  
24 to \$600,000 to buy out, plus legal fees, and cut  
25 through a whole bunch of red tape through the

1 franchisor. I mean, it could take me a year or two to  
2 do that. And I don't have that money hanging around.

3           So I wish and I would hope that the FTC  
4 will pay attention to the existing franchises and take  
5 a long look at some of our existing problems. These  
6 are problems that go back to 1985, you know, when  
7 I bought into the system. I didn't know much better  
8 in 1985. If I had known then what I know today, I  
9 would not have bought this franchise. So -- okay.  
10 I'll pause here. Any questions?

11           MR. TOPOROFF: Myra, do you have any  
12 questions?

13           MS. HOWARD: No.

14           MR. TOPOROFF: I just have one, and that  
15 is -- I just want to clarify why it is that you are  
16 using a different name. Is it that you fear possible  
17 retaliation from the franchisor? Is it that you've  
18 signed some kind of agreement or order that prohibits  
19 you talking about your experience? If you could just  
20 clarify that for us.

21           MR. DOE: I have not signed any kind of  
22 agreement that prohibits me from talking about my  
23 experience. This franchisor has exhibited over the  
24 past 12 years that I've known them to be retaliatory.  
25 They're embroiled in lawsuits right now with the other

1 franchisees.

2           They publicly humiliate franchisees that get  
3 out of favor. They sit in various meetings -- this  
4 just happened a couple weeks ago in New York -- and  
5 talk about franchisees who are not present, and they  
6 must be crazy because they think they have some sort of  
7 right. It just goes on and on and on.

8           It's not only personal humiliation. It is  
9 also almost harassment. And I know that if they  
10 walked through that door right now, I would be in  
11 more trouble than I know what to do with. I would get  
12 a letter from their lawyer like that, and they would  
13 not take kindly to that.

14           MR. TOPOROFF: Thank you.

15           MS. HOWARD: I do have a question. When  
16 you were speaking earlier about the percentage of  
17 money that goes to the franchisor in royalties and you  
18 said that was -- it was too much money, that you  
19 couldn't be compete --

20           MR. DOE: That's correct.

21           MS. HOWARD: -- are you saying you can't be  
22 competitive with their own outlets or with other  
23 companies that are similar to yours?

24           MR. DOE: Both. Both. A point I maybe  
25 have not made very well is everything has changed

1 since 1985. The business -- the temporary service  
2 industry has changed incredibly. I think everybody in  
3 this room knows that. So there are many more  
4 temporary services.

5           The industry in 1985 was probably, you  
6 know, I don't know, a billion. Now it's 40 billion,  
7 something like that. It's a huge amount of growth.  
8 Well, because it has gotten to be that competitive,  
9 what we paid at that time for licensure in 1985 is no  
10 longer competitive in the industry. It's difficult  
11 for me to go out and compete against the major  
12 temporary services in my market. Well, that's one  
13 issue related to that license agreement.

14           But the issue that's in my face today is  
15 the fact that I'm going to be competing against my  
16 licensor in effect, indirectly I guess and directly.  
17 And they are going to not have to charge as much for  
18 the same hour's worth of work, pure and simple. It's  
19 that profit margin that I'm currently getting that  
20 they don't have to charge.

21           MS. HOWARD: So the percentage that you're  
22 paying has not changed. What you're saying is that  
23 the market has changed?

24           MR. DOE: They have made some minor  
25 adjustments one time since 1985, they being the

1 licensor, and they're very restrictive.

2           There are problems with accomplishing them,  
3 and I would say my best guess is most licensees don't  
4 accomplish the requirements to get a little bit more  
5 money. But it's not much more money. It's, you know,  
6 dollars a month is about what it boils down to.

7           MS. KEZIOS: Can I ask him some questions?

8           MR. TOPOROFF: Susan.

9           MS. KEZIOS: Do you know of franchisees  
10 trying to get out of contracts?

11          MR. DOE: Absolutely.

12          MS. KEZIOS: Other than the litigation,  
13 are they trying to cut deals with the franchisor?

14          MR. DOE: Yes.

15          MS. KEZIOS: Do the franchisees when they  
16 get out, do they have to sign any kind of gag orders,  
17 gag rules?

18          MR. DOE: Absolutely, non-disclosures. I  
19 seen franchisees leave the system, and I've talked to  
20 them within a month, and they can't talk to me. They  
21 can't tell me what the deal was, what happened,  
22 anything more about it.

23          MS. KEZIOS: Can they -- if a prospective  
24 franchisee called them to ask about their experiences  
25 within the franchise system, would they be able to

1 speak to the prospective franchisee?

2 MR. DOE: I don't believe they can. I  
3 believe they're gagged, period, when they're out of the  
4 system.

5 MS. KEZIOS: Okay. In your contract and in  
6 -- in your contract, is there a post-term covenant  
7 not to compete?

8 MR. DOE: Yes.

9 MS. KEZIOS: So if you get out or if these  
10 other people get out, you can't work in the business  
11 that you've been in since 1985?

12 MR. DOE: That's correct. Yeah. Unless I  
13 pay that large amount of money I mentioned.

14 MS. KEZIOS: So if you pay that large  
15 amount of money, that's the consideration given to  
16 them so you can continue to work?

17 MR. DOE: But they keep my phone number and  
18 my indemnity that I currently have.

19 MS. KEZIOS: So in effect they've confiscated  
20 your business?

21 MR. DOE: That's correct.

22 MS. KEZIOS: You've built the business, and  
23 they've confiscated it?

24 MR. DOE: That's correct. And I would have  
25 to change all my phone numbers and change the name,

1 and I would have to make sure, because I think they  
2 would sue me if I didn't, that my staffers would never  
3 use the name again.

4 That would be a monstrous task. Let me just  
5 put it that way. I've probably got 100 to 300  
6 temporaries, contracts, and consultants out working,  
7 and it would be a huge task to accomplish that.

8 MS. KEZIOS: And going back to your  
9 protected territory, you said in your contract you're  
10 supposed to have a protected territory?

11 MR. DOE: That's correct.

12 MS. KEZIOS: But they're saying that when  
13 the merger occurs, it doesn't apply to the new  
14 franchisor's units that they may put up or that they  
15 have up already?

16 MR. DOE: Yeah, because they're saying my  
17 agreement is with my existing franchisor and not with  
18 the new franchisor. That's what they're telling me.

19 MS. KEZIOS: And going back to the gag  
20 orders again, out of this 80 or 100 franchisees that  
21 you said were in existence -- and there's, what, 20  
22 now, 20 percent?

23 MR. DOE: Probably 18 now.

24 MS. KEZIOS: Out of those 80 that have  
25 gotten out of the system, bought out or transferred

1 out or whatever, what percentage of them do you think  
2 have had to sign gag orders?

3 MR. DOE: I would believe all of them  
4 have. I would believe that. I believe that to be just  
5 the way they operate.

6 MS. KEZIOS: Okay.

7 MR. DOE: I have here with me a letter that  
8 I can give you parts of, which spells out what the  
9 franchisor's lawyer has to say about this. I'm going  
10 to have to edit out the franchisees' names and the  
11 lawyer's name and so on and so forth.

12 Your letter of September 29th, 1997 has  
13 been referred to me. This is corporate counsel for my  
14 franchisor. In that letter it is clear that you're  
15 continuing Mr. Doe's attempts to find a way to assert  
16 that the licensor is about to breach its licensing  
17 agreement with me, Steve Doe.

18 The facts that you have stated in your  
19 letter regarding -- my lawyer wrote a letter to the  
20 franchisor, and this is the response to that. The  
21 facts that you have stated in your letter regarding  
22 the form of the acquisition and the use of the  
23 licensor trademarks and the name are incorrect.

24 Your client's contractual dealings have  
25 been with the licensor. Since its name changed in



1 1995 -- they changed their name along the way -- your  
2 client has never contracted with the publicly trading  
3 holding company which is involved in the acquisition.  
4 So that's what they wrote to my lawyer.

5           The merger has no effect on your client's  
6 licensing agreement, and there has been no assignment  
7 of that agreement. Any other operations in Portland  
8 will not be under the licensor's name, will not be  
9 owned by the licensor, and will not use the licensor's  
10 systems or marks; therefore, there will be no breach of  
11 the provisions of paragraph 1B as to the enforceability

1 Myra?

2 MS. HOWARD: No.

3 MS. KEZIOS: None.

4 MR. TOPOROFF: Okay. Well, thank you very  
5 much. We appreciate your taking the time to speak  
6 with us today.

7 MR. DOE: Thank you for listening to me  
8 today. I appreciate it.

9 MR. TOPOROFF: We'll go off the record.

10 (Discussion off the record.)

11 MR. TOPOROFF: We're back on the record,  
12 and the speaker is going to continue.

13 MR. DOE: UFOCs. When we opened the  
14 operation in 1985, I'm mostly convinced I did not  
15 receive the UFOC. I did receive a UFOC in 1987 for an  
16 addition to my territory. The language in the UFOC is  
17 different than what is in my actual contract.

18 Now, that's an issue that my lawyer is  
19 working with right now, because the UFOC is probably  
20 two inches thick, and my contract is about an inch and  
21 a half thick.

22 But I don't believe that from what I've  
23 seen of the UFOC and the operation of the franchisor  
24 that they are following it, nor do I think they care.  
25 I think they see it as administrative trivia. So I

1 just wanted to bring that issue up.

2 MS. KEZIOS: What is the term of your  
3 contract?

4 MR. DOE: Until I die. It's forever.

5 MS. KEZIOS: It's perpetual?

6 MR. DOE: Yeah.

7 MS. KEZIOS: Okay.

8 MR. TOPOROFF: Is that true for other

1 record.

2 (Discussion off the record.)

3 MR. TOPOROFF: So we're back on the record.

4 We're going to be with our second speaker.

5 I just want to reiterate that this is an opening  
6 meeting. It's being transcribed. A copy is going to  
7 be put on the public record as well as on our internet  
8 web site. So with that background, I'll turn it over  
9 to our second speaker. Please identify yourself  
10 first.

11 MR. RAFIZADEH: I'm Mehran, M E H R A N.  
12 Rafizadeh is my last name, R A F I Z A D E H. And I  
13 own franchises under two different brands, General  
14 Nutrition Centers and Gloria Jean's coffee stores.

15 Basically the reason here -- the reason  
16 I'm here today is to voice my views on some of the  
17 practices that are going on in the franchise industry  
18 in the hope of in the future there is legislation that  
19 can even the playing field a little bit in this  
20 industry.

21 Personally I probably am somewhat of an --  
22 I assume I'm somewhat of an atypical franchisee in  
23 these hearings. The systems that I'm affiliated with  
24 and my business in general is doing very well; however,  
25 that does not mean there are practices going on which

1 basically do not take advantage or abuse the system.

1 to the first franchise store that I put in Las Vegas,  
2 which caused a drop in sales of in excess of 35 percent  
3 in that location. Okay.

4           At the time they could have easily taken me  
5 up on my offer, however. They could have listened to  
6 me and given me the freedom or the autonomy or the  
7 input to pick these selections jointly with them.

8           I'll tell you why they pass up the  
9 opportunity to put seven stores up. And so far they  
10 have been only able to put three stores up there in Las  
11 Vegas, but yet they chose these locations so poorly.

12           No. 1, I think they choose these locations  
13 the way they do because it is easier for them to  
14 Piggyback on an existing successful unit than literally  
15 go out there and build a unit that you have to go  
16 through all the motions building the customer base and  
17 the volume.

18           Secondly, by signing -- in the case of GNC  
19 -- now, this might be very particular to them. By  
20 signing national contracts for new locations, since  
21 GNC owns their own stores and a franchise group of  
22 stores, they do have the funding to go out there and  
23 sign 300 leases -- and they have done this -- 300  
24 leases a year through major real estate brokerage  
25 firms, put these stores up, and worry about selling

1 them later.

2           The reason for that is because these real  
3 estate developers and companies, they do provide quite  
4 a bit of incentive, such as build-up allowances and  
5 up-front cash for a branch to put their stores in  
6 their properties.

7           This money is additional profit once the  
8 store has been sold. Not only did they make a nice  
9 income by just signing those leases, they make the  
10 additional profit from the selling of the franchise  
11 fee and so on of the franchise.

12           Therefore, in every instance in every city  
13 that I operate the GNC stores, I have offered to  
14 supersede the number of units that they were going to  
15 put in that market if they would have given me the  
16 opportunity to choose these locations alongside with  
17 them; however, that never happened.

18           And at the same time, they encroached very  
19 -- especially on the most successful stores that I  
20 have had in those markets. Case in example, I have  
21 another very successful store in Portland, Oregon. At  
22 the time that I opened the store, the nearest store  
23 was 2.5 miles away. I built this store to a fairly  
24 admirable volume. Within the past year two stores have  
25 been opened very close to this store.

1           Again Portland is a market that they have  
2 an inadequate presence in. They could easily have  
3 picked different quadrants in the city to saturate the  
4 market.

5           In addition to that, they claim -- first of  
6 all General Nutrition Center offers zero protection  
7 with their base -- and I know there are other  
8 franchisees -- excuse me, franchisors which offer some  
9 form of criteria for putting another store where  
10 there's a base population, a density of population  
11 within a certain number of miles. GNC offers zero.

12           And yet they claim that often by opening a  
13 store very close, they are cultivating the culture for  
14 that product, and both stores initially experience a  
15 drop, and then they pick up and supersede their  
16 previous volume. That has not been the case.

17           That was not the case with the store that I  
18 had in Las Vegas and in turn I was forced to sell it  
19 back to them incidentally after a drop in volume,  
20 considerable.

21           And I think though they tell that to a  
22 prospective franchisee, at least it should be  
23 indicated in the standard franchise agreement that  
24 when they are doing that, what their experiences have  
25 been, not just simply as a pitch to the franchisee



1 that this -- by opening stores around you in the  
2 future, if we may or if there are, you will not  
3 experience any loss of business, and you experience an  
4 initial drop, and from there on you pick back up and  
5 even supersede your previous volume.

6           This has never been documented. They have  
7 never been forced to be accountable for it. And I  
8 know from talking to other franchisees that is not the  
9 case.

10           Besides the issue of encroachment, another  
11 issue that probably most franchisees experience, again  
12 talking about GNC, General Nutrition Center, is the  
13 issue of prices. As a franchisee when you buy into a  
14 system, you are buying into a system agreeing to  
15 pay franchise fees and ongoing fees in the form of  
16 royalties or what have you in order to have an  
17 advantage in the marketplace against the independents  
18 or others in that industry.

19           However, it seems that franchising has  
20 become a vehicle for the franchisors to just  
21 continuously create profit centers. I will give you  
22 an example in the case of the General Nutrition  
23 Center.

24           General Nutrition Center has got an  
25 extensive distribution center which distributes their

1 own house brands and national brands. The house  
2 brands contractually we are obligated to buy, and we  
3 really do not have any control over their pricing;  
4 however, the national brands through the years  
5 developing contacts with manufacturers and approaching  
6 them, we have been able as individual franchisees  
7 -- and recently we formed a co-op. We formed a  
8 franchisee association and a co-op. We have  
9 approached manufacturers and have been able to  
10 negotiate far better prices than this large system  
11 offers and claims that is offering to us.

12           Their claim is that they are offering to us  
13 the best possible price that can be obtained there.  
14 That's not the case. If I can go out there with  
15 six units and obtain the same brands and the same  
16 products and sometimes better quality products at far  
17 lower prices, then there is something wrong. As far  
18 as what is being promised as an advantage in that  
19 particular marketplace, that is not true.

20           And yet it would be fine if they would not  
21 interfere in that process -- contractually we are  
22 obligated to buy the house brands; fine -- but to give  
23 us the freedom to go out there and buy those other  
24 brands at better prices. And in confrontation they  
25 claim that they do; however, in reality they do

1 everything possible to sabotage that effort.

2           And here is a perfect example. I have a  
3 letter written by General Nutrition Center to the  
4 manufacturers -- pardon me. I'm looking at the wrong  
5 one. But that letter -- there is a letter on record  
6 from Bob Montanari, who is the senior buyer for  
7 General Nutrition Center, to the manufacturers whom we  
8 have contacted basically telling them that they do  
9 not need or want to deal with this group, referring to  
10 the co-op, due to the fact that by fragmenting this  
11 marketplace or this potential dollar amount that the  
12 franchisees spend, they are not doing anyone a favor.

13           Short of being in violation of antitrust  
14 laws in a very thinly veiled letter, they're  
15 threatening the manufacturers. Since they are the  
16 biggest company on the health food market, they are  
17 telling them that if you deal with the franchisees,  
18 we will not do business with you, you know. And that  
19 is wrong.

20           I think there has to be changes made to the  
21 standard franchise agreement to indicate and force the  
22 franchisor to provide the best possible price  
23 structure and services that they demand contractually  
24 for us to use and abide by. And if we can procure  
25 these service's products on the outside for better

1 pricing, we should have the freedom to do that. And we  
2 have done that.

3           Yet, besides that letter -- by the way, we  
4 are moving forward with the co-op and sending out our  
5 own catalog to the fellow franchisees to be able to  
6 buy these products directly. That letter was the  
7 first bit of retaliation that we saw, and we're  
8 waiting for the next round, and we don't know what  
9 it's going to be.

10           We already know they are contacting some of  
11 the manufacturers whom they work with closely. And  
12 again I heard from one yesterday that they are doing  
13 some very persuasive -- arguments are going on behind  
14 closed doors not to have them provide products to us.

15           Now, besides the issue of encroachment and  
16 issue of prices, there are other issues that -- like  
17 services that arbitrarily are being inflicted on  
18 franchisees on the whim of the franchisor. I will give  
19 you case and example.

20           Currently this is something that is going  
21 on with GNC. Initially the General Nutrition stores,  
22 they did not have a computer system when they started  
23 franchising in 19, I believe it was, 90. So there are  
24 franchises in the system that signed a ten year  
25 contract with no demand to have a, what is known as,

1 POS, point of sale, which is basically a computer  
2 system linked to a main frame in Pittsburgh.

3           A few years ago, four or five years ago,  
4 they did come up with a \$10,000 point of sale system,  
5 which since they brought -- rolled that system out,  
6 the contracts from that point on demanded the stores  
7 -- franchisees to buy the system, which is fine.  
8 Don't have a problem with that.

9           However, about six, seven months ago, they  
10 came out with an \$80 maintenance fee for the stores  
11 which do not have the point of sale system. Now, keep  
12 in mind these folks have signed to a ten contract  
13 which forces -- should force the franchisor to service  
14 their system with whatever pieces of equipment or  
15 hardware which was sold to them at that time if they  
16 do not wish to opt for it.

17           This \$80 -- and they have threatened -- by  
18 the way, this \$80 is mandatory. They automatically  
19 tag that to their monthly billing. Now what happens  
20 if a franchisee refuses to pay this \$80? Very simple.  
21 They stop shipping product to you.

22           What problem does that cause you? You say  
23 well maybe they can go out there and buy their product  
24 on the outside. Well, they can't because GNC has got  
25 proprietary house brands which we are forced to carry.

1 So if their shipments stop, they hold them in default  
2 because all of a sudden they don't have the full range  
3 of products and the house brands that they should have.  
4 So it's a vicious cycle.

5           And they have threatened to double that \$80  
6 to \$160 starting next year. By the way, we have  
7 reviewed the standard franchise agreement. This is a  
8 practice which is obviously not legal. There is  
9 nothing in the older franchise agreements that says  
10 they have to do that.

11           How they can get away with it? No. 1, the  
12 amount is small enough which they know individually  
13 franchisees will not probably spend the time, the  
14 effort, and the money to fight it legally.

15           And here's the ironic thing. By raising  
16 it to \$160 a month -- guess what the installment  
17 payment is to buy the computer system? Just a slit  
18 bit more. I think \$175 or something to that effect.  
19 So very cleverly they are pushing them to that price  
20 margin, so the franchisee basically gives up, and  
21 they pay the 175 rather than paying \$160 and not have  
22 the system.

23           In addition to that, there are issues with  
24 co-op advertising. We pay for a national advertising  
25 fund to GNC, which is, depending when the contract

1 was signed, 3 to 4 percent of the gross. Yet in 1995  
2 they came to an addendum to the standard franchise  
3 agreement trying to get the franchisees to pay an  
4 additional 3 percent for the local market, for the  
5 local advertising fund, which is fine. I have no  
6 problem with that.

7           However, they very cleverly and  
8 aggressively pushed towards doing -- they have these  
9 market funds which we participate in. However, they  
10 have total local market funds -- they have total  
11 control of these. And the reason that they very  
12 aggressively push and manipulate to prevent you from  
13 spending that 3 percent on your own on the advertising  
14 medium of your choice is because they have total  
15 control of these local market funds; therefore, by  
16 picking the product, the medium, and the method of  
17 advertising, their own corporate stores benefit from  
18 them greatly.

19           And there are various ways of -- methods of  
20 persuading franchisees to join this local market fund.  
21 Case in example, they constantly audit you. There are  
22 auditors in your store at all times. There are demands  
23 for proof of advertising, which, by the way is not on  
24 an incremental basis, but they wait a year, two years,  
25 and they say we have to see proof for the past two

1 years; otherwise, you will be liable.

2 I saw a letter, by the way, that said you  
3 can be liable from the inception of your franchise  
4 to this 3 percent. And the intention is simply to  
5 persuade the franchisees in the market to join their  
6 local marketing fund in addition to the national,  
7 which, of course, we all pay.

8 Besides that, in addition to that, there  
9 are issues of, as I said, arbitrary products that  
10 appear to write off various costs of doing business.  
11 Case in example, advertising material.

12 Up until this point basically the franchise  
13 fee and the national advertising fund that we pay to  
14 GNC covered all the posters, banners, everything that  
15 was sent to the stores on a monthly basis.

16 Now they are coming with products which are  
17 again mandatory; however, there's a price tag attached  
18 to them. Case in example -- and you have to keep in  
19 mind that in the case of larger systems, such as GNC,  
20 McDonalds, what have you, a simple product charged to  
21 the multiples of thousands of stores literally becomes  
22 a multi-million dollar profit center.

23 Recently we received this display. It's a  
24 wooden display for displaying books with wheels on it,  
25 which is known as a POP, point of purchase, probably a



1 foot and a half wide and five feet tall made out of  
2 slat wall, very cheap and inexpensive material. It  
3 was sent to the store mandatorily, and followed with  
4 it was a \$400 bill.

5 I can tell you something. Putting a piece  
6 of wood together like that doesn't cost more than 20,  
7 30, 40, \$50. However multiple \$400 by 1500 franchise  
8 stores. You know, it adds up. It adds up. And these  
9 are mandatory.

10 The fact is that the franchisors have  
11 enjoyed the position of being able to change the rules  
12 on you and come up with addendums and mandatory  
13 additions to the standard franchise agreement, and  
14 whether legally or not, they have been very forceful  
15 in -- on making the franchisees to abide by them or  
16 pay these bills.

17 Now, another issue besides that is the  
18 issue of building the stores. I will give you -- the  
19 franchisors continuously -- and again speaking in the  
20 case of General Nutrition Center, they have insisted  
21 whenever I build a new store, they pass on their  
22 cost, which is the best cost that can be obtained  
23 because of their size and buying power, in fixtures  
24 and construction, in the signage and everything else.

25 Having been one of the earliest franchisees

1 in their system, I have had the benefit of doing things

1 built, the same store cost me anything between 150 to  
2 \$200,000 to build.

3 Now, presumably I'm taking advantage of  
4 their buying power. They are giving me the best price  
5 in construction and fixtures and signage and everything  
6 else. Yet the same store cost me over twice than the  
7 one that I built by myself.

8 Again, I have -- you know, I would like to  
9 reiterate the fact that I don't have a problem  
10 building stores, expanding in a marketplace,  
11 contributing to the value of a brand. I think that's  
12 a job of the franchisor, and to an extent it should be  
13 the ambition of most franchisees; however, what I do  
14 have a problem with is the playing field that is very  
15 much tilted to the favor of the franchisor.

16 And there are no other products, no other  
17 investments out there -- if you buy a car, far smaller  
18 investment than a franchise often, you are protected.  
19 If you buy a house, often there are laws that protect  
20 you. However, here is an investment, in most cases  
21 one of the biggest investments most franchisees will  
22 ever make, yet there are literally no valuable  
23 protections against the franchisors.

24 Often even when there are judgments to the  
25 favor of the franchisee, they are often at best to

1 recover their legal costs or what have you.

2           Again, I think most franchisees are not  
3 looking for the blue sky in a sense of having the  
4 franchisor in a deadlock, if you will, because I fully  
5 understand the need of their brand to grow and expand.

6           However, there are many things can be done,  
7 many laws can be added, or demands can be levied on  
8 the franchisor to include in their standard franchise  
9 agreements or UFOCs to inform and educate the  
10 franchisee better, and in some cases to give the  
11 franchisee some degree of choice, alternative, and  
12 autonomy if they are with the system.

13           MS. KEZIOS: Buy backs.

14           MR. RAFIZADEH: Buy backs, yes. Recently  
15 in lieu of -- this is again speaking of GNC. In lieu  
16 of the association and the buying co-op, a letter  
17 roughly about two months ago was sent out by the C O of  
18 GNC, Bill Watts, basically saying that we know that  
19 some of you do not share our enthusiastic plans for  
20 future growth, so we are willing to buy your stores  
21 back for prices far higher than you have been quoted  
22 before.

23           So of course many franchisees -- from the  
24 last time I heard, 300 franchisees called in with  
25 interest to sell -- sell back. However, standard part

1 of these buy-back contracts are gag orders and no  
2 competition clauses ranging -- as far as the gag order  
3 and no competition clauses, they are standard and  
4 ranging in duration and length upwards of five years  
5 and five miles of any store that they own, which  
6 pretty much covers the whole country. They have  
7 quite a few stores. And also precluding them from  
8 any further participation in any lawsuits or any class  
9 action suits or what have you.

10           And literally by doing this, they are  
11 controlling the marketplace because these are  
12 individual franchisees that -- some of them even prior  
13 to becoming GNC franchisees, they were independent  
14 health food store operators that converted to GNC.  
15 And.

16           I think that is unfair, and I think that  
17 should be changed, or at least it should be indicated  
18 or declared to the franchisees -- or the prospective  
19 franchisees at the time that they buy the franchise;  
20 that in the case of sell backs or buy backs, there is a  
21 gag order. There is a no competition clause. But that  
22 is not, of course, as you know, in the standard  
23 franchise agreement.

24           That basically covers most of my issues.  
25 Now, I use the name GNC very frequently due to the

1 fact that even though I own other franchises, it's a  
2 system that I have the most number of stores with.  
3 But I can tell you maybe bar the specifics of the  
4 brand, these are very typical issues.

5           The degree of forcefulness that the  
6 franchisor imposes their will on the franchisee also  
7 depends on their size and their financial situation,  
8 and basically an evaluation of the franchisee,  
9 whether the franchisee -- their experience as business  
10 people and their ability to oppose or fight an issue.  
11 But these are very uniform, universal issues from -- to  
12 my experience, you know.

13           And basically that's all I have unless you  
14 have any questions for me.

15           MR. TOPOROFF: I don't have any questions.

16           MS. KEZIOS: I have some questions.

17           MR. RAFIZADEH: Sure.

18           MS. KEZIOS: Go back to the protected  
19 territory. In the UFOC what does it say about the  
20 protected territory?

21           MR. RAFIZADEH: They offer none.

22           MS. KEZIOS: Okay. But do they also say we  
23 have been known from time to time to come into the  
24 marketplace after you've built it out for two years,  
25 and this may in fact diminish your gross and/or net

1 revenue? Do they ever list that as a risk that you  
2 are taking in the UFOC?

3 MR. RAFIZADEH: No, to my experience none  
4 of the franchises that I have the UFOC or the standard  
5 franchise agreement ever indicated it in that way.

6 MS. KEZIOS: Do you think that would be  
7 useful for people?

8 MR. RAFIZADEH: Absolutely because this is  
9 something that -- believe it or not, a lot of people  
10 who buy franchises, they do not necessarily -- now, I  
11 came from a retail background, so I felt fairly  
12 confident and comfortable moving forward.

13 But you would be surprised how many people  
14 come from the private sector or the corporate life or  
15 what have you into franchising, in this particular  
16 case retail franchising, and it's a rude awakening to  
17 them. They absolutely do not have an idea what they  
18 are getting into. It is a shock.

19 And I know this because -- due to the fact  
20 that I was instrumental in forming this buying co-op,  
21 naturally a lot of franchisees from around the country  
22 call me. And to a lot of them it is -- it is a rude  
23 awakening.

24 And I think if nothing else, an entry like  
25 that into the UFOC or standard franchise agreement

1 might at least nudge them into researching things a  
2 little better. I don't think it will prevent them



1 besides GNC all the other independents in the health  
2 food business number to about I think 8,000, that is  
3 one third of them.

4 MS. KEZIOS: Okay. Do they say in their  
5 UFOC that they will negotiate the best possible prices  
6 for you, or that there is cross savings, or is this  
7 something that they just use in the sales process, a  
8 verbal sentence that they say?

9 MR. RAFIZADEH: The bulk of it comes on  
10 the sales pitch. A lot of things are said on the  
11 sales pitch. But also the UFOC and the standard  
12 franchise agreement does point to the direction that  
13 they are the largest of their type; therefore, that  
14 gives a franchisee an advantage.

15 And I think that's very clearly understood  
16 by most franchisees, that that advantage is in pricing  
17 and getting possibly the best pricing of its kind.

18 MS. KEZIOS: Do they disclose -- I'm  
19 assuming they disclose that they make a profit; they  
20 make money off of the sale of products to the  
21 franchisees? Do they say that in the UFOC?

22 MR. RAFIZADEH: I am not sure. I have not  
23 looked at the UFOC in a while, so I am not sure.

24 MS. KEZIOS: Would it be useful, do you  
25 think, to potential purchasers to put in the UFOC

1 in the section on pricing, buying goods that there  
2 is now a franchisee-sponsored purchasing co-op?

3 MR. RAFIZADEH: Oh, it would be extremely  
4 helpful. I think when we talk about leveling the  
5 playing field, if newer franchisees know the kind of  
6 pricing that can be negotiated and has been negotiated  
7 and is out there, it will be the ultimate tool to  
8 create a free market situation with the franchisor to  
9 reduce the price of their goods. Or for that matter  
10 if they cannot or they do not wish to provide these  
11 products at those prices, simply get out of the  
12 distribution of those products and simply distribute  
13 their own house brands.

14 MS. KEZIOS: Because otherwise right now  
15 new prospective franchisees won't even know that this  
16 franchisee-sponsored co-operative exists?

17 MR. RAFIZADEH: No. At this time, you  
18 know, we -- of course, we are doing our best to mail --  
19 we have put together a form of a catalog, and we are  
20 going to mail it to all the franchisees. But, no, at  
21 this time they don't, except for a few -- I'm sorry  
22 -- except for a few who have been instrumental in  
23 putting this co-operative together.

24 MS. KEZIOS: And also now that you have a  
25 GNC franchisee association put together, would that be

1 useful to put in the UFOC for prospective franchisees?

2 MR. RAFIZADEH: Definitely, and I will  
3 tell you why that can be very helpful. In the past  
4 whenever there have been new franchisees entering into  
5 the system, they were very efficient and quick in  
6 motivating, and, as I said, the sites are readily  
7 available, and moving them to these locations.

8 Just by the formation of the association,  
9 franchisees -- other franchisees -- and quite frankly  
10 most of the new franchisees once they receive the  
11 UFOC, if they are thorough, they call everyone on that  
12 list, or at least they call a few.

13 And recently a lot of us are getting calls  
14 from the franchisees who -- are getting calls from the  
15 newer franchisees inquiring about the franchise, and  
16 they are passing them onto the more experienced

1 of the franchisor pushing them into a location because  
2 this location is not making money, and it is their  
3 -- on their priority list to dump.

4 MS. KEZIOS: You talked a lot about  
5 arbitrary actions or arbitrary policies that the  
6 franchisor inflicts on the franchisees. In the UFOC  
7 do you remember -- I'm assuming it says that the  
8 franchisee must be in compliance with our operations  
9 manual at all times?

10 MR. RAFIZADEH: Right.

11 MS. KEZIOS: Yet does the UFOC say that  
12 this operations manual may change from time to time at  
13 the discretion of the franchisor?

14 MR. RAFIZADEH: Yes, it does.

15 MS. KEZIOS: Does it go on to say, and  
16 these changes may have material and negative impact  
17 upon you as a franchisee? Like is that listed as a  
18 risk factor at all?

19 MR. RAFIZADEH: No, it's not. It's not due  
20 to the fact that I think again if it is indicated with  
21 those wordings, it brings about a situation that  
22 probably the prospective franchisee will negotiate a  
23 little bit harder in their franchise agreement or may  
24 become a little more wise and aware if you will.

25 So, no, it does not. And that is how a lot

1 of things are -- as I said, arbitrarily are -- they  
2 come out of the blue and are inflicted, whether  
3 they're expenses or costs or demands on the system.

4 MS. KEZIOS: Because that in effect makes  
5 your operation manual a contract that you have to  
6 abide by, which you never signed?

7 MR. RAFIZADEH: Yes. Exactly. Exactly.

8 MS. KEZIOS: Okay. And one last question  
9 on the buy backs. What percentage do you think it is  
10 of franchisees who either sell their unit back to  
11 GNC or who sell it to somebody else, what percentage  
12 of those people have to sign a gag order where they  
13 cannot speak about their experience with the franchise  
14 system to anybody?

15 MR. RAFIZADEH: To my knowledge it has been  
16 100 percent. It has been something that is a standard  
17 part of a buy-back contract, because recently I have  
18 talked to quite a few franchisees who have sold their  
19 stores, and the gag order is not a negotiated  
20 paragraph if you will. It comes standard. The gag  
21 order and the no competition clause comes as a  
22 standard part of the buy-back contract.

23 MS. KEZIOS: And if you can recall, in the  
24 UFOC -- did it ever say anywhere in the UFOC in the  
25 transfer section that if you transfer your franchise,

1 you may in fact have to sign a statement saying you're  
2 not ever going to speak about your experiences with  
3 the franchisor?

4 MR. RAFIZADEH: No.

5 MS. KEZIOS: So that was not disclosed in  
6 the UFOC?

7 MR. RAFIZADEH: No, it was not. I'm  
8 certain of that. That is not disclosed in the UFOC.

9 MS. KEZIOS: So if you want to get out  
10 of the system, you find this out at that point in  
11 time?

12 MR. RAFIZADEH: Exactly. Yes.

13 MS. KEZIOS: Okay.

14 MS. HOWARD: I've got a couple questions.

15 MR. RAFIZADEH: Sure.

16 MS. HOWARD: You currently have six GNC  
17 outlets?

18 MR. RAFIZADEH: Yes.

19 MS. HOWARD: When you were looking into your  
20 second outlet, third, fourth, fifth, and sixth, did you  
21 ask for a UFOC at that time, or did you receive one?

22 MR. RAFIZADEH: I did not ask for one, and,  
23 no, I did not receive one.

24 MS. HOWARD: At any of those points in time?

25 MR. RAFIZADEH: No, I did not. I'm very

1 certain of that, that the UFOC at the time was not  
2 mailed out. In fact to this date I think the only  
3 UFOC I have in my position is the very original one.

4 MS. HOWARD: Was there a reason that you  
5 didn't ask for one? Is it because of your experiences  
6 already in the system?

7 MR. RAFIZADEH: In the case of this  
8 particular franchise, it evolved. That's the best way  
9 I can describe it. Since they were not -- they,  
10 themselves, did not have any experience in the  
11 franchise business prior to 1990, I would characterize  
12 the initial couple of years as very pleasant. And  
13 probably that was more than anything else the reason  
14 that continuously I did not ask for the UFOC as I  
15 built the follow-up stores.

16 MS. KEZIOS: Can I ask a follow-up  
17 question. I don't know how you started your question,  
18 but you would probably be considered in the eyes of  
19 many a sophisticated franchisee. You own -- you're a  
20 multi-unit owner of a couple of different chains.

21 Do you think that other people like you  
22 should then not worry about receiving a UFOC, or do  
23 you think that a franchisor ought to have -- ought to  
24 be able to say, well, I don't have to give Mike a UFOC  
25 because he's already involved in the business; he's

1 sophisticated enough; he knows what the heck is going  
2 on, or do you think it would be valuable that every  
3 time you opened a new store, depending on the changes  
4 that have been going on in the system, you got a new  
5 UFOC?

6                   MR. RAFIZADEH: I can tell you at this  
7 point based on my experience, I would demand it, you  
8 know. It is a necessity due to the fact of going back



1 6,961 franchisees, so we usually tell folks there's  
2 about 7,000 franchisees, people who own over 15,000  
3 stores. So usually, you know, the average is they're  
4 one or two store owners.

5           They've been franchisees -- we did a  
6 survey. The median age of the franchisees who are in  
7 the AFA is 9.65 years. So even though there are  
8 people who have only been franchisees for six months  
9 and there are some who have been franchisees for 30  
10 years, the median age is 9.6 years. So these are  
11 folks that reached break-even, reached profitability,  
12 they're probably coming up for renewal. So they've  
13 been around for a while.

14           And I believe the last count is something  
15 like 55, 56 different industries represented, everyone  
16 from hotels to fast food, or, as I like to say, from  
17 Kentucky Fried Chicken to Roto Rooter. We've got them  
18 coming and going. We've got franchisees in every  
19 system. You're probably going to want to strike that  
20 from the record, but that's a good way of explaining  
21 it.

22           And what was your other question?

23           MR. TOPOROFF: Is there any --

24           MS. KEZIOS: Oh, we're in every state.

25 Every state. We've got members from every state, all

1 50 states. We even have members from Puerto Rico and  
2 Australia. Even though it's the American Franchisee  
3 Association, we get phone calls weekly, we get E mails  
4 weekly from international licensees primarily asking  
5 do they do to the Americans what they're doing to us  
6 here? So that happens a lot.

7           And we're tracking to see exactly how many  
8 -- I would guess that we may have a franchisee in --  
9 our goal is to have a franchisee in every legislative  
10 district in the country. And that's the AFA's  
11 membership goal there.

12           MR. TOPOROFF: Thank you.

13           Myra, do you have any questions?

14           MS. HOWARD: No.

15           MR. TOPOROFF: Thank you. It's been very  
16 informative. We appreciate you taking the time to  
17 speak with us today.

18           MR. RAFIZADEH: Thank you.

19           MR. TOPOROFF: Off the record.

20           (Discussion off the record.)

21           MR. TOPOROFF: We are back on the record.

22           We are going to return to the first speaker  
23 that we heard from this morning, Steve Doe, who would  
24 like to add some additional remarks. So please.

25           MR. DOE: As I listened to Mike's

1 testimony, I reflected upon my original testimony,  
2 and I didn't bring up the fact very well that we  
3 don't have any end to our contract with our  
4 franchisor. So we have a real problem on our hands  
5 when we get ready to sell because the royalties we pay  
6 the franchisor are not competitive in today's market,  
7 and it would be very difficult for us to sell the  
8 operation on the open market.

9           So we really are kind of boxed in. The  
10 franchisor is somebody to sell to. As you remember  
11 from my earlier testimony, he won't buy our operation.  
12 And the only other alternative left to us, since we  
13 can't sell it on the open market and he doesn't want to  
14 buy it, is to pay him a large amount of money to buy  
15 out.

16           Thank you.

17           MR. TOPOROFF: Thanks.

18           (Discussion off the record.)

19           (Meeting concluded at 12:00 p.m.)

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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

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MARGARET BUSTOS, CSR

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SARA J. VANCE, Proofreader

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