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FEDERAL TRADE COMMISSION

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In the matter of: )  
 ) Matter No. R-511003  
FRANCHISE RULE )

- - - - -

Thursday, September 18, 1997

Federal Trade Commission  
26 Federal Plaza, Room 305  
New York City, New York

The above-entitled matter came on for meeting,  
pursuant to notice, at 9:00 a.m.

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APPEARANCES :

ON BEHALF OF THE FEDERAL TRADE COMMISSION :

**STEVEN TOPOROFF, ESQUIRE**

**MYRA HOWARD, ESQUIRE**

**KEITH ANDERSON, ESQUIRE**

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P R O C E E D I N G S

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1           comments. The comment period has been extended  
2           throughout the year. And you can also come tomorrow.  
3           Members of the Commission Staff will be here to discuss  
4           any issue concerning franchising and business  
5           opportunities. And we'll be in this room from 9:00 to  
6           3:00.

7                        As in previous workshops, if you want to offer  
8           a comment or to ask a question, please just lift your  
9           name tags like that or to the side where we could  
10          acknowledge you and call upon you for your comments.

11                      Okay. Very quickly, I would just like to go  
12          around the room and have everybody introduced themselves  
13          and then very quickly your name, the group that you're  
14          with if any and perhaps the spelling of your name for the  
15          benefit, again, of the stenographer.

16                      So I'll start. Again, Steven Toporoff. Last  
17          name is spelled T-O-P-O-R-O-F-F.

18                      MS. HOWARD: Myra Howard, Federal Trade  
19          Commission.

20                      MR. ANDERSON: Keith Anderson, Federal Trade  
21          Commission.

22                      MR. KIRSCH: Mark Kirsch, Rudnick, Wolfe,  
23          Epstien & Zeidman.

24                      MR. SHAY: Matthew Shay, International  
25          Franchise Association.

1                   MR. WIECZOREK: Dennis Wieczorek, Rudnick &  
2 Wolfe in Chicago.

3                   MR. KESTENBAUM: Harold Kestenbaum, Counsel,  
4 Hollenburg, Blevin, Solomon, Ross -- Daniels, Garden  
5 City.

6                   MR. SIMON: Neil Simon, Hogan & Hartson in  
7 Washington, DC.

8                   MR. KAUFMANN: David Kaufmann, Kaufmann,  
9 Feiner, Yamin, Gildin & Robbins in New York City. Also  
10 appearing for them on behalf of the National Franchise  
11 Mediation Program.

12                   MR. FORSETH: Mark Forseth, Jenkins &  
13 Gilchrist, Washington, DC.

14                   MR. TIFFORD: John Tifford, Rudnick, Wolfe,  
15 Epstein & Zeidman and also accompanying Coverall North  
16 American.

17                   MR. ZASLAV: Barry Zaslav, General Counsel for  
18 Coverall North American, San Diego, California. Z-A-S-L-  
19 A-V.

20                   MS. KEZIOS: Susan Kezios, American Franchisee  
21 Association. K-E-Z-I-O-S.

22                   MR. CANTONE: Dale Cantone, Office of the  
23 Maryland Attorney General.

24                   MR. PUNTURO: Joseph Punturo, New York Attorney  
25 General's Office. P-U-N-T-U-R-O.

1                   MR. TOPOROFF: Great. Moving onto the first  
2 item on the agenda and that is UFOC issues.

3                   By way of background, in the ANPR the  
4 Commission announced that it was interested in exploring  
5 further whether the Commission should revise its rule  
based upon the UFOC model.

1           And the cover sheet is one of those items that we really  
2           don't know at this stage what to do.  Whether we should  
3           keep our present cover sheet or whether we should revise  
4           ours to somewhat match what the UFOC now requires.  And  
5           if we go down that path, should we improve the cover  
6           sheet.

7                         Some of the comments that we have received --  
                          well, offered proposals like underlining the fact that



1 franchisors who use the Uniform Franchise Offering  
2 Circular guidelines, I think is of very good value. The  
3 UFOC mandated cover sheet is before it typically a  
4 franchisee might glance at the first cover sheet, but  
5 they certainly don't look at the second one. They want  
6 to get into the guts of the offering circular. So, I  
7 think ideally there would be a single cover sheet  
8 developed through coordination with NASA that would meet  
9 both the FTC's and the State requirements.

10 MALE VOICE: Are you saying, Neil, that  
11 currently they put two of them together?

12 MR. SIMON: Yes. That is correct. The current  
13 practice is that you would get an offering circular and  
14 there would be the State mandated cover sheet or a cover  
15 sheet that you can use for all of the registration  
16 States, which is what -- we do, and then behind it there  
17 will be a much abbreviated FTC sheet with the capitalized  
18 language. But I don't think investors and prospective  
19 franchisees look at it.

20 MR. TOPOROFF: Harold.

21 MR. KESTENBAUM: I happen to agree with Neil.  
22 The FTC cover page really doesn't provide any information  
23 to the prospective franchisee at all and the State cover  
24 page, which Neil is referring to, gives a greater detail  
25 -- a much greater detail as to what the offering is all

1 about. I think he's right. I think the FTC cover page  
2 is really a waste -- just a waste of paper.

3 MR. TOPOROFF: Okay. Any other comments on  
4 this issue? Dale Cantone.

5 MR. CANTONE: I think this comment goes to both  
6 the cover page and also to the UFOC in general. I think  
7 there is a lot of utility in -- if the FTC is revising  
8 the format to try to mirror as closely as possible the  
9 UFOC guidelines because of not only the fact that we've  
10 had some experience that seems to work well, but for the  
11 issue of uniformity.

12 So I think just as a general comment, I think  
13 that there's a great deal of benefit if that can be  
14 accomplished.

15 MR. TOPOROFF: Okay. Next? Susan.

16 MS. KEZIOS: And I'd just like to support what  
17 you said about taking out the language to protect you  
18 because in many UFOCs and many FTC documents the only  
19 misrepresentation from many of our members' eyes is the  
20 implied promise on that FTC cover sheet saying we're  
21 going to help you out. There's an implied promise that  
22 the FTC is going to do something when, in fact, that's  
23 not what happens.

24 MR. TOPOROFF: Okay. Another question that we  
25 have is risk factors. If a State requires the UFOC and,

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1 no more risk than the other obligation.

2 So I think -- to the extent that if the FTC  
3 requires risk factors, they should specify the types of  
4 categories of risk factors that would be included on the  
5 cover page.

6 MR. TOPOROFF: Harold, any comments?

7 MR. KESTENBAUM: I would think that if you did  
8 that you'd have the FTC risk factor -- specific State  
9 risk factors, which would imply for any particular State  
10 that requires -- any other State. So it would be clear  
11 that what the FTC would mandate and what the particular  
12 State would mandate.

13 MR. TOPOROFF: Any other thoughts on this  
14 issue? Neil.

15 MR. SIMON: I would just note that there are,  
16 of course, under the UFOC guidelines certain mandatory  
17 risk factors that, if applicable, a franchisor must  
18 disclose. Then, as they mentioned, there are risk  
19 factors that an examiner in a given registration State  
20 may seek to be added to it.

21 We use -- have developed a multi-State circular  
22 that franchisors can use in all 50 States, if they so  
23 choose. In certain cases you can put risk factors in  
24 State specific addendum to the offering circular, in  
25 which case they don't spoil the essential uniformity of

the core offering circular.

1 specific issues. So it is kind of a developing process.

When we see, for example, an issue that several

1 I think that it's important that when a prospective  
2 franchisee picks up a prospectus that the risk factors  
3 are there right in the front so they can immediately see  
4 what concerns the regulators have had. And, you know,  
5 hopefully they'll read the entire document, but the risks  
6 are there immediately to be seen.

7 MR. TOPOROFF: Let me ask this. If we were to  
8 adopt again the UFOC type cover sheet, could we address  
9 particular instances or risk factors from advisory  
10 opinions? Would that work? Is that a way to handle  
11 potential issues that may come up in the future or do  
12 there need to be much clearer guidance on risk factors --  
13 or an interpretative guides? John

14 MR. TIFFORD: As a practical matter, I don't  
15 think you're ever going to come up with any set of  
16 guidelines that's going to work because this is a very  
17 individual issue and it's going to depend on the  
18 individual offering and the individual State policies.

19 I think the way to look at it is more a  
20 question of how to preserve the uniformity of the  
21 document so that you don't have a demand for a risk  
22 factor that would, in essence, require a franchisor to  
23 have a State specific document. And I think you're just  
24 going to have to leave it up to -- in terms of the text  
25 or the subject matters and the risk factors, you're just

1 going to have to leave it up to the individual State and  
2 individual offering and concentrate on how to do it --  
3 how to accommodate these risk factor requirements without  
4 having to create a State specific document.

5 MR. TOPOROFF: Any other --

6 MALE VOICE: John, doesn't that really boil  
7 down to -- I mean, if a specific State wants a disclosure  
8 that really isn't an FTC issue in some sense at all  
9 because your client then has the option of saying okay,  
10 I'll do either -- I'll put it through all the  
11 registration dates. I'll either put it on for everybody  
12 or I'll do a separate one, right?

13 MR. TIFFORD: Well, in theory, that's right.  
14 In practice what happens is the filings are made at the  
15 same time because a lot of States, for instance, work on  
16 an annual report basis so that you have -- your filing  
17 may be six or seven States at about the same time.

18 In addition, you may have something in the  
19 middle of the year in one State where you have your  
20 offering circulars already registered in all the other  
21 States. So for you to go back and change your "generic"  
22 offering circular, you really need to go to every other  
23 State that you've registered to them and say I'm amending  
24 my offering circular to include this page that has a risk  
25 factor that, you know, the one State wants and I've



1           decided to put in.

2                       So it really becomes an administrative issue  
3           that takes on a lot of prominence. And what happens is  
4           to some extent I think we need to look at this as a  
5           totality. This is a cooperative effort among Federal and  
6           State regulators to make sure that the franchise office  
7           and sales are done not only in a way that fully informs  
8           prospective franchisees, but also permits franchisors to  
9           have a manageable process of providing the necessary  
10          information.

11                      And while in the one case you say my  
12          responsibility is limited only to, you know, the State of  
13          Rhode Island, that's really my paramount responsibility.  
14          Everything else is just going to have to fall in place.  
15          Or my responsibility is just the FTC and the States will  
16          just have to do what they want.

17                      Technically that's true, but if we're going to

1 are the most important risk factors or not. And  
2 obviously it would be terrific if the FTC and NASA would  
3 sit down and say here's the only approved risk factors  
4 that there are and don't do any others. But that's  
5 unlikely to happen.

6 So I think if the FTC is looking for some  
7 specified language, a couple of sentences or a paragraph  
8 or whatever, then the FTC should say that this language  
9 should appear on a separate cover page or should be  
10 integrated into the UCO seat cover. And that should do  
11 it.

12 And, by the way, the -- I think Neil said that  
13 the State -- the FTC cover always appears on top. At  
14 least that's the way we do it. And it's -- obviously  
15 that language stands out. Everybody knows it is a  
16 circular when you see the current language. So -- but  
17 there's nothing wrong with going to one single cover page  
18 with the FTC language inserted into it. The only problem  
19 with that is now you're going to start getting lengthier  
20 cover pages because some of the States when they have a  
21 lot of risk factors they're now two pages long. And then  
22 if you add some more language it's going to get even  
23 longer. So the short, quick snapshot of a little -- of a  
24 short cover page is slowly going to erode.

25 MR. TOPOROFF: Okay. We're going to move on.

1 The next issue on the agenda is item three, the  
2 litigation disclosure. And let me summarize some of the  
3 comments.

4 First off -- one second. Okay. The litigation  
5 disclosure. The Commission in the ANPR asked whether we  
6 should retain the language that is currently in our  
7 disclosure document for litigation that would require  
8 franchisors to disclose franchisor litigation against  
9 franchisees. That's material and that involves the  
10 franchise relationship.

11 The comments are really split and again -- on  
12 obvious lines. Franchisees and regulators, obviously,  
13 have urged the Commission to keep the current franchisor  
14 language. I would say as a general proposition  
15 franchisors have urged the Commission to go more in line  
16 with the UFOC that currently does not have an expressed  
17 requirement along those lines.

18 Suffice it to say that again we're looking to  
19 improve our rule, not necessarily to adopt the UFOC  
20 wholesale. And it seems to me that it is on the -- the  
21 burden is on those who want us to change what the current  
22 rule requires.

23 So again without rehashing all the comments and  
24 the pros and the cons on this issue, I just want to ask  
25 is there anything else that we should consider of the

1 Commission when we consider this particular issue in  
2 revising a new rule.

3 Nothing else? Mark Forseth, please.

4 MR. FORSETH: Just to consider the amendment  
5 process. I think that's what a lot of franchisors might  
6 -- noticing the comments. Everyone talked in terms what  
7 about the materiality of the type of litigation that's  
8 disclosed in there and the impact it has to the extent  
9 that you broaden that standard and that any dispute  
10 between a franchisor and a franchisee then would become  
11 material. The franchisor would then have to amend its  
12 offering circular, cease offering its selling, file  
13 amendments in the registration States. It is again an  
14 added administrative burden as to whether or not it  
15 enhances disclosure or not. I think it's questionable.

16 MR. TOPOROFF: Any other thoughts? Okay.

17 Next item is item 20 and we're going to take  
18 this in a few parts. The first part is the turnover  
19 rate. I think it's fair to say that every comment that  
20 addressed this issue urged the Commission to clarify,  
21 modify the turnover information to avoid double counting.

22 Our concern right now is how should we do that.  
23 On the assumption that there's consensus and that we  
24 should definitely re-examine this item. What should the  
25 Commission do to clarify the disclosure of turnover

1 rates?

2 I want to put a proposal out on the table that

1           which would be nearly -- currently you have four or five  
2           categories and then you have a total column. People are  
3           told to add across. Wouldn't we solve the problem if  
4           instead of adding across we merely said indicate the  
5           number of outlets that are in one or more of these -- of  
6           the four or five categories. And where one or more  
7           franchises appears in one -- in more than one category,  
8           do a footnote, so that we would maintain the four or five  
9           categories so if one is interested in terminations one  
10          can get the summary information without doing the detail  
11          analysis.

12                         But if you want the detailed analysis you got  
13          the footnotes and you've also got the total. So you know  
14          that in the State of Alaska five franchises were involved  
15          in one of these operations during the year. So that's  
16          the alternative that I would --

17                         MR. TOPOROFF: And again I'm just putting this  
18          forth as a proposal that was offered in the comments.  
19          It's not my proposal. What I'm looking for are comments,  
20          like Keith said, the proposal that I raised or any other  
21          solution to this issue. Neil Simon.

22                         MR. SIMON: I'll comment about Keith's  
23          proposal, the proposal that you articulated, Steve, but  
24          is not yours. And then an alternative approach.

25                         My concern about -- well, first of all,

1 franchisors currently can do essentially what Keith  
2 required. You can footnote an item in the item 20 table  
3 to explain, for instance -- why a franchisor may have  
4 listed a transaction or an event involving a single  
5 franchise in two or three different categories. Some  
6 franchisors choose to do it, many do not. But you can do  
7 that under -- currently under the UFOC guidelines.

8 I would also note that under the UFOC  
9 guidelines, there is not a mandate that you list it in  
10 every category in which it may fall. It's ambiguous.  
11 You may do so, but you also may make a decision you're  
12 only going to put it in a single category.

13 As to the proposal that you addressed, Steve,  
14 my concern would be that for large systems that would be  
15 wildly impractical. You would end up yet increasing the  
16 size of offering circulars and I happen to believe the  
17 very length of offering circulars is probably the most  
18 significant determinant about how effective they are.  
19 You make them longer. We make them denser. We add more  
20 footnotes. It's more likely to be less useful. It's  
21 going to be a less meaningful disclosure. So that would  
22 be my concern about that proposal.

23 I think with a relatively minor tweaking and,  
24 in fact, there is discussion of it going on in NASA's  
25 franchise committee in the context of the current

1 commentary project. But with minor tweaking the item 20  
2 can be improved to eliminate the double counting problem  
3 and allow the calculation of turnover rates that are more  
4 precise than is currently possible.

5 And that -- and all that requires is that you  
6 take existing categories and you put them in some  
7 priority. You establish a hierarchy so if a given event  
8 involved, let us say, a reacquisition, because that's at  
9 the top of the list, it's only listed as a reacquisition  
10 notwithstanding that there may also have been a non-  
11 renewal or a termination.

12 So you just take all of them and I don't  
13 propose to you what that order of categories should be.  
14 I think we can focus upon it and at the very bottom would  
15 be other and maybe transfer, which often can disguise  
16 what is really going on. It might be low on the list.  
17 So we might put termination right at the top because we  
18 make a judgement that that would be the most meaningful  
19 information that you want a prospective franchisee to  
20 have. And you order it and so forth.

21 So if a given event involves you just list it  
22 in the category that is at the top of the list and that  
23 would eliminate the double counting problem, allow for  
24 the calculation of meaningful turnover rates and I think  
25 would address the problem you referred to.



1                   MR. TOPOROFF: I'm curious to know what Dale or  
2 Joe has to say about this. Dale Cantone.

3                   MR. CANTONE: I like the concept of some type  
4 of history as the proposal that you described. I also  
5 fear that that could get very unwieldy for some of the  
6 larger systems and I think that it's critical that the  
7 disclosures have got to stay simple to be meaningful.

8                   I -- the NASA Committee is exploring the issue  
9 of trying to avoid this item 20 double counting and I  
10 think the proposal that Neil described is something that  
11 I think we're going to be working on. And again I'll  
12 just reiterate that to the extent that we can be  
13 consistent with the UFOC guidelines and the FTC I think  
14 there's a lot of utility in doing so.

15                  MR. TOPOROFF: John Tifford.

16                  MR. TIFFORD: I'm reminded of the expression in  
17 thinking about this question that there's a lot less here  
18 than meets the eye. It's really not a very complicated  
19 problem. We want to demonstrate the kind of turnover  
20 that franchisees -- that the franchise system has. We've  
21 developed a chart that really lays it out nicely. The  
22 only issue that arises is there are circumstances where  
23 there is double counting and I think the answer is very  
24 simple. Just come up with a simple formula to say when  
25 we have a situation where you are going to check more

1           than one box, how do you -- how do you prioritize which  
2           box you check.

3                         And I think what Neil is saying whatever --  
4           whatever you do is fine as long as you just come up with

1 franchisor who goes out because it is determined to  
2 acquire for significant amounts of money, profitable  
3 units -- business transaction.

4 And second of all, but most importantly, right  
5 now UFOC item 20, the table requires you to have -- this  
6 is the column that aggravates franchisors. Requires you  
7 to have as an ultimate number the total from the left  
8 column. So it's the total number of transfers,  
9 terminations, non-renewals, reacquisitions by the  
10 franchisor, and those who left the system.

11 The question is why do we have that. If  
12 there's a transfer, is that a negative? It's deemed to  
13 be such if you lump the number in adding up transfers,  
14 terminations and non-renewals. But it doesn't seem to  
15 impart any useful information to prospective franchisees  
16 while it negatives the franchisor trying to sell  
17 franchises. It seems like there is more turmoil in the  
18 system that there actually is. It's not a negative that  
19 a transfer takes place in a franchise system. In fact,  
20 the members of Sue Kezios' American Franchisee  
21 Association will be the first to admit that they're in  
22 business to get it up, running extremely profitable and  
23 sell it out after a good run or upon retirement. But  
24 cashing out after a period of time is not a sin and  
25 shouldn't be lumped together with termination. It

1           certainly is functional.

2                       So at the end of the day if we can eliminate  
3           that column that says total from all the left columns,  
4           and I'm getting very precise here again referring to UFOC  
5           item 20, the sample answer table as it is. And also make  
6           clear that every termination is not a reacquisition or  
7           shouldn't be counted as the same type of reacquisition as  
8           a franchisor going out and acquiring units for cash. I  
9           think that would go a long way toward hitting John  
10          Tifford's goal and Neil Simon's as well.

11                      MR. TOPOROFF: Keith.

12                      MR. ANDERSON: I guess my question about Neil's  
13          proposal is is it true that from the franchisee's  
14          prospective knowing that somebody falls in two boxes  
15          really isn't -- is that more information for them or is  
16          it just over -- I mean, that's the question we want to  
17          ask. I don't know the answer.

18                      Because your proposal would, in essence, reduce  
19          the number of things that are -- numbers that show up in  
20          the things that are further down. And so my notion was,  
21          you know, yes, you could check more than the number of  
22          boxes but at the end of the day, and maybe you don't need  
23          the footnotes, but at the end of the day, I guess, what I  
24          was thinking of was to take the totals column and instead  
25          of making it just a sum across, just list the number of

1 outlets that are involved in one or more of the things to  
2 the left.

3 MR. TOPOROFF: Hold that thought.

4 MS. KEZIOS: Let him respond. I'm going to  
5 respond to what David had to say.

6 MR. TOPOROFF: Okay. Neil Simon.

7 MR. SIMON: Well, I was going to say that I  
8 don't have an answer to Keith's question and I'm not  
9 aware of any empirical data on that.

10 The concern about just adding up the totals,  
11 that would not reveal that there had been -- let us  
12 imagine -- let us say that a given franchise unit had  
13 been transferred three times in the course of a year.  
14 Under your proposal it would not be clear -- it would say  
15 regular transfer activity, but it would not be clear it  
16 happened to the same unit.

17 So I'm not sure -- my concern would be that  
18 under -- what I mentioned, you would still list three  
19 transfers. Not one, but three because of three different  
20 events. But we would not list it as a termination and a  
21 transfer. It would go in one or the other. But  
22 certainly I think Susan might be able to address this  
23 issue of how do we balance giving detailed disclosure  
24 versus the minutiae that may make it less accessible and  
25 less meaningful.

1 MR. TOPOROFF: Susan Kezios.

2 MS. KEZIOS: First of all, I'm glad, David, to  
3 acknowledge your franchisee clients are members of the  
4 AFA, so --

5 MR. KAUFMANN: My what?

6 MS. KEZIOS: Your franchisee clients.

1           indication because often the franchisor terminates the  
2           franchisee and then transfers it. They should not be  
3           allowed to say it was just a transfer because that gives  
4           information to a prospective purchaser that they need --  
5           maybe there is something going on in that system and they  
6           need to know -- they need to be able to ask the right  
7           question.

8                         What you're proposing here is not a free flow  
                          of information. It's certainly not truth in disclosure.

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1 than, in fact, occurred, and this goes to Keith's issue.

2 Franchise Times had a cover story about  
3 franchise turnover rates. They took a methodology that  
4 had been developed by, I think, IFA's Educational  
5 Foundation and -- and -- Deloitte & Touche did a study  
6 for IFA's Educational foundation. Franchise Times took  
7 it to the next step and disclosed the turnover rates for  
8 specific franchisors, the names. The IFA study just  
9 talked about generally in the industry.

10 Not surprisingly, some franchisors, I imagine  
11 those that were revealed to have fine turnover rates,  
12 said wait a second. That number is not accurate because  
13 of this double counting phenomenon.

14 So I think that turnover rates are meaningful  
15 information. I think if I was a prospective franchisee  
16 who was counseling a prospective franchisee, which I do  
17 not do much of, although I would, of course, recommend  
18 they join AFA, I would say figure out what the turnover  
19 rate is. But so long as franchisors can say well there's  
20 this double counting phenomenon so you have to discount  
21 that number, it renders it less meaningful.

22 MR. TOPOROFF: Okay. John Tifford. No?

23 MR. TIFFORD: If you want to go on to a topic  
24 -- I just wanted to just clarify. I think what Dennis  
25 was saying, Neil, was that the names of item 20, where

1           you put the names of the people who left the system in  
2           the last year, you don't have to list next to the name  
3           what the event was.

4                         But the point is anyone of those events in the  
5           chart will mean that somebody who was an assistant is no  
6           longer an assistant and you have the name, address and  
7           the phone number of that person. You can call and find  
8           out for yourself what happened and why. And I think that  
9           that would also get to Susan's point that whether or not  
10          there's a clarification or however it is confused, you  
11          have the source of the information -- the first hand  
12          source of the information of why that number is on the  
13          chart and you can easily determine it for yourself.

14                        MR. TOPOROFF: Mark Forseth.

15                        MR. FORSETH: Just that that list is not just  
16          people who have left the system. That list is anyone who  
17          has had a transfer and if they had multiple units and  
18          only transferred one unit or closed one unit they are on  
19          that list. So you had existing franchisees also on that  
20          list so that the list is fairly comprehensive.

21                        MR. TOPOROFF: Susan Kezios.

22                        MS. KEZIOS: However, John, if the former  
23          franchisee signed a gag order you're not going to get any  
24          information out of that.

25                        MR. TOPOROFF: Well, that raises the next issue

1 on the agenda.

2 (Laughter.)

3 MR. TOPOROFF: But before we get there --

4 before we get there I just -- Myra, did you have a --

5 MS. HOWARD: Yeah, I do. I've got a question.

6 MR. TOPOROFF: Myra Howard.

7 MS. HOWARD: Two questions actually. The first  
8 is that are there so many events that can happen with a  
9 franchise system that, in fact, it would be way too  
10 unwieldy to list all the different type of events that  
11 occurred in one year? I mean, right now there's what?  
12 Five categories? Five or six columns? I mean, are there  
13 a hundred things that generally happen during a year or  
14 are there ten?

15 MALE VOICE: I think that depends on the size  
16 of the system and why do you need the system --I'm sorry.  
17 It really depends on the size of the system. Smaller  
18 systems wouldn't be an issue, but the larger ones I'm  
19 sure it would be a significant issue.

20 MR. TOPOROFF: John Tifford.

21 MR. TIFFORD: I think, Myra, that just about  
22 every thing on the chart has, I think, the categories  
23 that would capture just about anything that would happen.  
24 The renewals, the transfers, the terminations and the  
25 reacquisitions. I can't imagine there could be very many

1 that don't hit those four and when they don't then we  
2 have the table for all other that David have spoken about  
3 how confusing that could be.

4 MR. TOPOROFF: We're going to move on at this  
5 point.

6 I just want to say I think that this is an  
7 issue where we still need some more thought and I would  
8 encourage those who have possible solutions that the  
9 Commission should consider, please supplement comments or  
10 file additional comments with various proposals  
11 specifically on this issue. We would greatly appreciate  
12 it.

13 To the extent that without exception every  
14 comments who address this issue said that there's a  
15 problem and there should be a fix. What the fix is  
16 debatable at this point. We have no great thoughts on  
17 the issue right now. So again I would encourage people  
18 to supplement their comments and help us out a little bit  
19 here as we consider various solutions.

20 Myra Howard.

21 MS. HOWARD: One last question. As a general  
22 proposition, do you think that it would be feasible for  
23 everyone, sort of both sides of the issue, to agree on a  
24 prioritized list? Susan, do you think that --

25 MS. KEZIOS: Yeah, we can agree on it. As long

1 as Neil agrees with me we can agree on it.

2 MS. HOWARD: Neil, do you agree with Susan?

3 MR. SIMON: I could agree with Susan.

4 MR. TOPOROFF: Well, let's put it this way.  
5 We're having another round table like this in Seattle in  
6 November. It might be helpful to have comments and  
7 proposals on this fix by that time. We could write up  
8 the proposals and circulate them beforehand to  
9 participants and we could discuss this in greater detail  
10 at that time.

11 And as Susan opened the door, gag orders.

12 Before we talk about gag orders I think it is  
13 important to emphasize what we are not talking about. We  
14 are not talking about post litigation settlements. I  
15 also don't think that we're talking about confidentiality  
16 agreements or agreements that franchisees sign to  
17 safeguard proprietary information, trade secrets, what  
18 have you.

19 We're talking about something that is much  
20 narrower than that and that is terminated franchisees who  
21 may leave a system that are asked to sign different  
22 provisions, call them gag orders, call them whatever you  
23 want, that inhibit their ability to speak about their  
24 experience in the franchise system when called upon by  
25 prospects in the future.

1                   So terminated franchises are affected as well  
2                   as in some instances existing franchisees who may have a  
3                   dispute with the franchisor and resolve it in some way  
4                   and are asked at that time to also sign some kind of  
5                   confidentiality provision.

6                   I want to make it clear right from the start  
7                   that the Commission has already looked at this issue in  
8                   some respects. There's a Tutor Time consent order and in  
9                   that consent one provision was, to be very brief, that  
10                  the franchisor cannot have these kinds of provisions for  
11                  a period of five years.

12                  There was another case, it was a business  
13                  opportunity case that was brought under Section V of the  
14                  FTC Act, brought under the franchise rule, that had -- it  
15                  is called O'Ryan, that was brought by our San Francisco  
16                  regional office, I believe, and that also had a similar  
17                  type of provision there.

18                  So our concern in a nutshell is as follows: If,  
19                  in fact, the Commission is not going to mandate earnings  
20                  disclosures, if, in fact, the cover sheet now says to  
21                  franchisees or prospective franchisees we haven't checked  
22                  this, do you due diligence and find out about what's  
23                  going on, if we have an item 20 list of franchisees  
24                  current and former and we have said any number of times  
25                  that franchisees, former and current, are the best source

1 of information about what's going on in the franchise  
2 system, how can we put that out and at the same time  
3 create a situation where people or franchisees are under  
4 these gag order provisions that really silence them from  
5 speaking so that if I were a prospect and I called -- and  
6 I looked at the UFOC and it had lists of current and  
7 former franchisees and I tried to call them and they're  
8 under some kind of order that limits their ability to  
9 speak for us, I think, that raises some real serious  
10 issues and some red flags.

11 Again, the comments are split on this issue.  
12 There were a significant number of comments by  
13 franchisees and their advocates urging us to look at this  
14 issue. There were several comments by franchisors saying  
15 don't worry, it's really not a problem.

16 So without necessarily discussing the merits of  
17 this, what we want to focus on this morning is possible  
18 solutions.

19 Also if anybody has anything to add to the  
20 discussion that isn't addressed in their comments  
21 already, you know, by all means let us know.

22 Any comments? Susan Kezios.

23 MS. KEZIOS: Also aren't franchisors violating  
24 their disclosure obligations when they know, in fact,  
25 that when a franchisee expires or is terminated or is

1 politically incorrect and lost their renewal and it is  
2 not going to get renewed, that by not putting in the UFOC  
3 that upon exploration or termination we may, in fact,  
4 have you sign a gag order. I mean, isn't that -- because  
5 that seems to happen in a lot of systems.

6 Current franchisees call us and say I'm not  
7 going franchisee, I'm not renewing, but I've got to sign  
8 this piece of paper. And that they never told me that  
9 when I bought the franchise. It was never disclosed to  
10 me.

11 MR. TOPOROFF: Any comments? Mark Forseth.

12 MR. FORSETH: Well, I'm just curious in terms  
13 of gag orders. I mean, when you see settlement and  
14 release agreements all the time in any -- whether it is a  
15 prelitigation dispute or a post litigation dispute. I  
16 mean, there's not any gag order by a Court. What you're  
17 talking about is a pre -- you're saying because it  
18 doesn't apply to post litigation. What you're saying is  
19 that a settlement agreement involving mutual releases of  
20 the parties that contains a confidentiality agreement is  
21 a problem. Is that what you're saying?

22 MR. TOPOROFF: Well, I'm raising that it's a  
23 problem. The reason that I eliminated post litigation  
24 settlements is, as I understand it under UFOC those have  
25 to be disclosed as is. So that's not really an issue.



1                   The concern is -- and again I don't want to get  
2 hung up in what you call it, how it happened, what the  
3 exact language of it is. Our concern, what we're raising  
4 right now -- again in whatever format they might occur,  
5 those kinds of provisions that prohibit a franchisee from  
6 speaking about their experience in the franchise system.

7                   Yes, Mark.

8                   MR. FORSETH: Are you saying generally most of  
9 those type of agreements simply state that it's -- you  
10 can't discuss the terms of your particular settlement. I  
11 don't think I've ever seen one that specifically says you  
12 can't talk about your experience in this system and how  
13 this system is run. I don't think I've ever seen  
14 anything.

15                  MR. TOPOROFF: Well, I could tell you straight  
16 off the bat that at the Commission we have had any number  
17 of callers who refuse to identify themselves, refuse to  
18 identify what system they're with and said is there some  
19 way, could you subpoena us, is there some way that we can  
20 talk to you because right now under the provisions that  
21 we have signed, we cannot.

22                  MR. TIFFORD: And were these with litigation?

23                  MR. TOPOROFF: John Tifford.

24                  MR. TIFFORD: I'm sorry. Was this a litigation  
25 type situation where someone had settled an action, got

1           some consideration for franchisor and in exchange for  
2           that agreed to silence, or was this just basic --

3                       MR. TOPOROFF: I couldn't tell you.

4                       MR. TIFFORD: All right. Well I think that's  
5           an important question though.

6                       MR. TOPOROFF: Well, but, John, the question --  
7           my question to you would be so -- so they're willing to  
8           sign in return for some consideration, but signing an  
9           agreement not that says we won't talk about what the  
10          terms of the settlement are, but we won't talk about our  
11          experience when we were working for you. I mean, if  
12          that's going on then it seems to me that there may be an  
13          issue in terms of the ability of the potential franchisee  
14          to learn about the system.

15                      MR. TIFFORD: Well, unless I missed something  
16          in the last 20 years or so. Certainly at my time at the  
17          Commission I never saw this problem when I was --  
18          involving the franchise rule. In the last eight years of  
19          private practice, I've never been in a situation and  
20          never been with a franchise where that was part of a  
21          settlement agreement. I agree with Mark. I've never  
22          seen it.

23                      At certain times -- certainly you're going to  
24          talk about you may want to have a provision that says  
25          don't tell the world how much I paid you or don't tell

1           what we did to settle this thing. But I've never seen  
2           don't tell anybody, you know, about what your experiences  
3           were as a franchisee. We've never put it in. I honestly  
4           never seen it anyplace.

5                       MS. HOWARD: Can we check that out for a  
6           minute? I mean, at the Commission we have seen that  
7           before. Has anyone else at the table seen something like  
8           that?

9                       **(Inaudible responses.)**

10                      MS. HOWARD: Okay.

11                      MR. KESTENBAUM: I don't know if I agree with  
12           it, but --

13                      MR. TOPOROFF: One second. I'm going to  
14           interrupt. For the benefit of the stenographer since  
15           this is a large group, if you're going to speak please  
16           identify yourself, first name and last name beforehand,  
17           again. Otherwise, it will be kind of impossible to have  
18           organized transcript. So Harold Kestenbaum, you were  
19           speaking?

20                      MR. KESTENBAUM: Yes. Harold Kestenbaum. I've  
21           seen it in a few cases. I don't know that I agree with  
22           it, but I have seen it. It's not that it doesn't exist.

23                      MS. HOWARD: Okay. David.

24                      MR. TOPOROFF: Kaufmann.

25                      MR. KAUFMANN: David Kaufmann, K-A-U-F-M-A-N-N.

1 I think we better be careful to approach this subject in  
2 a sophisticated fashion.

3 Just last week, for example, there was a  
4 transaction with the largest franchisee of an  
5 international -- a real estate broker franchisor left  
6 that system to become the largest franchisee of competing  
7 international real estate brokerage franchisor. The  
8 franchisee in question had to seek permission to leave.  
9 And one of the conditions of leaving, in addition to  
10 other monetary consideration, was that the franchisee in  
11 question, who was upset, not torpedo the future  
12 operations of this franchisor by communicating broadly  
13 his displeasement with the franchisor.

14 The franchisee in question was more than happy  
15 to accede to that because there was great value to it in  
16 leaving that system. So there was a franchisee to whom  
17 this was not a concern at all. It was uniquely situated.  
18 It is larger by a factor of five, which are in terms of  
19 gross revenues of any other franchisee in the system.  
20 And there was good reason the franchisor wanted to clamp  
21 down on that information and also a good reason the  
22 franchisee had no desire to object.

23 They volunteered they were not going to speak  
24 to prospective or even existing franchisees, so not to  
25 deleteriously affect the franchisor going forward. In

1           return they were granted a big favor.

1                   Franchisors are compelled to give it a  
2                   grapevine nature of franchisee communications and the  
3                   type of trouble who this franchisee -- this type of  
4                   franchisee can engender. They are compelled all too  
5                   frequently -- not brightly in my mind, but all too

1 for myself, that, in effect, by having franchisees sign,  
2 what you're creating, perhaps, is a situation of  
3 basically leaving out and selecting those on the list in  
4 item 20 that you want prospects to speak to.

5 And everybody knows that the Commission has  
6 brought cases, mostly in the Bisoff (phonetic) area where  
7 we've gone after shells (phonetic). And these are people  
8 who are paid to give a glowing recommendation. By  
9 silencing some people in the system aren't you creating,  
10 in effect, the scenario that the people who can be  
11 contacted on the list are more or less handpicked by the  
12 franchisor.

13 MR. KAUFMANN: I understand the argument, Mr.  
14 Toporoff, although I don't agree. What I think maybe  
15 would be a reasonable solution or at least a compromised  
16 solution would be that anytime monetary consideration is  
17 paid to a franchisee in connection with a dispute of one  
18 form or another there would be a prelitigation or  
19 prearbitration or otherwise, that the franchisor would be  
20 -- that's knowledge that the franchisor would be able to  
21 secure, confidentiality provisions from the franchisee  
22 receiving those monies.

23 You know, the franchisee is terminated, is  
24 unhappy, wants to be able to speak to third parties. I  
25 understand the Commission's election not to bar those

1           communications. But if there are problems in the system  
2           where a dispute has arisen and the franchisor wants to  
3           take care of the franchisee, wants to rid itself of what  
4           could be a troublesome franchisee and is putting a lot of  
5           money behind his desire, then I think in that  
6           circumstance the franchisee will have achieved his  
7           objective if it can read the system, take the cash and  
8           still be able to badmouth the system to death.

9                           And also I would want to add that the impotence  
10           for franchisors settling such disputes with franchisees  
11           would be gravely narrowed because very frequently again  
12           one of the chief impotences to settle is the  
13           confidentiality gift factor.

14                           MR. ANDERSON: One -- just one reaction. I  
15           mean, your -- Keith Anderson.

16                           Your comment is sure, the franchisor and the  
17           franchisee can reach a private agreement that says I  
18           won't talk. But we're looking at a public good here from  
19           having the guy talk. I mean, that's not in the contract.  
20           So the fact that they can reach a contract agreement that  
21           for consideration he'll agree not to talk doesn't mean  
22           that it's -- that policy wise is something we ought to be  
23           permitting.

24                           MR. KAUFMANN: May I respond?

25                           MR. TOPOROFF: Yes.



1                   MR. KAUFMANN: David Kaufmann. Keith, I  
2 understand that there is a public good in mind in whole  
3 disclosure. There's also a public good that has to be  
4 achieved in terms of not having franchise systems  
5 destroyed through communications that are only vengeful  
6 in nature. It has happened. It happens today.

7                   There are systems that have been poisoned --  
8 where a franchise or franchisee relations have been  
9 poisoned through widespread mistrust, widespread conflict  
10 in gender by very few franchisees who have a personal --  
11 a personal disagreement with a franchisor that takes on a  
12 magnitude far greater than the dispute would suggest.

13                   All right. So on the level of public good I  
14 understand the public interest in broadening all  
15 communications with respect to franchisees. And frankly  
16 as the author of the New York Franchise Act, which is  
17 generally deemed to be the toughest pro-disclosure of  
18 franchise law in the country, I side with as full  
19 disclosure as possible.

20                   There is, however, a militating impact. You  
21 don't need to disclose information that's useless, even  
22 prejudicial both to the franchisor and to the prospective  
23 franchisee.

24                   MR. TOPOROFF: Okay. Dale Cantone.

25                   MR. CANTONE: Yes. Very briefly. First I want

1 to echo some of the comments that you made. I think  
2 these types of gag orders are destructive and run  
3 contrary to every concept of presale disclosure. To the  
4 extent that there may be a franchisee with a venge -- a  
5 crackpot franchisee that you might be characterizing,  
6 you're talking about one franchisee who may, in fact, be  
7 -- it might be evident to other franchisees. It's still  
8 the disclosure.

9 I mean, if you got a good system with a lot of  
10 happy people and one crackpot, that's going to come out.  
11 I mean, you -- you know, if you have one person who has  
12 got a reason to go after a franchisor, that's information  
13 that I think another franchisee can look at and discount.  
14 I mean, they're not stupid. They can see where someone  
15 is coming from.

16 I think the whole concept of a gag order is  
17 really destructive and I think it needs to be addressed.

18 MR. TOPOROFF: Dennis.

19 MR. WIECZOREK: Dennis Wieczorek. A couple of  
20 comments. Number one, I have never seen a franchise  
21 agreement that calls for a gag order that goes into place  
22 if parties reach a disagreement if there's a termination  
23 or if there's a non-renewal. I've never seen it in a  
24 contract.

25 So that probably means it would never be

1 disclosed and it would only be imposed in a negotiated  
2 situation. It is -- I very much doubt that there is any  
3 -- maybe there are certain companies that did it as a  
4 business practice. I've never seen that in people that  
5 I've worked with. It is relatively rare. It is done on  
6 a negotiated basis. And if the list of franchisees --  
7 former franchisees will include a wide variety of people.  
8 And there's also a list of current franchisees, by the  
9 way, too. And I don't know how you can gag current  
10 franchisees who might be unhappy.

11 We're just talking about gag orders applying to  
12 former franchisees. So I think there is a significant  
13 sampling of people that a prospective franchisee can talk  
14 to and just as when NASA imposed the -- notwithstanding  
15 confidentiality agreements, you must disclose litigation.  
16 that does have a chilling effect on parties reaching  
17 negotiated settlements. And you can -- that's one  
18 example. This is another.

19 You know, a franchisee is gung happy. Maybe  
20 he's happy. He wants to get out and they're negotiating.  
21 And everything has a price. You won't do this. You  
22 won't sue us. You won't talk about us. The money -- the  
23 monies are exchanged, the consideration is exchanged  
24 based on those private agreements. And I think they are  
25 relatively infrequent enough, they're relative rare, that

1 if there is a need for enforcement agencies have the  
2 ability to do it, but I still suggest that there is going  
3 to be a chilling effect on the parties' ability to reach  
4 agreements as to how to exit the system.

5 MR. TOPOROFF: Well, we're going to test the  
6 proposition of whether these are rare or not. We have  
7 Susan Kezios and we have Matt Shay, each of their  
8 respective organizations have franchisee members.

9 What I would like you to do, if possible, is to  
10 go back and ask your folks the following questions --  
11 with survey. And I'll understand that it's an informal  
12 survey. It's not necessarily going to affect, but --

13 MR. SHAY: This assumes that they'll be allowed  
14 to talk to us.

15 MR. TOPOROFF: And that is a valid point. That  
16 is a valid point. And ask simply have you been or are  
17 you now under a gag order provision or have you ever been  
18 asked to sign a gag order provision, and report back to  
19 us because that would be helpful information for us. It  
20 would be nice to know the raw number. We asked 1,000  
21 people, we asked 2,000 people, 100 people and so many of  
22 them responded, and this is what they had to offer.

23 MS. KEZIOS: Shouldn't the question be --

24 MR. TOPOROFF: Susan Kezios.

25 MS. KEZIOS: -- are you aware --

1                   MR. SHAY: I was going to suggest. Are you  
2 aware of it? I think that's --

3                   MS. KEZIOS: Yeah. Are you aware that it's a  
4 normal business practice in your system for expired or  
5 terminated franchisees or somebody who a franchisor wants  
6 to shut up to sign a gag order.

7                   MS. HOWARD: No, that's --

8                   MR. ANDERSON: No, that won't work.

9                   MS. KEZIOS: The lay person is the way of  
10 putting it.

11                  MR. TOPOROFF: Keith Anderson.

12                  MR. ANDERSON: That won't work because then we  
13 could have one guy who signed a gag order and 100 people  
14 who know about it and 100 tell us about it. That doesn't  
15 -- that doesn't tell us much about the prevalence of the  
16 practice.

17                  MS. KEZIOS: Well, neither does this question  
18 have you -- I mean, why would a current franchisee have  
19 signed a gag order?

20                  MR. TOPOROFF: Current franchisees do sign --

21                  MS. KEZIOS: As the former franchisees.

22                  MR. SHAY: Right.

1 franchisor and they've arrived at some solution, but  
2 they're still within the system, but the -- absorbed as  
3 part of the settlement or resolution wants them to sign  
4 it. So it's both terminated franchisees as well as  
5 people who may still be franchisees within the system.

6 MS. KEZIOS: How about both questions?

7 MR. TOPOROFF: Yes. Do both questions.

8 MR. SHAY: Do both questions.

9 MR. TOPOROFF: Are you now or have you ever  
10 been asked --

11 MS. KEZIOS: Was that the question you wanted  
12 though?

13 MR. TOPOROFF: For both questions. Have you --  
14 are you now or have you ever been asked to sign a gag  
15 order provision and the second question is --

16 MS. KEZIOS: Are you aware --

17 MR. TOPOROFF: Are you aware that it is within  
18 your system the franchisor uses or imposes gag orders.

19 MR. ANDERSON: And I would urge you to make  
20 that specific. I mean, we're talking about gag orders --  
21 we're only talking about gag orders that keep you from  
22 talking about your experience in the system.

23 MS. KEZIOS: Right.

24 MR. ANDERSON: We're not talking about trade  
25 secrets --

1 MS. KEZIOS: Right.

2 MR. ANDERSON: -- we're not talking about --

3 MR. SHAY: Litigation.

4 MS. KEZIOS: Oh, litigation. Right.

5 MR. ANDERSON: -- litigation settlements.

6 MS. KEZIOS: Right. And it's positive or  
7 negative experiences because we've had --

8 MR. TOPOROFF: Barry Zaslav.

9 MR. ZASLAV: Barry Zaslav. I just -- this may  
10 be a non-sequitur, but you keep talking about gag orders.  
11 When you have an order you have a Court which has some  
12 sort of contempt power in the event that you violate  
13 this. Are you talking about a provision in the contract  
14 or either pre -- part of the franchise agreement or a  
15 settlement agreement which says I can't talk because --  
16 how enforceable is something like that anyway. You have  
17 to have very elaborate provisions as to what happens if  
18 the person does talk.

19 I just can't see this as a pro-form type of an  
20 agreement.

21 MR. TOPOROFF: Well, all I can tell you is that  
22 we have been told that franchisees do sign these kinds of  
23 provisions. Whether they're mandated by a Court or  
24 otherwise, as I understand it, these are contracts like  
25 any other kind of contract. It would be part of the

1 settlement term that if violated the franchisee could be  
2 subject to a suit by the franchisor to the same extent  
3 that they could be subject to a suit or if they disclosed  
4 confidential or trade secret information.

5 MR. ZASLAV: I mean, it's just --

6 MR. TOPOROFF: It's a contractual provision  
7 like other contractual provisions.

8 MR. ZASLAV: It seems that, you know, number  
9 one, you can't unring the bell. You'd have to prove some  
10 sort of damages. And number two, you might even have  
11 some public policy issues there that you're just saying  
12 you can't talk about something period.

13 MR. TOPOROFF: Well, that's what we're -- I  
14 mean, that's what we're raising here. But before we move  
15 on -- Keith Anderson.

16 MR. ANDERSON: Just a quick answer to Barry. I  
17 mean, even if the thing is proved to be unenforceable, if  
18 we're talking about small business people --

19 MR. ZASLAV: You have intimidation, I guess.

20 MR. ANDERSON: You've got intimidation even if  
21 they couldn't enforce it.

22 MR. TOPOROFF: So before we move on I'm going  
23 to call on Dennis next. But before we do if you could  
24 get back to us, if you could do a quick survey and let us  
25 know -- Matt Shay.



1                   MR. SHAY: We need to get the definition of  
2 term -- a number of people made very good points about  
3 the distinction between what's legitimate, what's  
4 settlement and confidentiality and what is a gag order.  
5 And I think we need to make sure in whatever language we  
6 agree on for purposes of the survey we're asking the same  
7 question and it's defined in a way in which it's going to  
8 be understood by the people receiving it.

9                   MR. TOPOROFF: That's fair. That's fair. Let  
10 me ask you this proposal. Could I call you or somebody  
11 from the Commission call you next week and possibly  
12 between Susan Kezios and Matt Shay and possibly have a  
13 real quick conference call to iron out the details of the  
14 survey?

15                   MR. SHAY: Just so we're on the same --

16                   MS. KEZIOS: Come up with the language.

17                   MR. TOPOROFF: And the language.

18                   MS. KEZIOS: Yeah.

19                   MR. SHAY: I think that's important.

20                   MS. KEZIOS: Sure.

21                   MR. TOPOROFF: Okay. So we will do that next  
22 week or the week after. I mean generally you're going be  
23 around?

24                   MR. SHAY: Yeah. That's fine.

25                   MR. TOPOROFF: Okay. We will do that. Dennis

1           Wieczorek.

2                       MR. WIECZOREK: Just a quick comment and that  
3 is rather than legislating private conduct, maybe the  
4 sensible thing to do here would be to require a  
5 disclosure in item 20 or in the list that says that the  
6 franchisor may have entered into confidentiality  
7 agreements with franchisees and make that statement.

8                       Not necessarily pointing to which person  
9 deciding what, but simply disclose and put people on  
10 notice that confidentiality agreements have been entered  
11 into.

12                      MS. KEZIOS: That is a problem.

13                      MR. TOPOROFF: Susan Kezios.

14                      MS. KEZIOS: And that's what I brought up  
15 initially. That is a problem because the current  
16 franchisee or outgoing franchisees call us and say they  
17 didn't tell us we'd have to do this in order to get out  
18 of the system. So that is another aspect of it.

19                      MR. TOPOROFF: David Kaufmann.

20                      MR. KAUFMANN: Just again be aware not to paint  
21 a franchisee's and franchisor's with too broad a stroke  
22 of the brush. For instance, you know -- you're saying  
23 small business people.

24                      It happened and it was about five years ago.  
25 That there was a franchisee, one of the largest

1 franchisees of one of the largest fast food franchisors

1 consideration or both.

2 And that's the danger to be aware of in a broad  
3 brush stroke in this area.

4 MR. TOPOROFF: Keith Anderson.

5 MR. ANDERSON: Two quick things. One to  
6 Dennis. What if you had to do it specifically? I mean,  
7 just -- this guy, he's out of the system, and don't  
8 bother to call him. He's agreed not to talk. That would  
9 tell the prospective franchisee something about the  
10 system. Sure it would hinder settlement negotiations  
11 because the franchisor is not going to want to disclose,  
12 but it might not do as much.

13 MR. TOPOROFF: Well, I think it would be  
14 preferable to say that on this list there may be  
15 franchisees who have entered into confidentiality  
16 agreements and will not be allowed to talk to prospective  
17 franchisees.

18 MR. ANDERSON: Sure. But that doesn't tell me  
19 --

20 MR. TOPOROFF: Well, it does if I'm a guy  
21 that's calling around. I'm calling and I'm finding that  
22 Mr. X, Y and Z can't talk to me but I -- there's going to  
23 be others that I can talk to. And if there is a lot of  
24 people that entered into "gag orders" than I'm going to  
25 do some more digging and I'm going to go to another -- a

1 current franchisee and say, what's going on. Why did all  
2 these people leave and why won't they talk to me?

3 I mean -- you know, we can't like hold people's  
4 hands and take them step by step and this is who you ask

1           troublemaker, wouldn't franchisors almost always, who  
2           have somebody who is unhappy, say ah, he's a  
3           troublemaker. He's going to make trouble for me. I  
4           don't want him talking.

5                       MR. KAUFMANN: David Kaufmann. I understand  
6           that, Keith, which is why I said at the very least if the  
7           franchisor -- if there's financial consideration for  
8           company settlement or termination with a franchisor in  
9           question than the franchisee is entering into that  
10          settlement agreement freely of his or her or its own  
11          volition, understands the impact, understands the  
12          consideration it's receiving in return for giving up  
13          confidentiality. Quite frankly, he's not bargaining on  
14          behalf of prospective franchisees. He's bargaining on  
15          behalf of itself.

16                      And that arm's length transaction between two  
17          independent entities, I don't think the government should  
18          interfere with. I don't think there's an interest that  
19          is so compelling that it outweighs the freedom of those  
20          parties to contract. And there is a deleterious effect  
21          if it's not -- those settlements won't occur if  
22          confidentiality can't be retained.

23                      MR. TOPOROFF: Susan Kezios.

24                      MS. KEZIOS: There is no arms length  
25          negotiation again in the majority of the situations that

1 I see and I'm not talking about the Hispanic guy who is  
2 the third largest business owner.

3 David, you come up with some of the exceptions  
4 that are not what's going with the rest of us here, the  
5 general rules, and the -- what we hear in the office and  
6 these people are on their last legs and they've lost  
7 everything. They've lost their houses. They've lost  
8 their families money. They've lost their money. They  
9 got to go to work for ten years to make it up. And  
10 they're between a rock and a hard place. They got a gun  
11 to their head and they say what do I do. I've got to  
12 sign it or I don't get out.

13 We had a woman in Chicago who said the same  
14 thing. She was at the public workshop the day after the  
15 round table. We had her there at 11:00 a.m. and she was  
16 talking because she had to sign her gag order at 1:00  
17 p.m. Okay.

18 So -- you know, these people are not the third  
19 largest Hispanic businessman in the world. This is not  
20 the majority of the folks out there who are buying these  
21 franchises. They are not all sophisticated investors to  
22 talk a little bit -- that is to say. They are people who  
23 are buying into the dream of entrepreneurship to learn  
24 how to be an entrepreneur. They're not that  
25 sophisticated to begin with, the majority of them in the

1 first time buyers.

2 MR. TOPOROFF: David Kaufmann.

3 MR. KAUFMANN: Very briefly. Susan, I would  
4 suggest and I've said this before in other forums, there  
5 is a dichotomy present between the major franchisors in  
6 this country and the smaller newer franchisors in this  
7 country. The larger all the more established franchisors  
8 of today almost never are dealing with moms and pops of  
9 the type you were just referring to. They are dealing  
10 with existing multi-unit businesses to whom they keep  
11 getting more markets, more units, more areas and so  
12 forth.

13 And so perhaps -- and I'm not discounting what  
14 you're saying. I know that it is one of the systems.  
15 You have mom and pop situations where what you describe  
16 can take place. All I'm asking the Commission to do is  
17 to understand this is a sophisticated area. At one end  
18 we do have very large franchisors with very large  
19 franchisees with their own concerns, while at the other  
20 end you have smaller franchisors who may be more abusive,  
21 as a matter of fact, because the franchisees have less  
22 bargaining power.

23 MS. KEZIOS: But as you know those larger  
24 franchisors and their franchisee associations are all  
25 members of the AFA. So I have exceptions with what



1           you're saying there as well.

2                       MR. KAUFMANN:  There may be exceptions.  
3           There's no blanket rule across the board.  But I'm saying  
4           there is -- I think you would -- can see -- for instance,  
5           in the largest pizza franchisor in this country, the  
6           largest fried chicken franchisor in this country, the  
7           largest Mexican food franchisor in this country, with one  
8           or two exceptions.  That's not granted a new franchise to  
9           a new franchisee for the past two or three years.  
10          They're dealing with different franchisee populations.  
11          I'm just asking the Commission to understand that.

12                      MS. KEZIOS:  Okay.

13                      MR. TOPOROFF:  Okay.  We got it.  John Tifford.

14                      MR. TIFFORD:  I think we ought to try to get  
15          back to the practical level here.  Franchisors are in the  
16          business of selling franchises and when they have a  
17          prospective franchisee who calls somebody on a list and  
18          finds out that I am not permitted to talk to you about my  
19          experience with this franchisor, it doesn't take a rocket

1           problem and I think that -- I think that we need to go  
2           beyond the theory to the practicality. We need to know  
3           hard evidence and I think it's a good idea to get this in  
4           formal survey that you're thinking of Steve. But I think  
5           that the Commission should be obligated to do some very  
6           hard evidence, tangible empirical evidence of problems  
7           and not the -- you know, anecdotal stories of people who  
8           called up and when you don't know the situation  
9           surrounding it.

10                         I'm not aware that it's a problem. I think  
11           most franchisors were really very surprised when they saw  
12           this in the ANPR audit, that this was an issue, saying  
13           what is this about. I don't think it happens often. I  
14           think it happens to the extent it happens. To the extent  
15           that it happens in the context of litigation it's already  
16           disclosed. And I think that the comments have shown very  
17           sound policy reasons why it's a practical matter when  
18           people settle cases -- confidentiality provisions that  
19           deal with the specific terms of the settlement make both  
20           sense in both parties and should be interfered with  
21           though by this kind of a regulation.

22                         MR. TOPOROFF: We're basically going to move  
23           on. The only comment that I would have to say is that I  
24           will get together with Matt Shay and Susan Kezios to work  
25           on a possible survey.

1           The only other thought that I had was when we  
2           were trying to figure out how often or how prevalent this  
3           may occur, that can be a very difficult task because the  
4           people that we would want to hear from, the franchisees,  
5           could be the very ones who are under these provisions and  
6           rightly or wrongly may feel that they cannot contact us  
7           and speak with us.

8           So it is a very difficult issue to get from  
9           data on and we would like to hear more comments on this,  
10          as well as any possible solutions that the franchisee  
11          community may offer to address this.

12          MR. TIFFORD: Steve, I would just say we don't  
13          need to find out what their specific confidentiality  
14          agreement is, but we should be able to know how many  
15          people are in the position where they can't talk. I  
16          can't imagine that that's a breach of any  
17          confidentiality.

18          MR. TOPOROFF: Well, some people feel that they  
19          cannot call us because this confidentiality provision  
20          even prohibits them from contacting the FTC and saying  
21          that I signed this order. It has a very intimidating  
22          effect on them and they feel that if they just call the  
23          Federal Trade Commission, that alone breaches their  
24          contract and that they are subject to liability.

25          So I'm telling you from my experience at the

1 Commission that this is a difficult area to get data on.  
2 So the next best thing is to use the data that we can get  
3 and take it from there.

4 Give me one second.

5 What we're going to do now is there were two  
6 other items on the agenda. One was when should  
7 disclosures be made. That is somewhat an Internet  
8 related issue. So what I would prefer to do is discuss  
9 that later on in the afternoon in connection with the  
10 Internet.

11 Disclosure of franchisor's international  
12 information. We'll just skip for right now. It is not  
13 necessarily a high priority item and we can address that  
14 either in Seattle or at some other time.

15 When we resume, we will be talking about the  
16 earnings disclosures, the preambles that we set for in  
17 the ANPR. So let's really try to keep this short. It's  
18 11:15. Let's resume at 11:30.

19 **(A brief break was taken.)**

20 MR. TOPOROFF: We're back on the record. The  
21 next item on the agenda is earning disclosure issues.  
22 But before we do that, there is one other item that I  
23 neglected to mention in our last discussion, and I want a  
24 very brief discussion of this issue.

25 And that is some of the commentators have

1 suggested that in item 20 that franchisors were to  
2 disclose the existence of a franchisee trademark  
3 association. So if McDonald's franchisees have an  
4 association, then that should be listed with name,  
5 address, telephone number, what have you in item 20.  
6 Same thing for any other franchise system.

7 If there's an independent or not independent,  
8 whatever the format might be, franchisee specific, that  
9 information should be included in the disclosure  
10 document. The theory being that if we're serious about  
11 franchisees -- respective franchisees doing due diligence  
12 and finding out what's going on in the system, perhaps a  
13 good source of information is from other franchisees,  
14 have names, addresses and telephone numbers. Maybe they  
15 should also know about the existence of a franchisee  
16 association as well.

17 So with that, anybody have any comments on that  
18 proposal? Dennis Wieczorek.

19 MR. WIECZOREK: How do you pick if there are  
20 multiple associations? Is there, let's say, -- if there  
21 are regional associations, if there are local  
22 associations, if there are associations that the  
23 franchisor doesn't even know about that exist.

24 MR. TOPOROFF: Well, obviously, if they don't  
25 know about them that's one thing. But to the extent that

1           they are established recognized franchisee associations  
2           and maybe we could define that in some way. We could  
3           iron out the details later. The basic proposition should  
4           that information be made available to process. Do you  
5           have any comments?

6                       MR. WIECZOREK: Well, just one last thing and  
7           that is, if there is a franchisor sponsored advisory  
8           counsel and there is a "independent association" what do  
9           you do?

10                      MR. TOPOROFF: I would say list all of them.  
11           Neil Simon.

12                      MR. SIMON: I would just quickly note that  
13           there's already a disclosure requirement with regard to  
14           purchasing co-ops.

15                      Secondly, franchisees have to do their own

1 franchises? How do you know that? I'm aware of one  
2 purported organization where the so-called leader of it,  
3 who is not a franchisee in that system, will not disclose  
4 how many members he has or their names for purported fear  
5 of intimidation.

6 Would the franchisor in that case have to  
7 disclose this organization? I think this is a can of  
8 worms I think the FTC should stay away from.

9 MR. TOPOROFF: Matt Shay.

10 MR. SHAY: I have much the same concerns as  
11 Dennis and Neil and I would think that to the extent that  
12 they are in existence franchisee councils and  
13 associations, et cetera, they might not be the kinds of  
14 entities that some franchisees would have the greatest  
15 interest in talking to them.

16 I think to make a point for Susan before she  
17 makes it herself, she's not going to want to talk to the  
18 franchisor kind of sponsored councils anyway. She's  
19 going to want to talk to the other sort of runt groups  
20 and they come and go and may be there or may not be  
21 there, and I don't know how you'll ever keep track of  
22 them, identify them, certify them. I'm not sure this is  
23 going to provide any real good information.

24 MR. TOPOROFF: Susan Kezios.

25 MS. KEZIOS: The idea is to list national,

1           either independent franchisee associations or franchisor  
2           advisory councils. And if you are truly interested in  
3           full and complete disclosure, there should be no argument



1 properly, probably no one would care about putting this  
2 in if we could define it properly, but I think it's going  
3 to be very hard to find it properly across the board for  
4 all franchisors.

5 MS. KEZIOS: Well, let's work on a definition.  
6 I mean, work on a definition.

7 MR. TOPOROFF: I don't think -- and that  
8 clearly is something that can happen now based on the  
9 other information that's in the UFOC. I think the  
10 alternatives -- the obligation of the franchisor to  
11 identify and keep track of these entities that may spring  
12 up and down and as Dennis said, they may be regional,  
13 they may be loosely formed, they may be, you know, more  
14 formally constituted. I think it would be a challenge.

15 MS. KEZIOS: The franchisor always knows where  
16 there are franchisee associations starting. The  
17 franchisor knows if there's two guys getting together who  
18 want to talk to the franchisor. So that's not that big  
19 of a deal.

20 And, Dennis, can I just ask you what chains --  
21 I mean, what do they have, 25 different regional  
22 associations and there's no --

23 MR. WIECZOREK: I have some that have 3,000  
24 franchisees and there may be three, four, five councils  
25 or associations that are out there that are there for six

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1 to, maybe that's a thought.

2 What I'm talking about is where their  
3 franchisees --

4 MR. SIMON: A single system association.

5 MR. TOPOROFF: A single system association  
6 however denominated with everyone. I would appreciate  
7 receiving some supplemental comments on how we could  
8 define that.

9 Now, that's not to say that we are going to  
10 adopt that proposal, but we'd like to see some more  
11 comments on how it could possibly be defined.

12 Moving on, the next item is earnings  
13 disclosures and I hope everybody has their handout. The  
14 handout -- well, let me just make sure that people do.  
15 Does everybody have the handout that summarizes various  
16 proposals on earnings disclosures? Okay.

17 We are not, and I will repeat and emphasize  
18 over and over again, we are not going to debate today the  
19 merits of whether the Commission should or should not  
20 mandate earnings disclosures. If anybody wants to  
21 address that issue they're more than welcome to  
22 supplement their comments or show up tomorrow and we can  
23 discuss that in greater detail.

24 What we are going to focus on are the specific  
25 proposals that the Commission set forth in the ANPR.

1 Just to summarize so that everybody's on the same wave  
2 length.

3 In the ANPR the Commission set forth basically  
4 what we call two preambles, and this would be the item  
5 19.

6 The first preamble in a nutshell says that the  
7 franchise rule permits the making of an earnings claim  
8 provided that there is a reasonable basis for it and that  
9 there's written substantiation. You should not rely on  
10 information on sales income profits provided by a  
11 franchisor or sales person if written substantiation is  
12 not offered.

13 Every disclosure document would have to have  
14 that. That's what the proposal is.

15 Then either followed by the franchisor's  
16 earnings like -- like they are or what we call the second  
17 preamble, which basically says in a nutshell -- I'm not  
18 quoting verbatim. This franchisor does not make earnings  
19 claims, please do not rely on any representations by our  
20 sales people that we do. And that's it in a nutshell.

21 Various proposals have circulated in the  
22 comments on how we could include this language and that's  
23 what I want to focus on right now.

24 The first proposal basically is to insert the  
25 word franchise outlets in the first sentence so it would

1 basically read the FTC's franchise rule permits a  
2 franchisor to provide you with information about the  
3 actual potential sales increment profits of it's  
4 franchise outlets provided.

5 I think, although it wasn't expressed in the  
6 comment, the reason for putting in the words franchise  
7 outlets drives home to prospects that this information  
8 could be disclosed. If you just say outlets it could  
9 possible be interpreted as the company owned outlets.  
10 Another possible fix is just to say sales, income or  
11 profits of its company owned outlets or franchise  
12 outlets. So it's totally clear that the rule enables  
13 franchisors to make those kinds of disclosures.

14 On the first sentence, what I just read  
15 basically, is there any comment or suggestions? Any  
16 thoughts on that first part of the preamble? Neil Simon.

17 MR. SIMON: In the spirit of John Hayden and  
18 the UFOC Guidelines I am compelled to point out that  
19 provided that is not plain English, as requested in the  
20 third paragraph it should be in.

21 MR. TOPOROFF: If there is?

22 MR. SIMON: Uh-huh (affirmative).

23 MR. TOPOROFF: So take out provided then and  
24 put in if. Okay. We're making progress.

25 Any other suggestions? David Kaufmann.

1                   MR. KAUFMANN: No. Frankly I have a problem  
2 with everything on page one, the first preamble and the  
3 alternative proposals. All of this language and most  
4 especially the last one on page one of the handout  
5 suggests to prospective franchisees that they have the  
6 right to request information of the franchisor.

7                   As we all know, that's not the case. The  
8 franchisor can discuss these matters if it has an item 19  
9 earnings claim disclosure, and if it doesn't it can't  
10 give out information to prospective franchisees about  
11 gross sales, net profits and so forth.

12                   All of this language would suggest to me as a  
13 prospective franchisee -- I'd be interested in Susan's  
14 response, that, you know, the government is saying  
15 allowed to get this information, where is it? In which  
16 case franchisors have to say, well, let me explain the  
17 situation. We can if we want to give you the  
18 information. We have elected not to, but we're permitted  
19 to do that under the rule. I think the disclosures on  
20 the second page, specifically the first and the last  
21 disclosure on the second page, state what it is that the  
22 UFOC has in mind and what I think the Commission has in  
23 mind that, you know, we're not giving you disclosure now  
24 and if anybody does, let us know about it because they're  
25 not authorized.

1                   I think the spirit -- the Commission's ANPR  
2           language in the second preamble was to get away from the  
3           situation where franchisors claim all too frequently that  
4           the law won't allow us to give you earnings claim  
          information. Clearly, the w uí

1 ask for that information.

2 MR. TOPOROFF: They could -- again, they can  
3 ask, but the answer is going to be a simple no. So I  
4 don't know if that's all that helpful or not.

5 Let me propose this. As I was arriving on  
6 Amtrak yesterday, Myra and I worked on this and we  
7 thought of all the different comments and proposals, and  
8 perhaps this will take care of some of David's concerns.  
9 And let me read you what we came up with for the first  
10 preamble.

11 The FTC's franchise rule permits a franchisor  
12 to set forth below information about the actual or  
13 potential sales income or profits of its company and  
14 franchise outlets if there is a reasonable basis for such  
15 information and the franchisor offers to make written  
16 substantiation available to you. Do not rely on any oral  
17 or written earnings representations unless it is set  
18 forth below.

19 Now, the reason that we put in set forth below  
20 twice is to drive home if you're going to make these  
21 kinds of claims it has to be in writing there in the  
22 disclosure document. To take care of Dave Kaufmann's  
23 concern that we're not talking about making earnings  
24 representations in space or in some other context.

25 With that kind of language -- and again we're



1 not necessarily whetted to each and every I and T and dot  
2 and dash. But in the concept is that kind of proposal  
3 workable?

4 John Tifford.

5 MR. TIFFORD: I think that it's a little better  
6 than all the ones on page one of this preamble. I think  
7 all of these first preamble disclosures completely miss  
8 the mark and the problem. The problem is that  
9 prospective franchisees are not being told in proposal  
10 one that it's unlawful to make an earnings claim if they  
11 haven't put in an item 19. And that's the thing that --

1           franchisors to make earnings disclosures voluntarily.  
2           Let the marketplace do its thing without Federal Trade  
3           Commission intervention.

4                         And a way to drive that home to prospective  
5           franchisees who make up this disclosure document and are  
6           wondering hey, can't a franchisor make these kinds of  
7           claims? Yes. We are telling them directly that the  
8           Federal Trade Commission permits, and it does, a  
9           franchisor to set forth below its earnings claim. So  
10          that way there is no ambiguity about it and the people  
11          know what the state of the law is.

12                        MR. TIFFORD: Can I just respond?

13                        MR. TOPOROFF: John Tifford.

14                        MR. TIFFORD: May I suggest that the thing to  
15          do is to look at preamble two and whatever you have in  
16          preamble two, add a sentence that says the FTC permits  
17          the franchisors to make earnings claims and then you get  
18          your point across.

19                        MR. TOPOROFF: Well, it's too -- Keith  
20          Anderson.

21                        MR. ANDERSON: To both David and John, if -- as  
22          I understand this proposal, if a franchisor chooses not  
23          to put information below then you do preamble one and  
24          preamble two. They're both there.

25                        Preamble one is there even if you have -- I

1 mean, everybody does preamble one. Then you either do a  
2 disclosure of some earnings information or you put we  
3 don't do it. So it's not an either or kind of thing. We  
4 envisioned it as the franchisor who chooses not to make a  
5 disclosure says we're permitted to do it -- we don't and  
6 therefore don't rely on anything that our salesmen may  
7 tell us.

8 MR. TIFFORD: Well, then I pick -- John  
9 Tifford. The only answer then is just have one quick  
10 simple sentence that says the FTC permits a franchisor to  
11 make earnings claims and be done with it. There's a lot  
12 of loose language in here.

13 The point is to make sure that the prospective  
14 franchisees know that the franchisor can give information  
15 so no franchisor says, you know, I would tell you but the  
16 FTC won't let us. You've taken care of it in one  
17 sentence.

18 MR. ANDERSON: You know -- you know, frankly it  
19 started out there and I didn't like that and I would  
20 think your clients wouldn't like that because if they  
21 don't have substantiation they're not permitted to. So  
22 to say the FTC permits us to give out the information  
23 seems to me is going to put some franchisors in a box.

24 MR. TIFFORD: Okay. The FTC permits but does  
25 not require that we provide information --

1                   MR. ANDERSON: That says -- that, to me, says  
2 we're choosing not to do it.

3                   MR. TIFFORD: Well, that's what they are. For  
4 whatever their reason, good or bad, they have chosen not  
5 to do it.

6                   MR. TOPOROFF: Do you have any thoughts on  
7 that?

8                   MR. ANDERSON: I'm looking for allies from the  
9 franchisors around the table here. The franchisors like  
10 the simple one --

11                   MR. TIFFORD: Well, I can tell you from our own  
12 experience any time you sell a franchise somebody is  
13 going to ask you for substantiation. And I think from a  
14 franchisor's point of view, it would be a hell of a lot  
15 easier if they saw something in the document than for us  
16 to say to them what we'd like to -- we'd like to give you  
17 some information, but we can't do it without being in  
18 violation of law. If they see it in there it certainly  
19 makes it sound a lot more certain than one of our sales  
20 people telling them that.

21                   MR. TOPOROFF: Susan Kezios and then Mark.

22                   MS. KEZIOS: This is kind of going along the  
23 lines of what John Tifford was talking about because I  
24 think what we're missing the point about is that this is  
25 a voluntary disclosure and the franchisor has chosen not

1 to volunteer the information. And I think that needs to  
2 be stated much stronger, not if we tell you something  
3 that's not in the document we're in violation because  
4 that isn't the first issue.

5 The first issue is this has been a voluntary  
6 disclosure since 1979 and we've chosen for the last 20  
7 years not to do it. And I think that needs to -- for a  
8 prospective franchisee that says a lot and that should be  
9 stated stronger.

10 My other question is on your revised -- your  
11 train ride preamble, I missed it. Did you say franchise  
12 and company with outlets or just --

13 MR. TOPOROFF: Yes.

14 MS. KEZIOS: You did?

15 MR. TOPOROFF: Yes.

16 MS. KEZIOS: Because I was going to state that  
17 just franchise outlets is not enough especially if it is

1 voluntarily providing an earnings claim outlining the  
2 information that they're providing, why are you telling  
3 them that the franchisor permits them to do it. I see no  
4 reason to submit an earnings claim.

5 MR. TOPOROFF: Well, you can look at it as a  
6 consumer end piece. Even though a franchisor may have  
7 earnings information there, it doesn't necessarily mean  
8 that there is a reasonable basis for it and it doesn't  
9 necessarily mean that there is substantiation for it. So  
10 it's a caution to prospective franchisees not to take the  
11 document at face value, but to know that you should  
12 inquire whether this has a reasonable basis and a way to  
13 do that is to ask for the substantiation.

14 All the first preamble does is basically state  
15 -- restate what the state of the law is.

16 MR. FORSETH: The guidelines -- the state of  
17 the law is if you provide an earnings claim you're  
18 obligated to state in your earnings claim that  
19 substantiation will be made available upon reasonable  
20 request. We are obligated to state that. That's already  
21 in there.

22 So I guess my point is that the rest of it,  
23 whether -- stating whether or not you have a reasonable  
24 basis or -- I guess to me it's just -- it's just more  
25 fodder that the person's going to not really understand.

1           The average franchisees cannot -- an explanation to what  
2           constitutes a reasonable basis.

3                       MR. TOPOROFF:   Keith.

4                       MR. ANDERSON:   Keith Anderson.  I think, Mark,  
5           when we drafted this the thought was if we -- was that we

1 start-up franchise or for certain franchisors, they  
2 aren't able to provide it.

3 I would revise, and I'm just looking at the  
4 first sentence in the first preamble, not anything else,  
5 to make this clear or to clarify this by saying under the  
6 FTC's franchise rule, comma, a franchisor may elect to  
7 provide you with information about the actual or  
8 potential sales income or profits of its franchise and/or  
9 company owned outlets if the franchisor has a reasonable  
10 basis for the information and is able to provide you with  
11 written substantiation.

12 MR. TOPOROFF: Would that work in this  
13 proposal?

14 MR. SIMON: I'm not sure I want that thought of  
15 as Neil's proposal, but I'm just trying to address --

16 MR. TOPOROFF: All right. The proposal that  
17 Neil just offered.

18 **(Inaudible comments.)**

19 MR. TOPOROFF: Again for purposes of the  
20 record, we have to be clear as we're speaking. Susan  
21 Kezios.

22 MS. KEZIOS: Again, perhaps at the end of that  
23 you could put we have chosen not to provide this  
24 information or we have chosen to provide this information  
25 set forth below, going on with your set forth idea.



1                   But I think it's important that a negative  
2 disclosure, that's the proper way to characterize it is  
3 made.

4                   MR. TOPOROFF: Mark Forseth.

5                   MR. FORSETH: Mark Forseth. I'm just going to  
6 reiterate the same thing. I'm saying I still don't see  
7 the utility of it in connection with a franchisor that  
8 makes an earning claim to the extent -- likes this  
9 proposal better -- proposal better in clarifying that  
10 that information, if they are going to provide it to you,  
11 must be contained in this offering circular and in making  
12 it clear -- I think that that's just going to follow his  
13 thought.

14                   MR. TOPOROFF: Any comments on the first  
15 preamble?

16                   Okay. We're going to move on to the second  
17 preamble and that is on the assumption that, again, every  
18 disclosure document would have at least the first  
19 preamble to state what the law is, and again we can  
20 tinker with the language and shorten it or whatever, then  
the franchisor specifies -- well, this is an A or a B.

1 would have all the other caveats that we will currently  
2 require including a statement that was in substantiation  
3 of the data underlying the plan was available upon  
4 reasonable request. That would be in there.

5 If there is no earnings disclosure, then it  
6 would be in the second preamble which currently reads  
7 this franchisor does not make any representation about  
8 sales, income or profits. We also do not authorize our  
9 sales persons to make any such representations either  
10 orally or in writing.

11 Some commentors have said that we add an  
12 additional sentence, basically a reverting paragraph that  
13 -- that follows up on that. If the salesmen or the  
14 franchisor does make earnings representations, please  
15 report that to the franchisor so that they are aware of  
16 what their sales people are doing.

17 I would take it a step further and say should  
18 there be a sentence that says please report any  
19 unauthorized earnings representation to the Federal Trade  
20 Commission and there can be an address and/or State  
21 Franchise regulators, so that the Federal Trade  
22 Commission and/or the appropriate State officials are  
23 aware that there are salesmen or exhibitors or whatever  
24 you want to call them that are making unauthorized  
25 earning disclosures.

1                   So now I just want to focus on the second  
2 preamble. Does anybody have any thoughts on those  
3 proposals?

4                   Dale Cantone.

5                   MR. CANTONE: I agree with you that I would  
6 prefer something where they have to report it, making of  
7 unauthorized earnings claims to the State authorities and  
8 the FTC. I think that's a good idea.

9                   MR. TOPOROFF: Susan Kezios.

10                  MS. KEZIOS: While I dislike that idea,  
11 deputizing the consumer to go and report to the State or  
12 the FTC, I like the idea because there are instances of  
13 franchise or sales people who are told to use verbal  
14 earnings claims because they know once the contract is  
15 signed the integration clause will take away anything  
16 that was said. So, this is kind of a fall back position.

17                  MR. TOPOROFF: John Tifford.

18                  MR. TIFFORD: I like the concept of the second  
19 preamble. I would tell you that our firm in almost all  
20 of our offering circulars that we write puts this  
21 language now in item 19 and the State of California  
22 insists that it is taken out because it's not what the  
23 negative 19 says.

24                  So I think it's something the FTC would do to  
25 mandate that something like this goes in. I think it's a

1 good idea.

2 MR. TOPOROFF: Any other comments on the second  
3 preamble? Neil Simon.

4 MR. SIMON: I would just quickly note, and as  
5 you know this is something that NASA's Franchise  
6 Committee is talking about, and my understanding is that  
7 -- or its seems likely that the notion of earnings claim  
8 is going to be eliminated in favor of something which, in  
9 fact, is written more descriptive, which could be  
10 financial or performance information, something along  
11 those lines.

12 MR. TOPOROFF: With the magic word, earnings  
13 disclosure?

14 MS. KEZIOS: Yes.

15 MR. SIMON: The notion -- item 19, which is  
16 currently labeled earnings claim.

17 MR. TOPOROFF: Right.

18 MR. SIMON: I think down the road it is likely  
19 to be changed because franchisors see that and they say  
20 well, we're not disclosing earnings. We're just  
21 disclosing top line gross sales. So we can do that,  
22 right? Or we can provide cost data because it doesn't  
23 relate to earnings.

24 I think there's going to be a movement away  
25 from earnings claim, which is a misleading description to

1 the extent this mirrors the type of language that is  
2 likely to come out of NASA. It will eliminate the  
3 possible conflicts between the provisions of the UFOC.

4 MR. TOPOROFF: That's a very valid point.  
5 Susan Kezios.

6 MS. KEZIOS: And the other element of that was  
7 that it was the idea that it was historical financial  
8 performance information. That was something else that's  
9 coming out of NASA.

10 MR. TOPOROFF: Well, on that point, depending  
11 upon what NASA does or does not do and what the States  
12 may or may not adopt, there may be a conflict between  
13 what the Commission does and what the registration States  
14 might do.

15 If we could eliminate some of the  
16 inconsistencies -- and we will certainly consider that.  
17 But I think one factor that we need to consider is that  
18 the Commission is not removing from the realm of  
19 possibility franchisors who make projections. So  
20 whatever language that we have in terms of the preamble  
21 or whatever has to cover both performance -- historical  
22 performance data plus projections.

23 So if the language that NASA comes out with is  
24 limited strictly to performance data, that might not do  
25 the whole trick, and again we are not limiting the realm

1 of predictions.

2 So any other thoughts? David Kaufmann.

3 MR. KAUFMANN: David Kaufmann. I would, again,  
4 urge the Commission to avoid the inference in any of its  
5 preambles, including the Amtrak preamble, that the  
6 franchisors can give you this information -- suggesting  
7 that franchisors can give you this information if they  
8 like. I think the message has to be imparted.

9 MR. TOPOROFF: That's a very valid point.

10 That's very well taken.

11 MR. KAUFMANN: And I can even suggest language  
12 if you want.

13 MR. TOPOROFF: Well, I was going to get to that  
14 in one second. Joe Punturo.

15 MR. PUNTURO: Yeah. I like the second preamble  
16 as well. My only concern is in the second sentence where  
17 it says we do not authorize our sales person. Should it  
18 be limited to just sales persons or to anyone, any  
19 employee, et cetera, agent?

20 MR. TOPOROFF: Valid point. The agent, sales  
21 person --

22 MS. KEZIOS: Representative.

23 MR. TOPOROFF: Representative. The magic  
24 language that will cover it again. That's a very valid  
25 point.

1                   Okay. I was just going to add that again this  
2           is a working progress. The Commission has not, and I

1 was invited and accepted, and I don't know what his story  
2 is. He is very concerned about this particular issue and  
3 has submitted four, five separate comments on this issue.

4 Another comment that we received -- I can't  
5 remember the fellow's name, but he is apparently an  
6 American living in England, who bought a franchise and  
7 his comment was that the Commission should apply the  
8 rule.

9 I have not yet seen the comment, but I was  
10 contacted by at least one attorney who represents the  
11 franchisee in the dry clean case and he may submit a  
12 comment as well as the Government of Argentina may submit  
13 a comment on this issue. Now, whether they do or don't,  
14 I don't know. But again we will consider all these  
15 comments.

16 I want to make it clear that we're all aware of  
17 the dry clean case, so we don't need to belabor that  
18 point. I just want to give everybody an opportunity. Is  
19 there anything possibly additional to this issue that we  
20 should consider in making recommendations to the  
21 commission? If not, so be it and it's lunch time.

22 MR. PUNTURO: I just have one comment.

23 MR. TOPOROFF: Joe Punturo.

24 MR. PUNTURO: I just want to make sure that  
25 there's a statement -- whether it's in some sort of



1 interpretive guide or in the Statute that the FTC will  
2 allow the States to decide for themselves whether or not  
3 they want to regulate sales internationally since New  
4 York already has a case law that says that it can  
5 regulate international sales.

6 MR. TOPOROFF: Well, this isn't a preemption  
7 question as I see it. I mean it's very clear what the  
8 Commission should do for its own rule and I don't think  
9 anything that the Commission will do would preempt any  
10 State in adopting any kind of law at all. I just don't  
11 see that necessarily

12 MR. PUNTURO: With the exception of the little  
13 FTC act enforcing that.

14 MR. TOPOROFF: Well, the problem with the  
15 Little FTC acts, as I understand it, is they vary. Some  
16 of them are like Florida's which incorporate FTC rules  
17 wholesale and in which case our change would have  
18 mandated a different outcome, I think, in the dry clean  
19 case.

20 Other Little FTC acts vary and I don't know  
21 that a Commission statement -- modification to the rule  
22 would necessarily affect those Little FTC acts or not. I  
23 just -- I'm not well versed of that.

24 But John has his good old name tag up, so maybe  
25 he could inform on this issue. John Tifford.

1                   MR. TIFFORD: I'm sort of post done that. The  
2 two triggering elements for getting someone within a baby  
3 FTC act or first that the baby FTC act applies to  
4 business transactions as well as consumer transactions.

5                   Secondly, that it imports wholesale -- the FTC  
6 act and all the regulations promulgated under it, into  
7 the baby FTC act.

8                   There are 12 States whose laws have both those  
9 elements, both that incorporates business transactions,  
10 it incorporates the FTC act in total. And I would think,  
11 at least, in those 12 States that act itself would  
12 provide the basis for someone to get in and that's why it  
13 is really crucial that the FTC has to do something more  
14 than simply say we're not enforcing the rule because --  
15 well, that's just simply the FTC's discretion. It need  
16 to go further to make sure that --

17                   MR. TOPOROFF: But again even if you look at a  
18 Little FTC act and even if they incorporate our rule  
19 wholesale, there's nothing that would prevent a State  
20 from adopting some other regulation if it so chose to  
21 react international sales. So again I don't perceive  
22 this to be a preemption issue as such. John Tifford.

1 greater protection unless the FTC took a position that no  
2 State may and I don't know what the constitutional rights  
3 -- issues are there, but I don't see this as a problem  
4 whatever the FTC does to restrict its rule on any State  
5 doing whatever they would want to do.

6 MR. TOPOROFF: Following along in John's

1 territories or possession, and then that would be  
2 followed with the specific disclosure requirements.

3 Putting aside whether this -- the wording in  
4 this introduction could use some work or not to make sure  
5 they are clear or whatever, but the general notion of  
6 putting in the catch phrase in connection with the offer  
7 and sale of a franchise located in the United State of  
8 America, its territories, or possessions, would that do  
9 the trick to clarify this issue?

10 Dennis Wieczorek.

11 MR. WIECZOREK: I think it would do the trick,  
12 but I think this is also an instance where whether it's  
13 in the interpretive guides or in the rule itself, it  
14 needs to be stated that this is a clarification of FTC --  
15 of the FTC rule so that retroactively an international  
16 agreement that was entered in 1985 would be covered --  
17 would be "exempted" from -- the rule.

18 MR. TOPOROFF: Any other comments on this  
19 point? No. Okay. We're going to break for lunch.

20 **(A lunch break was taken.)**

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**AFTERNOON SESSION**

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MR. TOPOROFF: Okay. We're back on the record and before we move to our Internet presentation this afternoon there is an additional issue that I would like to address and that is stream of revenue franchises.

Before we do that I just want to, for the benefit of the stenographer, this machine is on. Is that -- does that have any effect on picking up my voice?

THE REPORTER: Yes.

MR. TOPOROFF: Please shut this off and then when we're ready we'll put it back on. Thanks. Okay.

Again, stream of revenue franchises. By way of background, the Commission franchisor defines earnings claim as very broadly and perhaps even broader than the UFOC defines it. And a suggestion of earnings is also considered in earnings claim as covered by our rule.

And the Commission has brought a number of actions that result in settlements with several companies in the janitorial services field on this specific issue. For those who are not as familiar with it, stream of revenue is a term that we use to indicate instances where a franchisor offers a package, and maybe John Tifford could correct me if I'm characterizing this wrong, but a package of basically contracts that are worth a certain amount somewhat on a sliding scale.

1                   So the franchise fee that somebody would pay  
2                   for, let's say, janitorial contracts for \$10,000 would be  
3                   X number of dollars. If you want a contract for \$20,000  
4                   then that would be a higher fee; \$30,000 contracts,  
5                   another fee. And the Commission in these various orders  
6                   has taken the position basically that these types of  
7                   package deals are in themselves the making of an earnings  
8                   claim.

9                   In the ANRP proposal the Commission asked  
10                  specifically whether these types of, again, stream of  
11                  revenue type earning -- are making -- of the making of  
12                  earnings claims and more importantly the role needs to be  
13                  clarified in any way or the definition of earnings claims  
14                  needs to be modified in any way to make that clearer.

15                  So I'm sure that the issue that's on the agenda  
16                  is is there confusion out there in the field whether a

1 of revenue type deals need to be clarified in the rule.

2 So does anybody have any particular thoughts on  
3 this one? Dale Cantone.

4 MR. CANTONE: I'm going to add that in Maryland  
5 we have a specific regulation recognizing that stream of  
6 revenue franchises have to comply with the requirements  
7 of making an earnings claim. And in Maryland we do --  
8 we're very clear. But we did see -- we did find that we  
9 had to have that regulation because there appeared to be  
10 in years past a lot of confusion on that issue.

11 So I think it might be a good idea to clarify  
12 that in the rule.

13 MR. ZASLAV: Can I asked one question?

14 MR. TOPOROFF: Barry Zaslav.

1                   MR. CANTONE: Dale Cantone. I'm saying that if  
2 a franchisor describes a stream of revenue -- a  
3 janitorial franchise is very similar. You don't have to  
4 do it this way. But if you offer a package based on a  
5 gross revenue or gross sales or something like that, a  
6 stream of revenue, there is a specific regulation in  
7 Maryland that requires you to comply with the item 19  
8 disclosure. And as far as I know, everyone who fits that  
9 definition is making that item 19 disclosure in Maryland.

10                   MR. ZASLAV: Okay.

11                   MR. TOPOROFF: David Kaufmann.

12                   MR. KAUFMANN: I'd like to say this as strongly  
13 as I can, but I think it is a mistake to confuse stream  
14 of revenue franchises, in and of themselves, to --

15                   MR. CANTONE: Can you speak up a little bit?

16                   MR. KAUFMANN: Yes. I think it is -- I'd like  
17 to say in the strongest terms as possible that I think it  
18 is a bad mistake to equate stream of revenue franchisors  
19 with franchisors with a similar earnings claim.

20                   The only area this issue is going to come in  
21 dispute, and I would add Janicating (phonetic) with  
22 respect to the Coverall, who represent Janicating, as  
23 well as a company called West Sanitation out of Los  
24 Angeles.

25                   The only time this area comes into dispute is



1 if the business that is promised is not, in fact,  
2 delivered. There is a -- there's a revenue that is  
3 readily available today and that's a lawsuit for breach  
4 of contract if that business does not deliver.

5 But equating the two only gives you --  
6 liability for stream of revenue franchisors that are  
7 unnecessary that are prejudicial. There is no need to  
8 make a bad situation in a breach of contract setting  
9 worse by trying to stack the deck in favor of the  
10 franchisee by also saying it's an illegal earnings claim.  
11 And again, I don't see any great need for it. I don't  
12 think anybody has been confused, what the distinction is  
13 between a true earnings claim and a stream of revenue  
14 franchise offer.

15 And I don't think that franchisors who engage  
16 in that are the very franchisors the government may want  
17 to encourage because they're promising X amount of  
18 business up front. It should be prejudiced either in  
19 Court or in their offerings by saying -- by subjecting  
20 them to this item 19 requirement.

21 UNIDENTIFIED SPEAKER: I would certainly agree  
22 with what you say, but the problem that we have is the  
23 reason why Janicating and Coverall and some other  
24 competitors in that market are making these claims is  
25 because of the FTC consent orders and not doing it

1 because their own interpretation of item 19. The problem  
2 is that we have other players who don't have these orders  
3 and they're not making these claims, whether they belong  
4 in item 19 or otherwise and we don't have a level of  
5 playing field. We can't have a situation where somebody  
6 coming into this arena permitted all of the disclosure  
7 documents and make any kind of meaningful comparison  
8 because we have been required to make these item 19  
9 disclosures.

10 MR. TOPOROFF: I think what you're addressing  
11 is two separate issues. As I understand it, Mr.  
12 Kaufmann's concern is that the Commission should not deem  
13 these to be the makings of earnings claims.

14 MR. KAUFMANN: In and of themselves.

15 MR. TOPOROFF: In and of themselves. And  
16 that's why I prefaced my remark by saying it already is  
17 Commission policy to view stream of revenue type deals.  
18 Maybe there are individual exceptions depending on the  
19 specifics. But as a general opposition, again, the  
20 Commission has to pursue the number of instances or cases  
21 that resulted in settlements where the Commission's view  
22 has been that these stream of revenue type deals do  
23 include the making of an earnings claim.

24 So what the proposal is on the table in the  
25 ANPR is whether given the Commission's posture, whether

1 the rule, itself, needs clarification to make sure that  
2 everybody in the field knows about this.

3 Let me just say one other thing. When we look  
4 at our rule in the rule review process and the rule  
5 amendment process that we have, one of the things that we  
6 are considering is going back to our old orders, advisory  
7 opinions, settlements, whatever, and see the Commission's  
8 policies as it has developed over the course of time  
9 since the world was initially promulgated.

10 And to that extent, if stream of revenue or any  
11 other issue hangs out there, if you will, then it is  
12 something that the Commission wants to make sure that the  
13 rule is clear.

14 So I'll accept your comment for what it is and  
15 we'll review it with all other comments, but, I think,  
16 what we're talking about is two separate issues.

17 As far as Mr. Zaslav's concern about a level  
18 playing field, the Commission's statement is the  
19 Commission's statement. And if other companies are not  
20 following suit, well then that's an enforcement issue,  
21 not necessarily a policy issue, which I think argues in  
22 favor of clarifying the rule so that all these companies,  
23 and right now it must be just janitorial services,  
24 perhaps in the future or maybe right now there are other  
25 companies that do the same thing.

1                   So what I gather is that the Commission, from  
2 Mr. Zaslav's comment, is that the Commission should  
3 clarify this in some way so that it is crystal clear and  
4 that everybody knows what their disclosure obligations  
5 are.

6                   John Tifford.

7                   MR. TIFFORD: Just two points. First of all, I  
8 understand the Commission's position, that it's an  
9 earnings claim, but, as you know, people sign consent  
10 agreements for a lot of reasons that have nothing to do  
11 whether they agree on the merits or the interpretation or  
12 not. I think that the Commission would find that there  
13 are significant disputes about whether there is an  
14 earnings claim or not, but that's really not the issue.  
15 We're going to sidetracked.

16                   The real issue, I think, that the Commission is  
17 concerned about, and it doesn't have to be called an  
18 earnings claim, it's simply a question is it important to  
19 make a disclosure to the extent to which a franchisor is  
20 contractually guaranteeing or contractually promising to  
21 provide revenues to a franchisee, is it a material piece  
22 of information that should be disclosed someplace in the  
23 offering circular, how successful they have been in  
24 fulfilling their contractual obligations. That's really  
25 the issue.

1                   And I don't think we -- to answer that policy  
2           decision doesn't mean that we have to decide it is an

1                   MR. TOPOROFF: No. Right now the Commission's  
2 view is -- or Commission's view has been that stream of  
3 revenue types of deals include the making -- parcel of  
4 what they're proffering is the making of an earnings

1 month in revenue. That's a contractual promise. If they  
2 don't fulfill that promise that's also a question of  
3 fact. Then the issue is the franchisee has a very clear  
4 cause of action.

5           Again, I don't think it's so much a question of  
6 substantiating whether or not they're going to do it, but  
7 just their success in doing it. And I mean that may be a  
8 material piece of information the Commission needs to  
9 decide whether it should be in. And all Coverall is  
10 saying is if they had made that decision or decide to  
11 make that decision, whatever we call it, earnings claim  
12 or not, let's make sure that the way in which the  
13 Commission decides to do it is something that is easy to  
14 understand and not burdensome to put together and better  
15 in a uniform matter throughout so that everybody can  
16 compare apples and apples and not various people  
17 comparing different charts that provide the information  
18 in different ways.

19           MR. TOPOROFF: Well, John, let me ask you a  
20 question. Let's say you have pizza franchise systems.  
21 Right now some may have earnings claim, some may not.  
22 Some may have predictions. Some may have historical  
23 information. And even within the historical information  
24 some might find it reasonable to have averages. Some  
25 might have some other kinds of way to disclose. And

1 right now there's no uniformity for pizza franchise  
2 systems. So a prospect who comes along and wants to buy  
3 -- is looking at the industry, it could be any industry,  
4 isn't going to necessarily compare -- be able to compare  
5 apples to apples.

6 So what makes stream of revenue type deals  
7 special that the Commission should carve out an exception  
8 and basically do what other franchisors have told us not  
9 to do -- they don't want us to dictate necessarily for a  
10 whole industry. And that's what we have in mandatory  
11 earnings discussions. I mean, repeatedly people have  
12 been telling us one size doesn't fit all. There's no  
13 clear cookie cutter way to have a disclosure for all  
14 industries and all circumstances.

15 But yet what I take in part from your comment



1 Commission should let people present it anyway they feel  
2 best.

3 I think that it would be a very, very serious  
4 dispute about whether this is an earnings claim or not  
5 and I think the Commission should not take cover in the  
6 fact that some people who have signed consent decrees as  
7 meaning that there's any agreement about whether it's an  
8 earnings claim or not. But that battle has been fought  
9 in terms of these companies. That's locked it.

10 And it seems to me what you're really talking  
11 about again is when someone makes a contractual  
12 commitment, how well do they fulfill it, and, to me,  
13 that's a specific fact that's very easily applied no  
14 matter whether it's a pizza franchise or a janitorial  
15 franchise. If you -- have you fulfilled your contractual  
16 requirement. And to me, I think, it's a very -- a much  
17 more simple format and a very much simple answer. And  
18 our suggestion is that if it's going to be made it should  
19 be made in sort of a uniformed manner so that all  
20 franchisors provide the answers in the same format and  
21 that it be done in a fairly simple way that's easy to  
22 understand and easy to prepare.

23 And that's why the comment sort of sits -- the  
24 Coverall suggestion of how it should be done. Barry,  
25 you --

1                   MR. ZASLAV: Yeah. I was going to say pretty  
2 much what you did. Just to add on that, perhaps the  
3 reason that we're suggesting uniformity is the companies  
4 that have entered into consent order thus far, why they  
5 were left free to make their own item 19 disclosure as a  
6 result of that. I know that the FTC had to approve what  
7 they were doing before they did that. At least that was  
8 my understanding.

9                   MR. TOPOROFF: I don't know if that's correct  
10 or not. I just don't know.

1 be addressed through an advisory opinion as opposed to  
2 tinkering with the rule?

3 MR. TIFFORD: John Tifford. I think that the  
4 Commission needs to -- I maybe shouldn't speak for the  
5 Commission. My suggestion to the Commission would be  
6 that again I think that you would -- should not be that  
7 -- all confident that the item 19, that this is an  
8 earnings claim and if somebody challenged in Court that  
9 you would be successful. And if you really think that  
10 you want to have this information in, my suggestion and  
11 recommendation to you is you better put it in the rule  
12 because then you know you have the authority -- the legal  
13 authority to do it. And without that I really wouldn't  
14 be competent that you should assume that you'd be able to  
15 do that.

16 MR. TOPOROFF: David Kaufmann.

17 MR. TIFFORD: Excuse me. Let me just finish.  
18 So in case -- an advisory opinion is not binding --

19 MR. KAUFMANN: This is not David Kaufmann.

20 MR. TIFFORD: I'm sorry.

21 MR. KAUFMANN: This is still John Tifford

22 MR. TIFFORD: I didn't really respond to that  
23 second part of your question. If you've given -- a staff  
24 advisory opinion is, of course, not binding. Not even on  
25 the Commission. And certainly not binding on

1 franchisors. It only tells the franchisor that if they  
2 choose not to do it they risk -- they risk an enforcement  
3 action. And I don't think that's a good proposal either.

4 MR. TOPOROFF: David Kaufmann.

5 MR. KAUFMANN: As bad as I feel for Coverall in  
6 this consent decree, frankly I don't want any other  
7 clients submitted to the impact of that consent decree.  
8 If we start down the path of saying that a fixed -- that  
9 a contract promising X number of dollars gross revenue  
10 constitutes them making an earnings claim, then the next  
11 step is for a transmission repair shop that gets a  
12 territory of let's say of -- encompassing a 300,000  
13 registered automobiles. Well, that could be an implied  
14 earnings claim.

15 At the end of the day -- I don't think there's  
16 much of a concern here, quite frankly. At the end of the  
17 day if any franchisee in a stream of revenue franchise  
18 setting doesn't get the amount of business that that  
19 franchisee has promised, the actions exist for fraud,

1 saying anything.

2 Now, again I understand Coverall is subject to  
3 a consent decree and it's calling for everybody else to  
4 be subject --

5 MR. ZASLAV: No. Just for the record, David,  
6 Terika (phonetic) is under the same consent decree.

7 MR. KAUFMANN: I understand -- I know that.  
8 But there are others -- Mr. Zaslav. There are others who  
9 are not.

10 MR. ZASLAV: Not many.

11 MR. KAUFMANN: And frankly I don't think any of  
12 them should be. I think it's unnecessary. It doesn't  
13 serve the public interest one wit. It was not the  
14 subject of hearing of this determination of the FTC that  
15 stream of revenue offering constitute an examination of  
16 earnings claims. Perhaps the FTC might want to revisit  
17 it.

18 MR. TOPOROFF: Dale Cantone.

19 MR. CANTONE: I think if a franchisor chooses  
20 to describe its franchise offering by a certain dollar  
21 figure of, for example, gross revenue per month, that it  
22 shouldn't be too burdensome to ask that franchisor to  
23 disclose how many people who bought that package made  
24 that amount. How long did they sustain it? How long did  
25 it take for them to get it? I will tell you that the

1 stream of revenue contracts seem to be some of the more  
2 -- the larger, the more complex. The deals are very  
3 complex and they're not always, with some exception, the  
4 most sophisticated franchisees.

5 So I think there's a real need in this area and  
6 in Maryland we try and structure the item 19 disclosure  
7 so that a franchisee who is shopping in that area can  
8 comparison shop by disclosing just that. And it seems to  
9 be working out fairly well. Some people at this table  
10 might disagree with me, but for the most part we have  
11 heard actual franchisors tell us, after putting up some  
12 resistance to making that type of disclosure, when they  
13 got good figures they said we want to show them off in  
14 comparison to the other people in the industry.

15 MR. TOPOROFF: Susan Kezios, do you have a  
16 comment?

17 MS. KEZIOS: I was just -- something that Dale  
18 said reminded me that Coverall and the janitorial people  
19 that we've heard from, they say that the average account  
20 lasts only a year in the industry. And so -- I mean,  
21 this is what we're hearing on the street, as it were, and  
22 hence the information -- I mean, it is an earnings claim.  
23 And you need to disclose how many people have, in fact,  
24 reached those levels of business.

25 But that's what we're hearing from Janicating

1 and Coverall members of the AFA.

2 MR. TOPOROFF: Before we go on, I just want to  
3 make it clear that this is not a law enforcement summit  
4 or roundtable, so I don't want it to be interpreted that  
5 we're picking on or seeking information for law  
6 enforcement purposes on any particular company. I mean,  
7 we're focusing on the concept of stream of revenue. So I  
8 really don't want to get into a tit-for-tat or the merits  
9 or I heard this about the company or that about the  
10 company. That's not our focus here. So -- Mark Forseth.

11 MR. FORSETH: Yeah. You keep referring to  
12 these things as stream of revenue, but that's not what it  
13 is and it -- by referring to them as stream of revenue  
14 what you're doing is you're presupposing that is an  
15 earnings claim when, in fact, what it is is  
16 representation that you're going to be provided contracts  
17 that have X value and how else can they -- how else can  
18 they state what those contracts are other than assessing  
19 what a value is.

20 And you're imposing an obligation concerning a  
21 disclosure of an earnings claim that really, when you  
22 read it, doesn't really track what they're doing. I  
23 mean, it's no different then saying I'm selling you  
24 \$5,000 worth of equipment, \$5,000 work of yogurt, \$5,000  
25 worth of whatever. I mean, it's just -- it's just a

1 value attached to it.

2 And so, I guess, from that prospective it's  
3 rather -- it seems to me you're singling someone out. I  
4 mean, why is it any different than someone who sells  
5 someone a territory and in order to maintain that  
6 territory you have to have \$20,000 a month in gross  
7 sales. And if you don't, we have a right to terminate  
8 that.

9 Isn't there an implicit earnings claim in that?  
10 And it seems to me that you are taking a concept as to  
11 representation out of its own context.

12 MR. TOPOROFF: Any other comments on this  
13 issue? Okay.

14 With that, we're going to take a short break to  
15 set up the Internet to give some context to this. In the  
16 ANPR and in the rule review that proceeded it, the  
17 Commission asked us specifically about new technologies  
18 or new market practices that might affect the rule that  
19 we should consider and Internet sales is certainly one  
20 that has come to our attention.

21 There are basically two big issues in this  
22 field. One is what kind of promotions, advertising, what  
23 have you on the net might trigger the rules disclosure  
24 requirements. And the other is how can franchisors  
25 comply with the rule through the Internet. And I think



1           it is fair to say that the Commission is very forward  
2           looking and wants to make it as easy as possible for  
3           consumers, for businesses -- not just in the franchise  
4           arena, but in all arenas -- to use new technologies via  
5           the Internet, video conferencing, fax, telephone,  
6           whatever else may come down the pike.

7                         So with that background, a few comments have  
8           come to our attention dealing with Internet specifically  
9           and we're going to see a demonstration of one proposal in  
10          a few minutes. Also other people have focused on the  
11          trigger for disclosures, which was an issue that we were  
12          going to address earlier this morning, but we've  
13          postponed until now. And that is whether the term  
14          face-to-face discussion still has any validity in this  
15          field and the Commission's proposal of whether the term,  
16          face-to-face, should either be done away with completely  
17          or substituted with something like for substantive  
18          discussion.

19                        So before we get into all that we will take a  
20          break and set up for the Internet demonstration. And I'm  
21          going to turn it over to --

22   **(A brief break was taken.)**

23                        MR. WAY: My name is Dick Way. I'd like to  
24          introduce my partners from PR-One. Vanessa Ayers and  
25          Andy Unger. I presume you can tell the difference. Andy

1 is a Securities lawyer and Vanessa's background is in the  
2 area of graphics design, architecture and a number of  
3 other businesses.

4 We originally started a company called PR-One  
5 and the purpose of that company was to assist public  
6 companies in the dissemination of their required  
7 information. As I indicated, Andy has been a Securities  
8 lawyer for 50 -- no, no. A long time. And I personally  
9 had some experience in the operation of public companies  
10 and the disclosure requirements. And so we initially put  
11 the company together for the purpose of meeting the  
12 disclosure requirements as well as what you promiscuity  
13 call financial public relations requirements of public  
14 companies.

15 What's going on here, of course, is just the  
16 computer loading since we shut it off to keep the noise  
17 down.

18 So what we're going to do here today is to show  
19 you, first of all, a little bit of that site to give you  
20 a little bit of the background of how this came to be and  
21 then move in to the prototype site that we want to show  
22 you with respect to the franchise business itself.

23 What we're going to show you doesn't measure up  
24 to what Web designers would like to talk about as being  
25 the latest in the way of technology. What a lot of

1 people who are involved in this business overlook is that  
2 the vast majority of people who access the Internet are  
3 still doing it with their 14.4 modems and most of them,  
4 or at least a very significant number of them, are doing  
5 so through one of the major on-line services. And when  
6 you use the latest bells and whistles and gadgets in the  
7 design of a Website, the time involved in getting  
8 anything there in the way of useful information is  
9 frequently seriously impacted.

10 For example, there are certain, what we call  
11 mind files, that you can't even transfer from your server  
12 through the on-line service to the other person's  
13 computer yet because they haven't actually upgraded their  
14 technology and I'm sure you've all heard about some of  
15 the difficulties that some of those companies have.

16 As a consequence, what we did in terms of a  
17 design philosophy is to undertake to design sites which  
18 deliver information and do so in a relatively simple  
19 format. These sites are designed with primarily the user  
20 in mind to make it easy for the user to get comfortable  
21 with the way in which the site works and be able to look  
22 at different, in the case of franchises, different  
23 franchisors offerings.

24 So -- I lose my train of thought here for a  
25 moment while I get these things loaded. There's one

1 other thing that I want to issue here in the way of a  
2 disclaimer before we get started since there's a roomful  
3 of lawyers.

4 We are not going to do this on-line. This will  
5 -- this is actually being put to you from the hard disk  
6 on this computer. The reason being that in the interest  
7 of saving your time we don't want to wait for the pages  
8 to load. So one thing you should understand is that what  
9 you will see here in terms of load times are much faster  
10 than what you would see if you were actually accessing  
11 these sites over the Internet itself.

12 There are really only two functions, and I'll

1 background.

2 What we've done is to come up with -- starting  
3 at the top left hand corner -- pages which are designed  
4 to provide information, both about the subject at hand as  
5 well as how to use it, because a lot of people access  
6 Websites who don't really understand why their particular  
7 browser, for example, may have limitations. And  
8 different levels of browsers support different kinds of  
9 things.

10 So we have a site map which describes all of  
11 the things which you can see on this site and a little  
12 bit about what's there. We have a listing of the  
13 portfolio companies, which I'll show you in a moment.  
14 The emerging companies. This site, remember, is not the  
15 franchise site. We'll get to that in a moment.  
16 Different kinds of companies and then a link to the  
17 franchise investment opportunities, a page about PR-One,  
18 our company, information about the site which describes  
19 the things that I just talked about, browsers, how it  
20 impacts what you can or cannot do.

21 Many -- if you've been on Websites you know  
22 that some offer you text versions only so if you don't  
23 have a -- if you don't want to wait for graphics you  
24 don't have to. Some browsers support different kinds of  
25 -- for example, you saw a marquee going across this site.

1 Some browsers don't support marques. So that's an  
2 example of the kinds of things that you may or may not be  
3 able to do.

4 Then we have an area where we talked about  
5 professional resources and I'll go into that one in a  
6 moment, how to become a PR-One client -- obviously we  
7 wouldn't be on the net if we weren't trying to sell our  
8 services -- and a request for information about any of  
9 the companies which are in here.

10 Let me just quickly how you a couple of these  
11 areas so that you get some idea of the layout of the  
12 site.

13 If you want to access a particular company from  
14 this group, you actually just click on their logo and  
15 each of these companies and franchisors have a series of  
16 these kinds of button links. We -- people accuse us of  
17 going button crazy. One of the things that a prospective  
18 user of these systems tires very rapidly about is waiting  
19 for the downloading of information which may be at the  
20 bottom of a long page and they don't want to wait to get  
21 that. So what we've done is to try to break these sites  
22 into relatively short bursts of information, and if the  
23 people don't want to dwell on that they don't have to.  
24 They can go on to the next subject.

25 Part of that has to do with, again, part of the

1 technology which is moving. Some machines, which people  
2 are using, may have little or no cash memory. And as a  
3 result, they can't download something and play with it  
4 without going back to the server to get it updated.

5 So we try to balance the reality of the tools  
6 of the technology with what the people are trying to do  
7 in terms of the users.

8 Let's go on then to the franchise site itself.  
9 Well, let me just quickly show you that part of what we  
10 want to do is to provide information about people, such  
11 as yourselves, who provide information to -- help to  
12 people, who are interested in franchises. That is  
13 lawyers, accountants, people who are -- whose practice  
14 involves providing information to -- providing help to  
15 these kind of people.

16 Quickly now they'll get into the franchise site  
17 and you'll note that in terms of the layout it is  
18 essentially the same so that there are investment  
19 opportunities for people who want to look at franchises.  
20 There are professional resources. We have a site for  
21 putting information about the franchise industry on a  
22 periodical basis. Again, information about the site, a  
23 map of the site, how to become a client, information  
24 about the company, disclosure about the use of the site,  
25 we have a place for regulatory agency information which

1 I'll show you in a moment, and then how to exit the site.

2 Before we go into a specific franchise, let's  
3 just for a moment take a look at the regulatory agency.  
4 Well -- for some reason or other that one doesn't -- that  
5 button won't respond. Let me just quickly tell you that  
6 in that area what we've done is to put links directly to  
7 the FTC and all of the State agencies. It's, in effect,  
8 the exhibit, which is a part of the UFOC that lays out  
9 all of the agencies in the various States that have  
10 regulatory authority.

11 So when a person uses this site, the first  
12 thing they do is to access this site to provide -- to  
13 find information about the franchise itself. In the case  
14 of Pack-Mail, which is the one that I'm going to  
15 demonstrate, this site is designed on the assumption that  
16 the people came here from Pack-Mail's own corporate  
17 Website. There is a certain amount of information  
18 delivered there and this is a continuation, which, in  
19 effect, picks up the process at the point that someone  
20 would have made -- ordinarily would have made a request  
21 for written information from the franchisor.

22 The purpose of the early part of the site then  
23 is to deliver to the prospect the information that the  
24 franchisor would send as a result of the initial inquiry.  
25 So the first part of these sites is laid out to provide



1           what I would -- what we call marketing materials.

2                         We won't take time to look through these, but  
3           let's take, for example, a particular piece of the  
4           information. This is essentially the same thing that is  
5           delivered in printed form to the franchise prospect by  
6           the franchisor. When they have gotten through with  
7           whatever piece of that material they want to look at --  
8           and by the way I proposed some of your earlier  
9           discussions, this site is, of course, is available to  
10          them 24 hours a day, seven days a week. They can look at  
11          any of this material from any of the franchises and go  
12          back and forth and read and do whatever they want to do.

13                        The point at which the issues which you are  
14          addressing begin in this particular prototype site has to  
15          do with the provision of information from the prospect  
16          back to the franchisor, which would trigger the next  
17          step, that is the evaluation of the prospect to determine  
18          whether or not the franchisor wishes to deliver the  
19          offering circular. I should say that what we have done  
20          here is based on our interplay with two or three  
21          franchisors and we don't represent that they necessarily  
22          meet all of the needs of all of the other kinds of  
23          franchisors, although we are gradually expanding that.

24                        In this particular case, at the point that  
25          they've reached the question what do I do next, they then

1 can fill out this on-line questionnaire, which after they  
2 have filled it out they can then submit it and this  
3 information goes back to the franchisor. They then can  
4 evaluate that and decide whether or not they want to  
5 proceed with delivery of the additional information.

6 I'm going back up to the top because what we've  
7 tried to do here is to design a site which sort of builds  
8 the sidewalks where the people are walking. I can tell  
9 you that from the standpoint of the use of the technology  
10 there are certain things about the regulatory environment  
11 which we do without ever really understanding why with  
12 this kind of medium available you need to do. But that's  
13 beside the point.

14 The point is that if a person does not wish to  
15 have -- to go through the process at this point of  
16 filling out the on-line questionnaire, there is a link  
17 provided there where they can actually go back to the  
18 background -- the corporate Website and revert to the  
19 written approach, if they wish to do so. They can then  
20 fill out an on-site questionnaire on that site and get  
21 the same documentation sent to them in written form.

22 After they have submitted this information --  
23 and by the way, this is one of the places where if the  
24 server -- if we were actually on to the server. When  
25 that information is submitted this system delivers back

1           what we call a confirmation page that shows what they put  
2           in the questionnaire so that if they want to make any  
3           changes they can do so before they actually move on.

4                       In this particular system, then, what we have  
5           done is to design the next stage so that the franchisor  
6           actually has to give them a password to proceed. So if,  
7           in fact, they go to the franchise offering documents they  
8           will find jurisdictions for all of the jurisdictions  
9           provided by this particular franchisor.

10                      Now, I was interested in listening to your  
11           discussions about the various requirements of the State.  
12           Behind each of these buttons is a special UFOC with all  
13           of the exhibits modified to meet each of the  
14           jurisdictions represented here.

15                      If you look at the Illinois documents, for  
16           example, each of the pages which are different from the  
17           standard UFOC or what we call the generic UFOC, have, in  
18           fact, been changed. Whether or not that ultimately is  
19           the way in which it is done depends upon the regulatory  
20           people and others.

21                      Now, if, in fact --

22                      MALE VOICE: How is this person who is going on  
23           line is to know which jurisdiction applies to that?

24                      MR. WAY: We -- if, in fact, they live in South  
25           Dakota we assume --

1                   MALE VOICE: Let me suggest that is not a  
2                   simple determination and that State law is varied greatly

1           again doing just what we were talking about where a form

1       somebody just read them through that UFOC, the table of  
2       contents is linked so that if they wish to look at any  
3       particular part of it they can click on that and -- here  
4       again this gets back to the subject you and I were  
5       discussing in terms of how much cash memory they have.  
6       If, in fact, you're operating a system which has  
7       sufficient cash memory, you download this document which  
8       runs to about 175 k-bytes of information, then you can  
9       actually sit there and look at that document over and  
10      over again and link back and forth. If you don't have  
11      that capability you got to wait for it to download  
12      essentially every time, that may not be a practical way  
13      to do that.

14                 And some of the other approaches, which can be  
15      used, we should talk about for just a second at this  
16      point. Any of you who are familiar with these systems  
17      know that one of the things you can do from the browser  
18      is to actually save that file. You can save it from the  
19      browser. Other people talk about the possibility of  
20      using what we call file transfer protocol, where you can  
21      actually have a button that the people can depress and it  
22      will go and use a different form to download the text  
23      document.

24                 We'll get into discussions about whether or not  
25      pagination becomes important. We work with some very

1 conservative lawyers who seem to be concerned about the  
2 fact that when you print it out on the browser the  
3 pagination may not turn out to be exactly the same as it  
4 is if you get it in hard copy. Well, is that a big deal  
5 or isn't it. I don't know. To me it's not a big deal.  
6 To some people it might be.

7 But those are some of the issues which we're  
8 trying to address through a practical site to look at  
9 these things.

10 You can actually do things within the  
11 documents. I don't remember personally -- for example,  
12 you can highlight certain tables in the document. You  
13 were talking about these revenue claims and that kinds of  
14 things. There are different ways to highlight those.

15 One of the things that could be done is to  
16 actually convert these to links to the actual franchise  
17 agreement. So that if the person was looking at the  
18 offering circular and wanted to see what that particular  
19 segment of the franchise agreement, itself, says, they  
20 could link to that. But again you get back into the  
21 issue of how practical is it for people to use that  
22 approach depending upon where they are in their own  
23 system. Those are some of the issues that we're trying  
24 to identify.

25 So once the person has actually been through

1           the -- I'll go back to that UFOC page. All of the  
2           exhibits associated with the uniform offering circular  
3           are available to them. Again, all of these are  
4           specialized by the particular jurisdiction.

5                         Any other things that -- you know, in terms of  
6           the size of these documents, one of the things that we  
7           found out as we get into this is that -- at least for  
8           this particular franchisor, the hard copy support for



1 franchisor.

2 I think with that, Steve, what we want to do is  
3 to not take any more of your time except to the extent  
4 that we can answer questions or get into the discussion.  
5 So we'll back out of here and let you go on with that.

6 MR. TOPOROFF: Okay. Thank you. Can we turn  
7 on the lights?

8 The comment that came in in connection with  
9 this demonstration. Before I do that, though, is this  
10 turned off?

11 MR. WAY: It will in just a minute. I'm  
12 letting -- you need to cool that lamp down just a second  
13 and then I'll turn it off.

14 MR. TOPOROFF: Okay. The comment that we  
15 received again from this company proposes a way that  
16 companies' franchisors can sell through the net. This is  
17 a proposal. It's not necessarily the only method.

18 But I should point out that we received earlier  
19 on a comment from Myron Fox, who basically set forth a  
20 very similar type of proposal, and that is the notion  
21 that franchisors on the net, excuse me, should be able to  
22 have some kind of Web page where they advertise what  
23 they're all about, have some kind of application process  
24 on-line, which the franchisor can respond with a  
25 password. Using the password the prospect can download

1 or have access to a specific State disclosure document  
2 and basically read that on-line. And again this is one  
3 proposal, possibly many.

4 One thing I would like to do is put off for  
5 right now the discussion of first substantive meeting and  
6 all that, I think it's a separate issue entirely, and  
7 focus on this proposal. I should also mention that in  
8 connection with this proposal Mr. Unger has filed for an  
9 advisory opinion request, which is outstanding, and we  
10 will get to it -- I don't know when.

11 But the difficulty here is we have  
12 simultaneously the Commission studying these issues  
13 generally. The Commission has a policy as I mentioned  
14 before of looking at Internet issues. Certainly we are  
15 looking at it very specifically in terms of the franchise  
16 rule. We have other workshops and, in particular, the  
17 one in Seattle that will address Internet, plus the  
18 comment period is over. And before we can address the  
19 merits of this particular proposal in terms of the  
20 advisory opinion request, we would want to have more  
21 input from groups like yourself and certainly others who  
22 may wish to comment.

23 Before we get to specifics and open this up for  
24 further discussion, I did have one major concern and that  
25 is something that Neil Simon hinted at before. It is

1 possible that a franchisee who goes on-line and reads  
2 about this particular -- visits this particular Website,  
3 he may be on vacation in a different State, he may live  
4 in a particular jurisdiction but want to open a business  
5 somewhere else, and just merely filling out a form or  
6 putting down his current address does not necessarily  
7 indicate where they intend to do business and the State  
8 specific disclosure document that they're going to  
9 receive.

10 So is there a mechanism built into this that  
11 would capture that kind of information so that the  
12 franchisor and the franchisee are assured that they're  
13 going to get the appropriate State specific disclosure  
14 documents?

15 MR. WAY: Dick Way. The answer to that is yes.  
16 In the questionnaire it specifically asks where it is  
17 that the franchisee intends to do business and the  
18 password is jurisdiction specific, so that when the  
19 franchisor gets the information from the prospect as to  
20 where they intend to do business, they then deliver a  
21 password which will allow them access to that UFOC

22 MR. TOPOROFF: Neil, did you still have a  
23 question?

24 MR. SIMON: That addresses the question I had.

25 MR. TOPOROFF: Dennis Wieczorek.

1                   MR. WIECZOREK: The difficulty with that kind  
2 of an analysis is that the States do use location of the  
3 franchise and domicile of the franchisee as part of the  
4 test. Many of the Statutes also ask where the offer took  
5 place. And an offer over the Internet is theoretically  
6 not an offer in the State because it is not an  
7 advertisement in the State because it doesn't -- New York  
8 Times in New York is an -- if you advertise in the New  
9 York Times, you're advertising New York most likely.

10                   But there are some State laws that a person  
11 could have an out-of-state domicile proposed location  
12 outside that State, but the State law would apply because  
13 the offer was made in that State. And I'm not sure how  
14 this kind of a procedure could ever get that kind of an  
15 analysis.

16                   That's not necessarily an FTC concern. It's  
17 more of a state-by-state concern. But that is an issue  
18 that probably can't be resolved through passwords,  
19 questionnaires, et cetera.

20                   MR. WAY: This is Dick Way again. I would  
21 simply respond and, you know, I'm not a lawyer but the  
22 whole issue of commerce on the Internet is, as I think  
23 you're saying, much broader than this particular problem  
24 because there are a number of other activities on the  
25 Internet where people have tried to address the concept

1 of where that transaction takes place, not the least of  
2 which are the taxing authorities and the various  
3 jurisdictions trying to decide whether or not you sold  
4 something over the Internet and that particular issue.

5 And I think that the resolution of that is  
6 probably going to be forced into the Courts fairly soon  
7 because it's raising its head in a number of issues all  
8 over the country.

9 Technologically, there are probably no ways,  
10 unless somebody can define legally what constitutes where  
11 the offer takes place, which I'm not aware of anybody  
12 being able to do that at this moment. Technologically,  
13 I'm sure those can be dealt with, but I think that's a  
14 legal issue as opposed to something that we can do with  
15 passwords, et cetera.

16 MR. TOPOROFF: Another question I had about the  
17 password and the acknowledgement receipt, what happens if  
18 the franchisee or the prospect, just doesn't hit that  
19 button and doesn't acknowledge that they received the  
20 UFOC? What happens?

21 MR. WAY: This is Dick Way again. Our attitude  
22 about that is that unless that transaction occurs and --  
23 you understand we addressed this issue from our  
24 particular view. Unless that transaction occurs the time  
25 period has not started.

1 MR. TOPOROFF: Dale Cantone.

2 MR. CANTONE: If I, as a State regulator, want  
3 to see a copy of the acknowledgement of receipt, am I  
4 going to get a preprinted form with no signature and a  
5 date that's printed by computer. What will I have to  
6 verify that the franchisee, in fact, did sign or did do  
7 something to acknowledge receipt of the document other  
8 than maybe a preprinted computer page that maybe is  
9 susceptible to fabrication.

10 MR. WAY: This is Dick Way again. The fact of  
11 the mater is that technologically the Web is -- or the  
12 Internet is currently capable of actually recording  
13 signatures, but realistically the vast majority of people  
14 do not have yet that capability to do that. That will be  
15 here some day.

16 But we believe that the only way to really  
17 resolve that issue -- I mean, after all what you're  
18 addressing here are downstream negative results. That is  
19 to say if everybody's happy with this transaction these  
20 things never become an issue. If they're not happy with  
21 this transaction is when you really begin to look at  
22 them, and we believe that at this point there's no really  
23 good way to substitute for hard document closure  
24 involving face-to-face discussion and signature.

25 We just don't see that -- I mean, there are

1 people who obviously will take issue with that who think,  
2 you know, you can use some of these gizmos to do that,  
3 but here again, there are just aren't -- there aren't  
4 very many people who have access to that kind of  
5 capability and therefore we think that once the people  
6 have reached the point they wish to consummate the  
7 transaction that then they have to resort to it at least  
8 a hard copy closure document which would include  
9 acknowledgement that those things took place at that  
10 date.

11 MR. TOPOROFF: I have a question. What  
12 assurances are there that the State specific disclosure  
13 documents that are going to be posted at the site have  
14 been approved and are registered in the respective  
15 jurisdictions?

16 MR. WAY: From a delivery standpoint, all we  
17 can do is actually put on the documents, and if the  
18 system were still up I can show you, that in each of  
19 those cases when the law firm that represents the  
20 franchisor delivers that document to us, they put on that  
21 page that that is a State specific page and we include  
22 that image in the site.

23 A lot of people have raised the question about  
24 manipulation of the documents. I don't know that there  
25 is any way, even in hard copy, to prevent someone who is

1 willful in terms of trying to mislead the prospect from  
2 doing do. Neither can you do so in terms of this kind of  
3 presentation because what really is capable -- what we're  
4 capable of doing is generating these documents on the  
5 fly. That is, if you make an inquiry for, say, the  
Indiana UFOC, I can make the server take pieces from a



1 don't talk to someone unless you got the receipt. Please  
2 don't proceed at a certain point.

3 And the same way with the assurances that the  
4 documents are registered. There's always the possibility  
5 that the franchisor could take the documents and file it  
6 in Maryland, it hasn't been approved yet, and send it  
7 out. You know, there's got to be some policing at the --  
8 level of the franchisor's headquarters. I think it would  
9 work the same way with paper or on the Internet.

10 MR. TOPOROFF: So basically what you're saying  
11 is it's no better, no worse than the risks that  
12 prospective franchisees now have with hard copies  
13 disclosures.

14 MR. KIRSCH: From what I can see, yes.

15 MR. TOPOROFF: Okay. Fair enough. David  
16 Kaufmann.

17 MR. KAUFMANN: A quick question, Mr. Way. Does  
18 Pack-Mail send out a hard copy of anything and get a hard  
19 receipt?

20 MR. WAY: Currently Pack-Mail does not use this  
21 site. It would be our understanding that what they would  
22 do is if -- they would certainly do the hard closing that  
23 I talked about where there are actually execution of hard  
24 documents before they would sell the franchise.

25 But in terms of whether or not at any point in

1 the process absent a request from the prospect for the  
2 hard documents, the answer would probably be no.

3 MR. TOPOROFF: Neil Simon.

4 MR. SIMON: I agree with Mark. A lot of these  
5 problems we're talking about are -- we have the same  
6 problems with hard copy today. I think the one issue we  
7 identified or that's come up is the one that Dennis  
8 talked about. Where does the offer take place? And that  
9 is -- that is an issue that comes up everywhere with the  
10 Internet and the Web.

11 I just want one clarification on the -- does  
12 the receipt have to be completed before they then can get  
13 the document?

14 MR. WAY: Dick Way, again. No. The answer to  
15 that is no and I must tell you that I had extensive  
16 discussions with the legal people who represent Pack-Mail

1 won't do anything. That's the end of the transaction  
2 until such time as they're willing to submit the receipt,  
3 then the time period can start.

4 MR. TOPOROFF: Dennis and then John Tifford.

5 MR. WIECZOREK: Actually many franchisors don't  
6 let people have the document until they get the receipt  
7 actually. I mean, they will say here's our document.  
8 Here's your receipt right now. If they're smart about  
9 it, they'll do that because otherwise they have to chase  
10 after the person and try to get it back.

11 So it's fairly common their receipts are taken  
12 when the documents are given before they're read.

13 MR. WAY: All right. And my response to that  
14 would be if that's what the franchisor wants to do it's  
15 no problem to do it.

16 Mr. WIECZOREK: Right.

17 MR. WAY: The system can simply say okay, you  
18 didn't give me the right password or the receipt.  
19 Therefore, I'm not going any further.

20 MR. TOPOROFF: John Tifford.

21 MR. TIFFORD: That was my question.  
22 Technologically, it's possible to simply deny --

23 MR. WAY: No problem.

24 MR. TIFFORD: All right. And the second  
25 question is in terms of what offering circular to give.

1 As Neil and others have pointed out, it really isn't so  
2 simple as to say where are you located, but don't you  
3 technologically have the same capability of asking the  
4 questions of where you -- what State are you a resident  
5 of, what State are you planning to locate your business  
6 in, things like that, and then based upon those answers  
7 wouldn't you know what offering -- you could program the  
8 computer to determine what offering circulars those  
9 people should have access or must have access to?

10 MR. WAY: Currently, the system does, in fact,  
11 get all of that information and provide it to the  
12 franchisor before they determine which jurisdiction to  
13 give access to. I think the question that -- that went  
14 beyond that though was that some States may -- I'm only  
15 looking at you because you're --

16 MR. TIFFORD: Did the States.

17 MR. WAY: I dearly remember putting together  
18 the Maryland differences in my system. But -- and that's  
19 not many, by the way.

20 But it gets back to this issue of, you know,  
21 where did -- if the regulators raised the issue of the  
22 offer of question, then that's something that I don't  
23 know that we can deal with. But certainly in terms of it  
24 the prospect represents that they live someplace and want  
25 to do business someplace, then the franchisor has exactly

1 the same information that they would have in the written  
2 form.

3 MR. TIFFORD: John Tifford again. That means,  
4 for example, suppose someone is not registered in  
5 Maryland and the computer asks them the question where do  
6 you live and they say Maryland. And this computer says  
7 where do you plan to put your franchise and they say  
8 Maryland. Doesn't the computer have the capability of  
9 saying I'm very sorry, I can't provide anything to you  
10 right now?

11 MR. WAY: Absolutely.

12 MR. TIFFORD: Well, that would settle our  
13 problem.

14 MR. TOPOROFF: Mr. Unger.

15 MR. UNGER: I just want to clarify one thing.  
16 Those determinations are made by the franchisors. They  
17 don't have to be by the computer. So it's no different  
18 than the franchisor putting an advertisement in  
19 Entrepreneur Success and someone who lives in New York  
20 who is on vacation in Michigan and they pull it out and  
21 they call this and they send the information.

22 When the questionnaire is completed it goes to  
23 the franchisor and the franchisor follows the same  
24 protocol that they would do where the information or  
25 questionnaire is submitted as with some of the media ads.

1 MALE VOICE: Where is your server located?

2 MR. BROWN: This particular one is in Newport  
3 Beach.

4 MR. TOPOROFF: I'm going to remind people, you  
5 have to identify yourself for the record.

6 MR. BROWN: Harold Brown.

7 MR. TOPOROFF: Neil Simon, your comment please?

8 MR. SIMON: I was just looking at the array of  
9 issues involved. Although it should be absolutely  
10 irrelevant, I can imagine the question coming up about  
11 where is the electronic source of this data that is being  
12 transmitted. So I was wondering where the server was  
13 located, which I understand to be in Rhode Island?

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1 Web is only being used as a mechanism of communicating  
2 information or facilitating commerce, additional notions  
3 of jurisdiction, i.e. where is the residence, where is  
4 the business intended to be located, those are -- those  
5 tests still remain as the law.

6 Again the question with the location and the  
7 server, in fact, the servers may physically be in a  
8 network that's located in a number of different states.  
9 Although the taxation authorities in some States have  
10 tried to attack the servers at the site as for  
11 retaxation, those attacks have been unsuccessful. So  
12 traditional notions of jurisdiction remain.

13 MR. WAY: This is Dick Way. Just as a -- Mr.  
14 Brooks is also from California and, of course, the  
15 franchise tax board in California is one of the most  
16 aggressive taxing organizations in the entire world with  
17 respect to trying to claim the commerce that takes place  
18 in that State. That's, you know, just pain.

19 MR. TOPOROFF: Any other questions? Mr.  
20 Kaufmann.

21 MR. KAUFMANN: Yes. How are we going to deal  
22 with the vast preponderance of franchisees who are  
23 corporations?

24 MR. TOPOROFF: And the problem with that would  
25 be --

1                   MR. KAUFMANN: How are they going to  
2 acknowledge receipt?

3                   MR. TOPOROFF: How do they acknowledge receipt  
4 now?

5                   MR. KAUFMANN: Name of corporation, Inc., by  
6 and they fill in -- the officer will sign and tell him  
7 his title.

8                   MR. TOPOROFF: And why couldn't you do the same  
9 thing with being on-line?

10                  MR. KAUFMANN: Because what you're going to  
11 have on-line is just a password as I understand it,  
12 saying that this individual received it on this day, not  
13 the corporation.

14                  MR. WAY: If there is a need -- if there is --  
15 this is Dick Way. If there is a need for the receipt to  
16 have alternate means of being filled out, that's easy to  
17 do. We can change those to say whatever it is they need  
18 to say.

19                  MR. TOPOROFF: Also, I should mention, at least  
20 in this specific proposal, no one has to go through this  
21 method. If you have a unique circumstance where you want  
22 the receipt to state whatever, you want a hard copy,  
23 whatever your issues may be, there's nothing that forces  
24 you to go through the Internet mode. You can call up the  
25 company. They'll negotiate or get the contracts or get



1 the UFOC as you normally would. We're not suggesting --  
2 no one is suggesting, I think that this be the sole  
3 method for selling franchises or getting information  
4 about franchises. It is just a vehicle that might be  
5 available out there for the public to review.

6 Mr. Brooks.

7 MR. BROOKS: There is also a technique that can  
8 be incorporated in this design where there's a mandatory  
9 button which will print a hard copy receipt and require  
10 that that be returned by fax or mail or however so that  
11 an actual physical signature can be retained in the file  
12 which answers Mr. Cantone's question.

13 So that can be done as part of the process. If  
14 you want to design that extra step you can either print  
15 those or hold them in memory for the next time it goes to  
16 a vendor or actually print immediately while you're on-  
17 line it can be done.

18 MR. TOPOROFF: Any other questions? Well,  
19 thank you very much for the demonstration. We greatly  
20 appreciate it.

21 MR. WAY: Our pleasure.

22 MR. TOPOROFF: And as I mentioned before, we  
23 have received the advisory opinion request. To be honest  
24 with you, I would not count on a response anytime soon.  
25 Mark Forseth could testify to that personally because his

1 firm, God bless him, keeps me in business reviewing and  
2 considering advisory or opinion requests.

3 So there will be an answer. I just cannot tell  
4 you. Mr. Tifford.

5 MR. TIFFORD: Yeah. I wrote 60 of those, you  
6 know, until 1988, if you have some overflow or may need  
7 some help, I'll be happy to.

8 **(Several inaudible responses.)**

9 MR. TOPOROFF: We will consider that. But on  
10 this specific proposal for on ideas generally on how  
11 franchisors might be able to advertise on the net, are  
12 there any other comments or questions before we move on?

13 Okay. I should mention that this issue is  
14 going to come up again, I think, in Seattle. It  
15 certainly will be on the agenda and we can discuss it in  
16 greater detail at that meeting.

17 Again, if anybody has any additional thoughts,  
18 comments, proposals, please submit them. This is one  
19 area where we really do not have any specific agenda in  
20 mind or any specific proposal that we're advancing.  
21 We're really looking toward the practitioners in the  
22 field to give us feedback on what currently exists, what  
23 could be done, some of the options, so that we can  
24 consider this when we revise the rule.

25 Mr. Simon.

1                   MR. SIMON: Neil Simon. I just want to mention  
2 that I believe it was last week or perhaps the week  
3 before last, the SEC delivered a no action letter with  
4 regard to the delivery of over the Internet of roadshow.  
5 Of a company about to go public in the underwriter. And  
6 this was delivery information to institutions -- this is  
7 not the delivery of a prospectus for the purpose of  
8 buying stock.

9                   But that's probably what examined -- I  
10 understand there was some interesting technology and  
11 features involved in that.

12                  MR. TOPOROFF: Thank you. Okay. We're going  
13 to move to the second part of this issue and that is what  
14 triggers disclosure. And let me frame the issue for you.

15                  In a nutshell what the Commission has set forth  
16 in the ANPR is a very simple proposition and that is does  
17 the term face-to-face personal meeting still have  
18 relevance in our day and age when vehicles --  
19 communication vehicles such as video conferencing, fax,  
20 telephone, certainly Internet, and perhaps others, have  
21 come into being.

22                  The comments are fairly split. A number of  
23 folks -- and they don't break down on any particular  
24 lines. A number of people have said that the term  
25 face-to-face is irrelevant. That now a day in age where

1 information can be gotten and communications are  
2 available in any number of ways, the term substantive  
3 discussion to these commentors makes more sense.

4 Others have said that the term substantive  
5 discussion is ambiguous, it doesn't mean anything, and  
6 doesn't -- or does away with what now is a clear or  
7 bright line rule and just adds ambiguity where it doesn't  
8 really need to be.

9 On that thought I have a few comments before we  
10 open this up. I don't know personally whether the term  
11 face-to-face is any less ambiguous for the following  
12 reason. It certainly doesn't mean literally a

1 trigger, is substance, the substance of discussion, well  
2 why don't we just change the term to first face-to-face  
3 -- first substantive discussion. That would clarify  
4 trade show sales, Internet sales, telephone sales or any  
5 number of other ways that franchising may be -- or  
6 franchises may be sold.

7 So with that I open it for any comments.  
8 Dennis Wieczorek.

9 MR. WIECZOREK: Actually you almost misspoke, I  
10 think about the rule, which would be the first face-to-  
11 face substantive discussion. That's more of a bright  
12 line. That's a better characterization of where we are  
13 today.

14 But let me say that the first face-to-face  
15 meeting has now been in place for, whatever, 18 years.  
16 There is a sense in the community as to what that means.  
17 A first substantive discussion -- I don't know if that  
18 was a first substantive discussion because I turn on my  
19 computer and started surfing the Internet and looked at a  
20 couple of UFOC, et cetera, et cetera. Or looked at some  
21 advertising material on the net. Or made a phone call.  
22 I don't really have -- I don't want to belabor this  
23 because it's already stated in writing.

24 The first substantive discussion does not  
25 provide any guidance in the context of computer

1 information, telephone discussion, brochures being  
2 mailed, et cetera. All of those potentially are first  
sub

1 of even the concept of face-to-face and get right onto  
2 the issue of let's have a minimum number of days that the  
3 written materials have to be given to prospective  
4 franchisees. I mean, that's really what we're talking  
5 about here.

6 It's the concept of let's not hustle somebody  
7 into buying a franchise before they've had the  
8 opportunity to consider it. And I think as we see more  
9 -- that is really what's, I think, at heart here. And I  
10 think that as we're seeing more and more technologically  
11 advanced ways of communicating information the whole  
12 concept of the nature of the discussion whether how close  
13 you are to the person at the time that you make it, isn't  
14 really -- it really begs the real key issue is do you  
15 have enough time to review it.

16 And I think that the answer to that is if we  
17 just found a specific number of days that people should  
18 have the documents in their hand before they buy, then  
19 we're really accomplishing a very basic objective that  
20 the Commission is trying to establish.

21 MR. TOPOROFF: Let's do this. For purposes of  
22 discussion, I think there are two separate issues, and  
23 we'll discuss each in term.

24 One issue is whether the only trigger should be  
25 what we are now going to call 14 days instead of ten

1 business days, because then everybody doesn't have to  
2 worry about what Federal holiday falls out on when.  
3 Okay. Fourteen days. Okay. That is one item we will  
4 discuss.

5 The other is if the Commission for any reason  
6 decides it wants to have an earlier trigger either to  
7 avoid high pressure sales if there's a face-to-face, or  
8 situations where a company may lead a prospect on and on  
9 and on so that they're committed to the point where the  
10 disclosure really becomes meaningless. Whatever the  
11 policy is.

12 What should be given the Internet and other  
13 modes of communication -- what should be an early trigger  
14 and then we'll get into discussing that we should just  
15 rely on the 14 days.

16 So there are really two separate issues. Mr.  
17 Brooks.

18 MR. BROOKS: Kennedy Brooks. The question I  
19 have is all that kind of oppression that you're  
20 describing might arise in a sale context which is -- I  
21 think it can be placed entirely electronically where the  
22 contact is made over the Web, where E-mail is exchanged,  
23 where telephones are exchanged, where documents are sent  
24 out by Federal Express, and where, in fact, there never  
25 is a face-to-face meeting. I have a difficulty imaging



1 the kind of overbearing situation where -- anything more  
2 than what John suggested is assuring that there is an  
3 adequate time between the delivery of comprehensive  
4 documents.

5 MR. TOPOROFF: Well, let me give you a  
6 hypothetical that is based upon a complaint that came to  
7 our attention several years ago. So it really doesn't  
8 involve the Internet, but nonetheless.

9 An allegation was brought to our attention  
10 after this particular franchise company, that had  
11 promotional materials, what have you, like all of them  
12 do, and then proceeded to give prospects a personality  
13 test. And based upon the personality test certain  
14 prospects were told you're wonderful for this business,  
15 this is right up your alley. Then they were told to go  
16 out and meet whoever. Not necessarily a face-to-face  
17 meeting. And then they were led along -- and it was  
18 months before the initial contact and the time when they  
19 finally got around to talking about the terms and  
20 conditions or whatever.

21 And the allegation that was presented to us was  
22 that this company violated the rule, was they didn't give  
23 out the disclosure documents timely, and that this  
24 individual or group, I don't remember who submitted the  
25 complaint at the time, this is many years ago, said that

1           they felt that they were strung along. That up until the  
2           very last minute everything seemed fine and whatever.  
3           And then when it came time to get the disclosures, they  
4           were already personal friends with the people that they  
5           were negotiating with and the franchisor or the  
6           representative said oh, by the way, there's this FTC  
7           document, here's another piece of paper you need to look  
8           at. You know, and just by stringing people along tended  
9           to minimize the value of the UFOC And I think that  
10          that's the concern that we have.

11                         Now, in that scenario I think you can have the  
12          same or similar kind of thing on-line. You download.  
13          You speak to people. Conversations go back and forth.  
14          It could be chat rooms. Go visit this site. Find out  
15          this kind of information. And perhaps there could be  
16          some kind of high pressure -- not high pressure, but at  
17          least stringing somebody along to the point that when  
18          they actually seek to commit the disclosures become again  
19          just another piece of paper, a formality, and basically  
20          what you lose is the real import of the disclosures, and  
21          that is to put people on notice of material information.

22                         MR. BROOKS: And therefore the 14 days that  
23          you're proposing would have to be -- in falling back to  
24          what David Kaufmann was saying earlier about you still  
25          have your traditional -- the 14 days are still there.

1 You're stringing along your salesmen, too. That's what  
2 is going on. And those people are protracting the sales  
3 cycle. But fourteen days would --

4 MR. TOPOROFF: Well, again, one of the benefits  
5 of early disclosure, be it face-to-face or whatever other  
6 model you want to come up with, is that before prospects  
7 get personally involved, hooked, become buddy with the  
8 sales force or whatever, that they really are committed  
9 and that the disclosures are just a formality. And part  
10 of the benefit of having disclosure at the least  
11 face-to-face meeting is that very early on before that  
12 hook and that commitment arises people get disclosures  
13 and can assess what is going on with the system.

14 So the concerns -- they're really two-fold.  
15 One is -- and we will get to if we should have just the  
16 14 business days.

17 But -- so let's put that aside for right now.  
18 If we are going to have an early trigger for the rule,  
19 what could that early trigger be that would also serve us  
20 well in an Internet age?

21 John Tifford had his hand up, but --

22 MR. TIFFORD: I wasn't going -- my response was  
23 not to that question. That's why I took it down.

24 MR. TOPOROFF: Dennis Wieczorek.

25 MR. WIECZOREK: Yeah. I made a comment on it.

1 I'm incredulous that you have an example like that  
2 because I have yet to see a franchisor or franchise  
3 salesman that is willing to wait months and months and  
4 months to try to sell a franchise. I mean, these are  
5 people that are usually compensated by commission. They  
6 want to get sales in as quickly as possible.

7 For there to be a situation where a franchisor  
8 would let a sale go for months and months and  
9 precondition people and become buddies with them, et  
10 cetera, et cetera, and then at the last minute give them  
11 a circular, most of the time you have salesmen that are  
12 saying I want the circular, now I want to get it to them,  
13 I want the time to run, I want to get this thing done as  
14 fast as possible.

15 So I don't think that's a very odd fact.

16 MR. TOPOROFF: Well, let's test this one.

17 Susan, any comments on what you observed?

18 MS. KEZIOS: Yeah. We've observed that kind of  
19 thing. I mean it happens. It's probably not -- I mean,  
when I was a franchise salesper

1 MR. TOPOROFF: Dale Cantone.

2 MR. CANTONE: We see it actually happening in  
3 the business opportunity contacts where there's probably  
4 even more of an urgency on the part of the sales person  
5 to close the deal. So it does happen. It may be rare,  
6 but it certainly is possible.

7 MR. TOPOROFF: David Kaufmann.

8 MR. KAUFMANN: Yeah. I, again, want to point  
9 out that there may be a dichotomy here at work between  
10 more sophisticated franchisees and less sophisticated  
11 franchisees, which I would urge the Commission to be  
12 aware of. One of the problems we have with the larger  
13 franchisors and larger franchisees are these franchisees  
14 saying why do I have to wait one day. You know, if  
15 somebody is taking a license to put up a Hilton resort  
16 and is going to be spending two or two hundred and fifty  
17 million dollars to do so, the last thing they need is a  
18 fraternalistically granted 14-day cooling off period. If  
19 anything, they're riding curb on Hilton, not the other  
20 way around.

So I would ask -- I know this sounds radical

1 disclosure is given, assuming it is not exempt, that  
2 these sophisticated entities can sign on the next day.

3 We've had complaints coming from them, and the  
4 Hilton example happens to be on that point. It wasn't  
5 the resort in Hawaii. It happened to be a property in  
6 Wisconsin where the franchisee was saying why do I have  
7 to wait two weeks. I want to take it in my third  
8 quarter. I want to write the license fee in my third  
9 quarter. Why do you make me wait?

10 MR. TOPOROFF: Mr. Brooks.

11 MR. BROOKS: My suggestions with following the  
12 data is put it up on the site and if there is a current  
13 document that's approved by all the States and it's a  
14 current document, let him download it and print the  
15 receipt anytime he would like to. That gets the 14 days  
16 running and that's under the control of franchising  
17 prospect.

18 MR. TOPOROFF: One second. Mr. Unger, I had a  
19 question that triggered a thought that I had in your  
20 system that I forgot to ask before, and that is as I  
21 understand your proposal the franchisor would know when  
22 the receipt is answered, whatever, and the franchisor  
23 would know when the 14 days would run. But is there a  
24 mechanism to alert the prospect that now by pushing this  
25 button you have 14 days to review this disclosure. I

1 mean, is there anything that gives the prospect the  
2 import of what pushing that button is all about?

3 MR. WAY: This is Dick Way. Currently the  
4 system does not have any language which communicates that  
5 to the person filling out the receipt. However, it would  
6 be a simple thing to say right about that submit button,  
7 you know, when you submit this document it has the  
8 following effect. And for that matter we could either  
9 quote the piece of the UFOC that talks about that or else  
10 summarize that right at that point so that when they hit  
11 that submit button they, in fact, acknowledge that they  
12 know they started the time period.

13 MR. TOPOROFF: Because otherwise what could  
14 happen is the prospect goes on-line, goes through this  
15 system and then finds out, you know, gets the disclosure  
16 document and says, oh, let me sit on this a while. I'll  
17 get back to it in a month. I'm going on vacation. And  
18 then they come back to it, lo and behold, they find out  
19 that the 14 days has elapsed.

20 MR. KIRSCH: They don't have to sign a  
21 contract. They can always say no, I'm not ready yet  
22 typically. I mean, there are --

23 MR. SIMON: They won't have the document for --  
24 Neil Simon -- for more than 14 days. There's no magic to  
25 14 days. That's just the minimum period. There's no

1 maximum period.

2 Of course, if you wait six months it may be  
3 that there have been some changes in the franchisor in  
4 which case you have to redisclose and we all face that  
5 situation. But there's no magic whatsoever to that 14  
6 days. It's a minimum period. There's no problem that he  
7 downloads it, does the receipt and goes on vacation for  
8 three months.

9 MR. TOPOROFF: Mr. Brooks, did you have  
10 anything to add?

11 MR. BROOKS: I just -- I just want to say  
12 you've accomplished the process of delivering the  
13 document and ensure yourself that you have a record of it  
14 either electronically -- and even more so than having a  
15 password under any other scenario, you would have a law  
16 that that would wind that particular E-mail address,  
17 accessed your server and downloaded that particular file.  
18 So there's no -- under each of those buttons that are  
19 State specific files you know that each of those files is  
20 downloaded by a particular E-mail address.

21 MR. WAY: Just to follow -- this is Dick Way.  
22 To follow-up on the comments, Mr. Brooks. The server  
23 records in time stamps every access of every page on the  
24 site. Not only does it do that, but unless the browser  
25 is behind the fire wall, we can tell you the IP address



1 of the browser that did it and in many cases their name.

2 MR. TOPOROFF: John Tifford.

3 MR. TIFFORD: I just want to make sure we  
4 understand that basically the -- we have a rule that's  
5 going to apply to every franchisor and every sale. I  
6 think that we need to look at the rule in the context of  
7 where it is -- what is the way that things go and where  
8 are the opportunities and potentials for injuries before  
9 we start incorporating additional burdens on franchisors  
10 or ambiguous concepts.

11 Certainly we can probably think of a scenario  
12 that would say whatever it is that we can find a way that  
13 this could go wrong just as you -- the experience of one  
14 of the people who contacted the Commission, but that is  
15 absolutely atypical and should not be the driving force  
16 in promulgating the rule that every single franchisor  
17 throughout the country needs to comply with.

18 As a practical matter, the franchisors want to  
19 get disclosure over as quickly as possible. They want to  
20 hurry these sales. Franchisors don't spend the time and  
21 effort like this and I think that we need to look at the  
22 vast majority of sales in determining what's the most  
23 appropriate rule. And in those contexts this is not the  
24 kind of issue that comes up that requires any special  
25 protections.

1 MR. TOPOROFF: Mr. Kaufmann.

2 MR. KAUFMANN: Yeah. My comments seem to  
3 engender a whole lot of psychological analysis which it  
4 wasn't meant to at all. I want to make sure that my  
5 point is really understood by the Commission. I think it  
6 was, but just to make sure.

7 Sophisticated franchisees should have the  
8 ability to reduce or waive the waiting period altogether.

9 MR. TOPOROFF: I'm going to interrupt you  
10 because we're going to talk about sophisticated --

11 MR. KAUFMANN: No. This is not on the  
12 exemptions. This is dealing with early trigger, Steve.

13 MR. TOPOROFF: Okay.

14 MR. KAUFMANN: Okay. There are classes of  
15 franchisees -- let's take a Pizza Hut franchisee who has  
16 55 restaurants and wants to pick up another five. The  
17 franchisor will always give out a new UFOC even if it is  
18 substantially the same franchise offer. You always give  
19 it out. It has the latest numbers. It's almost like an  
20 insurance document.

21 But in that circumstance and in many of the  
22 circumstances with larger franchisees, they don't want to  
23 wait the 14 days. They have no interest. Everybody sits  
24 around for two weeks because that's what the rule  
25 currently says. And perhaps if we're addressing this

1           issue maybe these types of more sophisticated franchisee  
2           transactions should be considered as granting the  
3           franchisee the ability to reduce or waive any waiting  
4           period.

5                         MR. TOPOROFF:   Okay.   Any other discussion on  
6           early trigger?   To be honest with you, I don't know that  
                          we need to really discuss just the 14 days because that

1 issue has never come up on the first personal meeting in  
2 the franchise context that I'm aware. So just from a  
3 practical standpoint, we do look at the ten business days  
4 more often than the first personal meeting in the  
5 franchise context.

6 MR. TOPOROFF: Okay. We're going to move on to  
7 the next issue on the agenda, which is co-branding. And  
8 in case anybody doesn't know what co-branding is, I  
9 invite them to step outside the front door of this  
10 Federal building because there's a very good example of a  
11 co-branded outlet right across the street, which if I  
12 remember correctly is Pizza Hut, KFC and Dunkin Donuts.  
13 Okay.

14 MALE VOICE: Roy Rogers.

15 MR. TOPOROFF: Well, I didn't see that one.

16 MALE VOICE: Where's the cardiologist's office?

17 MR. TOPOROFF: I can't comment on that. I want  
18 to make this real, real simple. People have expressed in  
19 their comments concerns that the Commission is going to  
20 get into some area and regulate and expand jurisdiction,

1 and technologies, again one of the standard questions we  
2 ask in the rule review, people brought to our attention  
3 on that line -- I've noticed the increase in co-branded  
4 outlets.

5 And we just want to make sure of two things.  
6 That to the extent that there are disclosure obligations,  
7 is it clear on the part of franchisors what they need to  
8 do when they're offering or enter into co-branded  
9 relationships. And the flip side of prospective  
10 franchisees, do they get the appropriate disclosures for  
11 a co-branded outlet.

12 Now, I have to tell you that in the -- to be  
13 honest and I believe in full disclosure, I don't think  
14 that we've received any complaints at all in this area  
15 except with one exception where it happened to be a  
16 co-branded relationship, but what was complained of had  
17 nothing to do with co-branding. So it just happened to,  
18 I think, if my memory serves me correctly.

19 So this is not something -- I don't want  
20 everybody to be shocked and, you know, what in the world  
21 is the Federal Trade Commission doing here. That's not  
22 it.

23 To the extent that there are issues where  
24 there's ambiguity or disclosures are not clear on  
25 co-branding, we want to know about it. And one of the

1 key issues that we are wrestling with and maybe there's  
2 not a good answer is the following: I certainly  
3 understand that co-branding comes in all matter, shapes,  
4 forms. There's license agreements, sub-license  
5 agreements, whatever. We're not talking about that. So  
6 let's move them off the table.

7 If a relationship is not currently covered by  
8 the rule we are not seeking to put it in the rule just  
9 because it has the name co-branding on it. So that's not  
10 on the table.

11 What we are concerned about is what is the  
12 nature of co-branding? Is it -- and it doesn't  
13 necessarily need to be choice A or choice B. It could be  
14 a combination of the two.

15 Is co-branding or at least the co-branding that  
16 we're concerned about, is it -- if I'm a prospective  
franchisee and I want to buy a co-branding outlet, am I.4 0 TDteÜent

1           about is if, in fact, what we're talking about is a new

1                   My general comments were that I believe that  
2                   the UFOC guidelines it adequately reviewed did provide  
3                   sufficient information for prospective franchisees. The  
4                   one place where I can't say that for sure is that there  
5                   is not a lot of true co-branded franchises where you have  
6                   A and B and there's a lot of history where A and B are  
7                   combined together and sold as one -- as one franchise in  
8                   a combo. You're creature C.

9                   The other things that I raised and I put on the  
10                  table is that a lot of co-branding, however we define it,  
11                  is being done with large and sophisticated franchisees.  
12                  Those sophisticated co-branded franchisees could be  
13                  another franchisor system. It could be a multiple unit  
14                  operator within the system. It could be another business  
15                  which is familiar with this, such as a convenience store  
16                  chain which understands food service.

17                  And that there -- the rationale for the rule



1 rule because a lot of these co-branded franchise entities  
2 which either are not relying to a large degree on the  
3 franchisor or the franchisor is not providing a  
4 significant amount of the systems.

5 Those are my general comments.

6 MR. TOPOROFF: I just want to go around the  
7 room and don't feel obligated to speak up if you have  
8 really nothing to offer. But to the extent that we have  
9 a large number of attorneys here who do represent  
10 franchise systems, some of which I am sure have either  
11 counseled or drafted co-branding contracts or at least  
12 may be aware of the issues. I would just like to know  
13 your thoughts. Is this an area where there really needs  
14 to be any Commission guidance, clarity or whatever? I'm  
15 going to start with Dennis.

16 MR. WIECZOREK: Dennis Wieczorek. I think at  
17 this point the -- it would be premature to try to create  
18 some special rules for co-branding other than -- you  
19 know, obviously I agree with Mark's position, there may  
20 be some ways to create or expand or clarify exemptions so  
21 that there's more of an ability to utilize those  
22 exemptions in co-branding situations.

23 I don't see it as being a problem primarily  
24 because most of -- the lion's share of the co-branding --  
25 co-branded franchisees are people who are less deserving

1           -- who don't need the protections that the single unit  
2           mom and pop franchisee would need necessarily. Usually  
3           they are bigger operators and variables to protect  
4           themselves quite well.

5                        But I will say from a disclosure standpoint  
6           that if a franchisor enters into an extensive co-branding  
7           relationship with another franchisor and they have  
8           experience with that, they have a number of units

1           than going ahead and doing another book. It becomes a  
2           unwieldy, extensive, et cetera. And I think that the  
3           disclosures that we're providing are adequate and the  
4           rule needs to --

5                         So I'm not sure that you need to create a third  
6           disclosure document when you can take the one that you  
7           already have and modify it to a degree that it is  
8           acceptable by the administrative and by the rule.

9                         MR. TOPOROFF: Mr. Simon.

10                        MR. SIMON: I agree with all the comments  
11           before. I would note that oftentimes it's not a  
12           situation where a franchisor is offering some combination  
13           of A and B, but is taking existing franchisees in the  
14           system and extending to them an additional opportunity to

1           there, I believe, any significant problem here and that  
2           may be, in part, because we are dealing with very  
3           sophisticated franchisees and sophisticated franchisors  
4           for the most part.

5                         So in the situations in which -- on a new  
6           franchisee, a new prospect -- let's say and it's  
7           franchise A and that franchise may also be offered the  
8           opportunity for this other franchise, rather than giving  
9           them a separate offering circular typically we handle it  
10          through -- keeping it the same offering circular and  
11          maybe some footnotes or maybe some additional tables. An  
12          initial thing for item 7, for instance, initial  
13          investment.

14                        But I have not had real difficulty using the  
15          existing UFOC format to make those disclosures.

16                        MR. TOPOROFF: Mr. Kaufmann.

17                        MR. KAUFMANN: Ditto.

18                        MR. TOPOROFF: Mr. Forseth.

19                        MR. FORSETH: There's only -- ditto with  
20          everything else that Dennis has said and a lot of these  
21          things could be handled through exemption along with what  
22          Mark said.

23                        And one issue that I haven't heard discussed  
24          and which kind of concerns me as a franchisor  
25          representative where you have circumstances where

1 franchisor A has its franchise and you have franchisor B  
2 who has their franchise and they're doing a joint  
3 venture, and the concerns of the responsibility of  
4 franchisor A, the liability he takes on by delivering  
5 franchisor's B his offering circular describing that --  
6 whether or not he's taking on a brokering role and maybe  
7 would clarify that he does not necessarily have liability  
8 with respect to disclosure prepared and provided by  
9 franchisor B with respect to the joint arrangement.

10 And there could be some benefits there because  
11 I think, you know, a franchisor may be entering into  
12 these arrangements, but he hasn't gone out and  
13 independently verified the disclosure prepared by  
14 franchisor B concerning those relationships and with the  
15 joint several ability under the rule whether or not he is  
16 "taking on a brokering role" and is hence, you know,  
17 jointly and severally liable for misrepresentations by,  
18 you know, franchisor B in his offering document or  
19 omissions.

20 MR. TOPOROFF: Mr. Tifford.

21 MR. TIFFORD: Nothing to add that hasn't  
22 already been said.

23 MR. TOPOROFF: Okay. I want to give the  
24 regulators a chance --

25 MS. KEZIOS: I have something to say, too.

1 MR. TOPOROFF: Okay. And then we'll get --

2 MS. KEZIOS: I know you find that hard to  
3 believe, but --

4 MR. TOPOROFF: Dale and/or Harold on this  
5 issue.

6 MR. KESTENBAUM: I have nothing to say.

7 MR. CANTONE: We haven't had too many problems  
8 on the issue of co-branding. We've had franchisors file  
9 disclosures and we really haven't had too many issues  
10 with it.

11 MR. TOPOROFF: Okay. Susan Kezios.

12 MS. KEZIOS: Two issues that I don't know if  
13 the Commission wants to look at, but we're hearing from  
14 our members on the issue of co-branding. Two different  
15 things.

16 One is that the franchisees interchain or the  
17 franchisor makes the determination that they're going to  
18 strike a deal with another chain and co-brand. They'll  
19 put a small entity inside an existing unit. There's the  
20 problem of encroachment on the franchisees in both  
21 chains.

22 So the franchisees are saying well now I have  
23 to deal with -- I have this kiosk. I'm selling bagels or  
24 tacos or whatever it is in my convenience store and now  
25 I'm in competition with fellow franchisees and I didn't

1 intend to be in that business.

2                   And the second issue is bringing in an extra  
3 brand like that is precisely the strategy that a lot of  
4 marginal single brand franchise systems are using to

1 circular, what you should do is go -- say I can't -- I  
2 don't offer that and vice versa.

3 On the issue of encroachment, I'm not sure that  
4 is particularly a disclosure issue as opposed to contract  
5 issue when the systems when we've dealt with when they  
6 want to combine, they look at prospective co-branding  
7 alliances or partners.

8 Well, one thing you do is you take out a map  
9 and you figure out where the overlap is. You look at the  
10 agreements and you figure out what is restricted and what  
11 is not restricted and I don't doubt that there can be  
12 problems -- the issue is focus on it up front to see  
13 whether or not you can do it any more so than if you want  
14 to put a mini unit close to a full service unit, whether  
15 that's permitted under your franchise agreement.

16 But in essence some of the things I've heard --  
17 suggest that we can take the basic UFOC guidelines,  
18 follow them to describe your co-branding operation, and  
19 if you have sufficient information on item seven you can  
20 put it as sufficient. If you have an item 19 earnings  
claim for your general full service units and you're



1                   MR. FORSETH: Yeah. I just -- so if you've got  
2 franchisor B offering to franchisor's A franchisees and  
franchisor A is doing the introduction, you go out and do

1           that have been brought to our attention -- again  
2           exemptions. There are two that have really been brought  
3           to our attention. One is a sophisticated investor  
4           exemption and the other is something -- we'll just call  
5           it institutional buyer or institutional franchisee, which  
6           I suppose is really a subset to be a sophisticated  
7           purchaser.

8                         By way of example, Mark Forseth knows very well  
9           that we have been having several discussions about a  
10          recent advisory opinion that marketing practices issued

1 was addressed in the Minneapolis conference that we had  
2 and at that time one person in particular, named Dennis  
3 Wieczorek, commented, and he's entitled to change his  
4 mind and we're not holding this against him, but I  
5 thought it was an interesting comment nonetheless, said  
6 most franchisors do not just sell to sophisticated  
7 institutions. Therefore, they're going to have to have  
8 disclosure documents anyway. So if we're going to have  
9 to have disclosure documents, what's the disadvantage if  
10 they give it to mom and pop people and they also give it  
11 to the sophisticated folks. Indeed the sophisticated  
12 folks are probably going to ask for it. They know it  
13 exists. They're probably going to ask for it.

14 So I'm going to go out of turn a little bit and  
15 use my facilitator's discretion and call on Dennis to  
16 either support or modify his comment in Minneapolis.

17 MR. WIECZOREK: I think my comments are taken  
18 out of context. I think the comment is an accurate one,  
19 that most franchisors will still have an offering  
20 circular even if they are a hotel company that sells  
21 largely to sophisticated investors.

22 But I do think the exemption would be  
23 worthwhile because often the sophisticated investor is  
24 the investor that is also looking for very, very fast  
25 action, a lot of changes, a lot of movement at the very

1 end of the string. The five business day delivery rule  
2 is often breached.

3 So I think -- no matter what I said the last  
4 time, I think an exemption would be helpful because those  
5 situations will come up where a sophisticated investor  
6 will require that these -- the time periods as a cooling  
7 off periods largely become irrelevant because they want  
8 to move very quickly.

9 MR. TOPOROFF: Mark Forseth.

10 MR. FORSETH: As you know, we've spoken in a  
11 lot of correspondence back and forth in terms of finding  
12 what constitutes the entire business, and I think if it  
13 goes beyond just sophistication and experience in the  
14 particular business, but whether or not the risks,  
15 because of the size of the prospective franchisee, not  
16 necessarily experiencing any particular industry, merit  
17 then having, you know, disclosure concerning opportunity  
18 and whether or not they can or not. As Dennis put it,  
19 there's a lot of movement, there's a lot of negotiation.  
20 Whether or not it's necessary.

21 Currently the Commission takes the position  
22 that the assistance or control being exercised and  
23 whether that is, indeed, significant is determined based  
24 on the business or function that is being licensed or  
25 franchised in this circumstance. And it is not, although

1           you're misreading what constitutes the entire business  
2           when one could consider that to be the entire business of  
3           the prospective franchisee, which might mean in hospital  
4           network circumstance, you know, a massive business as  
5           opposed to a significant assistance or significant  
6           control relates to one particular aspect of the business  
7           that's being licensed.

8                         And I'd be curious as to other people's  
9           thoughts with regard to that.

10                        MR. TOPOROFF: David Kaufmann.

11                        MR. KAUFMANN: I'm sorry I didn't see this  
12           raised in the ANPR if it was. This is something that,  
13           again, brings some attention to the schism between the  
14           larger and the smaller franchisees. Should I sit up  
15           higher or just speak louder?

16                        MR. TOPOROFF: Speak louder.

17                        MR. KAUFMANN: Okay. Again, I'm sorry I didn't  
18           see this raised in the ANPR if it was, but this again  
19           draws attention to the schism between larger and more  
20           experienced franchisors and smaller newcomers.

21                        History has shown us and I think it is valid  
22           today that abuses in the franchise field are frequently  
23           committed, more fighting in the newer start-up  
24           franchisors -- or let's say not even abuses, but less  
25           fortunate consequences for franchisees result and

1 governmental complaints in the governmental action or  
2 fields that incidents of abuse or unfortunate franchisee  
3 experience as a result from the smaller, less experience  
4 franchisors.

5 I've always felt that the FTC rule should have  
6 what many -- indeed, most of the State franchise  
7 administration disclosure laws have, which is an  
8 exemption for, number one, sophisticated franchisors, and  
9 number two, an exemption such as that afforded by  
10 Illinois and California amongst, as well, the  
11 sophisticated franchisees.

12 Number three, the delineation that, for  
13 instance, when any franchisor's licensing Marriott or is  
14 licensing New York University Hospital in New York, you  
15 know, to put in a cafeteria for Docks, that NYU Hospital  
16 doesn't turn into a franchisee the same as the standard  
17 typical -- the typical franchisee we generally think of.

18 So in addition to the international I would  
19 strongly urge the Commission to look at a sophisticated  
20 franchisor exemption, a sophisticated franchisee  
21 exemption and institutional nature of the franchisee,  
22 including an entity like Marriott.

23 I know that my brother -- will have to issue  
24 opinion letters to large companies -- come up with new  
25 projects. We always have to have this bifurcation in the

1 opinions that if you do this with Marriott you're not  
2 controlling Marriott's business although under the rule  
3 you may be giving it advise, suggestions and so forth.

4 I think the list of what constitutes control or  
5 assistance under the FTC rule has to be very carefully  
6 tailored to segregate Pizza Hut, let's say, giving advice  
7 and suggestions to Marriott which is a behemoth versus  
8 giving advice and suggestions to Mr. and Mrs. Smith who  
9 are newcomers to the system.

10 And I would ask for that -- I would ask for  
11 that sensitivity to be brought to date on this issue.

12 MR. TOPOROFF: We have Susan Kezios and then  
13 Dale Cantone.

14 MS. KEZIOS: Are you talking about institutional  
15 buyers of franchises?

16 MR. TOPOROFF: Yes.

17 MS. KEZIOS: Okay. Because we've had some  
18 experience with hospitals that want to buy a franchise,  
19 for example. And just because they're an institution  
20 doesn't mean they have any greater knowledge about  
21 franchising or that they should be looking out for, then  
22 the ma and pa first time franchise buyer.

23 So in that -- I mean, our experience has been  
24 that those institutions need franchise advice and counsel  
25 and they shouldn't be given an exemption just because

1 they're a large buyer, just because they have a certain  
2 net worth or whatever your perimeters are to give that  
3 exemption to an institutional buyer of a franchise.

4 And a question I have for Dennis is how fast do  
5 your large buyers want to move? The deals happen within  
6 less than ten days?

7 MR. WIECZOREK: Absolutely, yes. Sure.

8 MS. KEZIOS: Two days? Four days?

9 Mr. WIECZOREK: Well, let me just give you an  
10 example. In the hotel business there's often competing  
11 franchisors and -- for the buyers business and they may  
12 be bouncing offers off of each of them and trying to get  
13 -- to get the best deal they can and then a franchisor --  
14 you know, we've heard it repeatedly. You mean I have to  
15 wait. I put my offer on the table and I have to wait ten  
16 business days. And then the other franchisor comes in  
17 and they better it.

18 So it's just a never ending cycle. So they  
19 would like to do in a situation where they negotiate,  
20 they get a deal, they sign it that day and they're done  
21 with it. That's pretty typical scenario.

22 MR. TOPOROFF: Dale Cantone.

23 MR. CANTONE: Yeah. I just want to clarify for  
24 the record, Maryland is one of the States that have a  
25 sophisticated franchisors, sophisticated franchisee



1 institutional franchisee exemption. But in Maryland and  
2 I suspect the other States it's an exemption from  
3 registration requirements. There's still a disclosure  
4 requirement, which is what we're talking about in the  
5 context of the rule review.

6 I have had a situation in Maryland where a  
7 truly large institutional franchisor was trying to do a  
8 deal and wanted an exemption. In Maryland we also have a  
9 mechanism kind of to grant an exemption for something  
10 that's not specifically in any other category. And in  
11 Maryland I can turn around a request for an exemption in  
12 a matter of a week if it's something where that's that  
13 time sensitive.

14 The issue that I had in Maryland, it was a  
15 longstanding deal that took several weeks. So I don't  
16 know how common it is to have one of those deals where  
17 time is that much of the essence.

18 MR. TOPOROFF: Keith Anderson.

19 MR. ANDERSON: A quick question for you, Dale.

20 MR. CANTONE: Yeah.

21 MR. ANDERSON: So even if it's sophisticated  
22 franchisor, sophisticated franchisee, they have to  
23 disclose and there's a waiting period or just they have  
24 to disclose? Dave Kaufmann's point was yeah, have them  
25 give the disclosure -- at least as I understood it. Have

1           them give the form, but don't require 14 days.

2                   MR. CANTONE:  There's a disclosure requirement  
3           and a waiting period.  We could, if we wanted to, take  
4           the position that we wouldn't take action if they didn't  
5           do that, but that's a different issue.  I mean, in  
6           general the exemptions are built -- these are exemptions  
7           from the registrational requirements only.

8                   MR. TOPOROFF:  John Tifford.

9                   MR. TIFFORD:  Just -- secondly in terms of  
10          Susan, just to respond to you and to follow up on what  
11          Dennis says, not only do you have the issue of ten-day  
12          rule, but you also have the situation of the five day  
13          rule of a completed contract.

14                   It's people -- in these transactions you are  
15          negotiating at the time you're signing the agreement and  
16          oftentimes even after you signed it you're still  
17          negotiating.  And it just doesn't work in a realistic way  
18          that you can just feel that everybody's got the deal set  
19          in stone and they all take a break for five days.  
20          Generally you just want to get some sleep, if that alone.  
21          It may be worth it for all the work that you've done, but  
22          it just isn't realistic in the context of these kinds of  
23          operations.

24                   MR. TOPOROFF:  Mark Forseth.

25                   MR. FORSETH:  Well, your point is well taken

1 that in certain circumstances just because someone is a  
2 large institutional investor they might not have  
3 experience in a particular business. But in those kinds  
4 of circumstances, in securities and in every other  
5 investment vehicle and even under the Maryland Rules you  
6 can sell to institutions where there is no disclosure. If  
7 it's a bank or financing institution, no disclosure is  
8 required.

9 We're talking about requiring a business to  
10 prepare an offering circular when it is dealing with  
11 entities that have a sophisticated battery of lawyers who  
12 ask for insurance certificates, who ask for  
13 indemnifications, who ask for everything up the ying-yang  
14 and negotiate the contract, you know, eight ways from  
15 Sunday, and you're asking this person then to go to the  
16 expense to prepare an offering circular that isn't even  
17 going to remotely reflect what the ultimate deal is going  
18 to look like. And it's a waste of money.

19 And there are certain circumstances where a  
20 disclosure is just inappropriate and unnecessary for the  
21 person's protection.

22 MR. TOPOROFF: David Kaufmann.

23 MR. KAUFMANN: Just so it is clear. Mr.  
24 Anderson, I was not suggesting that franchisors dealing  
25 with sophisticated franchisees give disclosure for these

1 types that won't be relieved from the obligation of the  
2 14-day rule.

1                   The disclosure in those instances means very  
2 little. It means nothing.

3                   MR. ANDERSON: Okay. Let me ask another  
4 question. Keith Anderson.

5                   Imagine that we waive the waiting period, but  
6 still require that we hand over the book. There may be a  
7 little benefit there, but is there still a cost?

8                   MR. KAUFMANN: It's a minor cost. I wouldn't  
9 have a problem with that. You know, a great -- I'd  
10 rather see it -- I'd rather see us be relieved from any  
11 regulation. We have -- we have in franchising so many  
12 regulations and it extends right here to the Federal  
13 government.

14                   If you look at a cup of coffee from Starbucks  
15 it's an expense here. The Federal cafeteria that says  
16 careful the beverage you're about to enjoy is extremely  
hot. Every

1 MR. TOPOROFF: Federal Tort Commission.

2 MR. KAUFMANN: What I'm saying is franchisors  
3 have so much to do with that. Yes, maybe the cost -- the  
4 rental cost wouldn't be so great. But if we could be  
5 relieved from it that's one less thing we have to deal  
6 with.

7 MR. TOPOROFF: Mark Forseth and then Mark.

8 MR. FORSETH: There's some excellent examples  
9 if you look in the securities fund. You also look at the  
10 State of Washington, which has a sophisticated franchisee  
11 exemption which exempts the franchisor from disclosure --  
12 based on a million dollars net worth exclusive of  
13 household properties, amenities. Or if you have income  
14 -- expected income of \$200,000 a year.

15 I mean, these people can -- they can go out and  
16 hire Skadden, Arps and represent themselves. They don't  
17 need your protection.

18 MR. KAUFMANN: Not on \$200,000.

19 MR. FORSETH: Yeah.

20 MR. TOPOROFF: Mark Kirsch.

21 MR. KIRSCH: I think what's important is if  
22 you're going -- if the Commission is going to consider  
23 these sorts of exemptions, look at whether it's the  
24 exemption from the disclosure, giving it out at all, or  
25 having it be tailored precisely to the rules. I think

1           that in some of the large transactions and whether it's a  
2           huge and sophisticated company like Marriott or it's  
3           simply a company, which is, you know, a hospital that has  
4           resources to hire an attorney.

5                       Basically what I'm trying to suggest is  
6           creating a safe harbor so that the franchisor, which is  
7           granting this franchise, which is clearly not a typical  
8           other business, is giving out a document. You don't have  
9           to worry about either the State coming back or a  
10          franchisee who has the knowledge to dig up what the  
11          business is about, what the investment is about, coming  
12          back and say well, I didn't get an appropriate document  
13          because you didn't tell me about such and such in item 7.

14                      And I think if you consider some sort of safe  
15          harbor, that's really what I think a lot of franchisors  
16          made feel comfortable with.

17                      MR. TOPOROFF: Okay. I would suggest this. A  
18          number of people, as I mentioned John Tifford's comment  
19          in particular, raised this issue of exemptions, basically  
20          saying this is what the Commission should adopt, but  
21          there's very little focus on what the definition of  
22          sophisticated should be of institutional, investor, what  
23          have you.

24                      So I would appreciate it if anybody is  
25          interested in this subject to supplement their comments

1 giving us much more specific direction. If you point us  
2 in the direction of specific State Statutes and include  
3 the language, that would be helpful, because I don't know  
4 in our office whether we necessarily have access to those  
5 Statutes or not. But whatever you could provide by way  
6 of definitions where you see something tangible, that  
7 would be helpful.

8 With that we're going to take a break for one  
9 second. But before we do that, an announcement or a  
10 request from David Kaufmann. As we mentioned the  
11 invitations to a reception this evening and David just  
12 needs to know how many people plan on attending because  
13 he's arranging for our transportation.

14 So during our break, and again everybody in the  
15 room is certainly welcome, as I understand it.  
16 Absolutely, Dave says.

17 MR. KAUFMANN: It's not my reception. New York  
18 State Bar Association.

19 MR. TOPOROFF: New York State Bar Association.

20 MALE VOICE: So, David, that's what you need to  
21 count, how many subway tokens?

22 MR. TOPOROFF: We're going to break for 15  
23 minutes.

24 **(A brief break was taken.)**

25 MR. TOPOROFF: Before we begin with the last



1 item on the agenda, which is alternatives to law  
2 enforcement, I just want to make sure that everybody who  
3 may be seated in the audience today is aware that there  
4 is the opportunity to offer statements on the record at  
5 the end if you so wish. And again I want to remind  
6 people that Myra and I will be here tomorrow in the same  
7 room, 9:00 to 3:00, to take additional statements from  
8 members of the public.

9 So just for the record, a show of hands, if  
10 any. Is anybody interested in making a statement on the  
11 record? None. Okay.

12 Alternatives to law enforcement. Let me give a  
13 little bit of background where this issue comes from.  
14 This is not your typical disclosure, rule, issue. One  
15 second.

16 This issue of alternatives to law enforcement  
17 comes about in a few ways. First off, as stated in the  
18 ANPR, there are executive orders from the White House,  
19 part of reinventing government, that require agencies,  
20 including the Federal Trade Commission, to consider ways  
21 to reduce civil penalties, regulatory burdens, what have  
22 you, on business. And certainly that would include  
23 franchisors and the administration of our franchise  
24 program.

25 There's another reason why this is on the

1 agenda and that is the -- what we call at the Commission,  
2 SBREFA, which stands for the Small Business Regulatory  
3 Enforcement Fairness Act of 1996.

4 This Act was the outgrowth of the White House  
5 Conference on small business, which made recommendations  
6 to the Congress and one of the recommendations was, in a  
7 nutshell, get government, big government, off our back if  
8 possible.

9 So Congress, as part of the contract on  
10 America, passed the Small Business Regulatory Enforcement  
11 Fairness Act of 1996 which, in a nutshell, does somewhat  
12 similar -- similarly to the Executive Orders and that  
13 requires us, the Federal Trade Commission as well as  
14 other agencies, again, to consider ways to reduce civil  
15 penalties or waive civil penalties on small businesses  
16 and certainly that would include small business  
17 franchisors. And, in fact, it may very well be that many  
18 of -- I don't want to quantify it per se, but many of the  
19 complaints that we receive it's possible that those are  
20 small -- what would be considered small business  
21 franchisors.

22 So because of those policies and Commission  
23 policy generally of trying to see where we can have a  
24 more positive effect in alternatives to law enforcement,  
25 this issue is very much on the agenda.

1           In the advance notice of proposed -- advanced  
2 notice of proposed rule making, we ask for comments and  
3 proposals on possible programs to reduce rates of  
4 penalties. We ask questions like when would it be  
5 appropriate and when not?

6           In response we received one comment, which is  
7 comment 26, from the National Franchise Mediation  
8 Program. As far as I'm aware to date, that is the only  
9 program or proposal that has been submitted to address  
10 this issue.

11           I want to make it also clear that what we are  
12 talking about or contemplating is not industry self  
13 regulation. Some people have called me or reporters have  
14 written that somehow the Commission has been turning over  
15 the regulation of franchising to the industry -- to the  
16 franchise industry and that's not what we're talking  
17 about. There is a distinction between self regulation  
18 and industry programs or industry support in helping us  
19 enforce our rule.

20           Self regulation, as I understand it, as  
21 typically the case, the Commission or whatever the  
22 regulatory body involves says I'm out of this. Industry,  
23 you develop programs, you monitor, you get your people's  
24 act together. We are not contemplating such a move.

25           What we are contemplating is help in enforcing

1           our rule. It has been brought to our attention many  
2           times by franchisees, by the AFA and others, that perhaps  
3           our law enforcement program is maybe lax. We could  
4           debate that or not. That's not the issue.

5                     Our concern is that we address violations out  
6           there in the best way that we can given our limited  
7           resources and resources are limited.

8                     So one avenue is to develop partnerships with  
9           other groups that could help us out in this field. And  
10          again that's what the National Franchise Mediation  
11          Program, at least that came to our attention, seeks to  
12          do.

13                    Comments on this proposal vary. There are many  
14          people -- many of the commentators have supported it in  
15          whole and in part. There are others that raised  
16          questions about how it could be implemented in practice.  
17          And I have my own questions.

18                    Before we go into the specific proposal, I just  
19          want to give anybody an opportunity to bring us up to  
20          date. Are there any other proposals? Are there any  
21          other factors that we should consider? If not, then  
22          we'll use for the basis of the discussion this National  
23          Franchise Mediation Program. So I'm going to open it up  
24          to the floor.

25                    No. Okay. Then we're going to focus on the

1 specific proposal. And I certainly have a number of  
2 questions.

3 The first question that I'm going to address is  
4 the proposal says that it will address -- that this  
5 mediation program will address technical violations or  
6 minor or technical violations of the rule. So an obvious  
7 question is what is a technical or minor violation? So  
8 I'm sure opinions vary on this one.

9 Along the same lines, should the Commission or  
10 staff or what have you in developing this proposal  
11 consider itemizing very specifically which items of  
12 disclosure would be considered minor, which one would be  
13 considered technical, so that the whole community,  
14 franchisor or franchisee or anybody else who has an  
15 interest in this, will know very clearly up front what  
16 this proposal seems to address.

17 So on either of those issues, what's technical  
18 or minor or should we define it more specifically? Any  
19 comments?

20 David Kaufmann.

21 MR. KAUFMANN: Let me just say I'm here in lieu  
22 of three people who wanted to be here on behalf of the  
23 National Franchise Mediation Program, but couldn't.  
24 Those three people are Lowell Dixon of McDonald's, Clay  
25 Small of Pizza Hut and KFC, and Michael Davis of

1 Southland, all of whom are scattered across the country  
2 today. So they asked me to speak on their behalf.

3 The proposal as originally submitted by the  
4 National Franchise Mediation Program to the Commission  
5 suggests that minor violations be referred to the NFMP,  
6 which is the acronym for National Franchise Mediation  
7 Program, and gives some examples, but it is not meant to  
be all embracing in the examples it gives.

1 material change doesn't impact the overall disclosure  
2 given with respect to the franchisee, although it is not  
3 -- although it beyond doubt that the change is material  
4 as the term material is defined legally. It being  
5 understood that sometimes there is a distinction to be  
6 drawn between the legal definition of the term material  
7 and the real life definition according to that term.

8 In setting forth those instances of what we  
9 call minor or technical rule infractions, the NFMP was  
10 careful to keep a very elastic doctrine seeking to work  
11 with the Commission to the extent the Commission wanted  
12 to work with the NFMP. This is the --

13 The NFMP, for those of you who don't know, is  
14 an organization that belonging to which are some of the  
15 nation's foremost franchisors, McDonald's, Midas, Pizza  
16 Hut, Taco Bell, Seven-Eleven, Wendy's, Jack in the Box,  
17 Holiday Inn, Jiffy Lube, KFC, Burger King, Barbie's,  
18 Baskin Robbins.

19 They realized a long time ago that conflict in  
20 franchising was proving destructive to both parties and  
21 that mediation seemed to be the way to go. These  
22 franchisors committed to mediate with any franchisee that  
23 had a dispute and wished to mediate in turn.

24 Through the end of July, 1997, the latest  
25 period of which figures are available, we were told of

1 101 matters submitted to the NFMP. There are some 30 odd  
2 matters still pending. Sixty-seven matters were closed.  
3 Of those 67 matters that have been closed, 61 were closed  
4 successfully, meaning that each party walked away with a  
5 settlement that he, she or it felt was proper and that,  
6 of course, reflects a resolution rate -- a favorable  
7 resolution rate of 90 percent.

8 The disputes that the NFMP has heard -- the  
9 best preponderance of them, by the way, deal with a hot  
10 button topic of the franchise namely encroachment. A  
11 number dealt with under-reporting of sales or other  
12 financial violations of the franchise agreement. And yet  
13 other subjects of these disputes involved the rights of  
14 the franchisee termination issues, non-renewals of  
15 franchises, miscellaneous violations of franchise  
16 agreement and things related to the purchase of the  
17 franchise to begin with.

18 Franchisors, especially the larger ones,  
19 understand that the acrimony engendered by litigation and  
20 confrontation or arbitration proceedings is unhealthy all  
21 around. Franchisees on the other hand understand that  
22 the expense of litigation at the time, the acrimony and  
23 the perversion of the everyday responsibilities of  
24 operating their units are similarly destructive to their  
25 interest, and so far all involved seem to have been very



1           pleased. Certainly franchisors have and the 90 percent  
2           of franchisees who received settlements, they deemed  
3           acceptable to them, seemed very favorably disposed to the  
4           NFMP and how it has been working to date.

5                         We will not, as I said before, put any cat or  
6           bound other than that which the Commission wishes to  
7           place on the role that the NFMP could play to assist the  
8           Commission. I will avoid the term self-regulation, but I  
9           will note that the NFMP proposal stems from two prior  
10          governmental and quasi-governmental programs.

11                        The first the FTC is intimately familiar with  
                and that is the Funeral Rule Offender's Program. That is

1           until recently, again according to the Commission, that  
2           one prior survey showed only 36 percent of homes examined  
3           for compliance with the Funeral Rule. So the Funeral  
4           Rule defender's program which is fairly similar in  
5           certain respects to the NFMP submission, seems to have  
6           had its intended salutary effect. The Funeral Rule  
7           Offender's Program, without going into great detail, also  
8           calls upon an industry group to administer education to  
9           its members who are in violation. Compliance training to  
10          its members and calls for the payment of penalties.

11                        The decision here, of course, is not only would  
12          the NFMP under its proposal dealing with errant  
13          franchisors by administering very broad compliance  
14          retraining that would call for in-house seminars taking  
15          up a period of days, the preparation of manuals for the  
16          franchisor in question that contain directives, check  
17          lists and so forth, but continuing oversight of the  
18          franchisors ongoing disclosure and indeed spot checks of  
19          the franchisor to make sure that disclosure is made or  
20          amended -- once required to be made or amended.

21                        In addition, the NFMP proposal would -- calls  
22          for the franchisor involved and the process would be  
23          voluntary. Essentially the way it would work is the  
24          Commission would suggest to a franchisor that had been  
25          found to have committed a violation of the rule, that it

1 had a choice. It could proceed as a target of an FTC  
2 enforcement action or it could be referred to the NFMP.  
3 If referred to the NFMP, the compliance retraining kicks  
4 in. The client retraining frankly would be conducted by  
5 many of the lawyers sitting around this table with the  
6 foremost authority as the area franchise law. In  
7 addition, the franchisor in question would have to agree  
8 to subject itself to mediation with any franchisee who is  
9 deleteriously affected.

10 So if there's a technical violation and the  
11 franchisee or group of franchisees or all of the  
12 franchisees say look, this costs me money as a direct and

1 review the alleged -- to re-review the alleged FTC rule  
2 infraction. So there would be some degree of pressure  
3 brought -- through that element of the NFMP proposal.

4 MR. TOPOROFF: Okay. Let me interrupt just a  
5 second.

6 MR. KAUFMANN: Sure.

7 MR. TOPOROFF: I just have a few questions.  
8 According to the proposal or if not the written proposal  
9 or at least the thinking of the folks who are going to  
10 put it together, is there any consideration given to the  
11 payment of the civil penalty -- reduced civil penalty?

12 MR. KAUFMANN: The notion here as originally  
13 contemplated was to reduce, if not eliminate, altogether  
14 a civil penalty or have a token civil penalty because the  
15 franchisor in question is going to have to pay for the  
16 illustrious lawyers around this table who engage in the  
17 compliance retraining, compliance oversight, UFOC  
18 checking and rechecking and so forth over a period of  
19 time.

20 Nobody around this table is expected to do this  
21 on a pro bono basis and so there will be monies involved.  
22 And second the mediation fees again are not  
23 insignificant. This is mediators who serve the National  
24 Franchise Mediation Program are highly skilled, highly  
25 decorated veterans, as it were. If you look through the

1 list of mediators for the NFMP you will recognize in each  
2 region of the country some of the foremost practitioners  
3 in those regions and so their fees have to be paid as  
4 well.

5 MR. TOPOROFF: Okay.

6 MR. KAUFMANN: But the NFMP is an open  
7 operation.

8 MR. TOPOROFF: Now, is -- if the Commission  
9 were to refer a matter to this -- whatever body handles  
10 this. Is that considered -- should that be considered an  
11 agency action that would have to be disclosed in a  
12 subsequent disclosure document?

13 MR. KAUFMANN: No. All the attractions to a  
14 franchisee -- the attraction to a franchisee is clear.  
15 The ability for the first to have some avenue of redress

1                   Again what we're dealing with here, at least  
2                   initially, are some of the lower level minor or technical  
3                   violations that a franchisor can commit. So the NFMP,  
4                   again, is open to discussion. That disclosure is the way  
5                   to go on those.

6                   MR. TOPOROFF: Another question I had is  
7                   attached to the proposal is a list of major franchises.

8                   MR. KAUFMANN: Right.

9                   MR. TOPOROFF: What happens if the violations  
10                  committed by one of the members of the list, if you refer  
11                  them to the mediation program, isn't there a conflict of  
12                  interest because basically you're sending the violator or  
13                  alleged violator to the program that that violator is

1 Securities and Exchange Act of 1934. Prior to that time  
2 the States and then the Federal government regulate --  
3 the often sale of securities in this country directly.

4 But there came a time following the great  
5 depression that the Federal governments need to protect  
6 the investing public and to make confidence in our  
7 national market system on the one hand and the need of  
8 the securities markets to be as free of regulation as  
9 possible on the other hand gave rise to a hybrid where  
10 beginning in 1934 and continuing to this day the  
11 securities corporate dealers of this country, by and  
12 large, regulate themselves under the auspices of what are  
13 called SRO, Self Regulatory Organizations, which for  
14 those not familiar with securities jargon, most of you  
15 are, happen to be the New York Stock Exchange, the  
16 American Stock Exchange and the National Association of  
17 Securities Dealers.

In a previous life I served as Directory of

1                   In fact, I will note two things. Not only do  
2 the exchanges discipline their foremost members, floor  
3 traders for Merrill Lynch, floor traders of Bear Sterans,  
4 and so forth and so on. In fact disciplining them  
5 includes referring them to the SEC and even to the  
6 Department of Justice on occasion.

7                   But the exchanges each maintain an arbitration  
8 bar through which customers can, and indeed under the  
9 Supreme Court ruling in 1987, must bring their claims  
10 against corporate dealers. So you can say to yourself  
11 how can this happen, you know, an exchange whose  
12 membership includes Merrill Lynch, Bear Sterans, Paine  
13 Webber and so forth, how can they possibly have an  
14 arbitration forum that's neutral.

15                   The answer is as of 19 -- as of the latest GAO  
16 study of this area conducted in 1992, arbitrators decided  
17 in favor of investors in 59 percent of the cases in which  
18 investors filed claims against their brokers.

19                   So it has worked quite well. The SEC just last  
20 year under Arthur Levin, who I worked under when he was  
21 Chairman of the American Stock Exchange, also has  
22 acquired great neutrality of arbitrators, the fairness of  
23 the arbitration proceedings conducted by this nation's  
24 security exchanges and has found them, by and large,  
25 quite safe and sound for investors to participate in.



1 Similarly here, whether it's a -- whether the franchisor  
2 is a member of the NFMP or not, we intend to have full  
3 process applied.

4 MR. TOPOROFF: What happens if in this  
5 monitoring training stage the franchisor violates the  
6 rule in some respect or doesn't -- or fails to correct  
7 the initial violation, what obligation would there be or  
8 should there be on the part of Neil Simon or Dennis  
9 Wieczorek or whoever the person is who is working for  
10 this organization who is going to do the retraining to  
11 report that information back to the Federal Trade  
12 Commission?

13 MR. KAUFMANN: That's a good question.

14 MR. TOPOROFF: How is that handled?

15 MR. KAUFMANN: That's a good question. I'll  
16 have to take it up with the NFMP members. I would hazard  
17 that one possibility of this would be the compliance --  
18 if it's known the compliance retraining is not being  
19 adhered to then we can simply report to the Commission  
20 that the NFMP is unable to fulfill its function in this  
21 regard.

22 The FTC is never giving up jurisdiction by  
23 referring -- franchisor to the NFMP. And so an early  
24 termination of the NFMP's duties and responsibilities and  
25 oversight here could result in the Commission retaining

1 its powers and, I suppose, moving appropriately.

2 MR. TOPOROFF: Now, for the mediation program,  
3 who is the mediator? How is that person selected?

4 MR. KAUFMANN: These are neutrals -- these are  
5 neutrals. The National Franchise Mediation Program is  
6 administered by an entity here in New York City called  
7 the Center for Public Resources. This is one of a  
8 limited number of nationally, in fact, internationally  
9 recognized ADRO, Alternative Dispute Resolution  
10 Organizations. It's not as large as the AAA, but among  
11 large commercial enterprises it has a slightly better  
12 reputation.

13 Indispute -- Jams Indispute is another one that  
14 we're all familiar with. The mediators are selected by  
15 CPR, not by the -- not by the franchisor members of the  
16 NFMP. The mediators are selected based on, again, the  
17 qualifications of simple experience, standing in the

1           warranty disputes? And I'll give you a little bit of  
2           background in case you're not familiar.

3                         Ford, for example, and Chrysler, most of the  
4           major auto dealers have consumer appeals grievance or  
5           they call it something else that meet periodically  
6           throughout the country. And usually what happens is a  
7           claim is submitted and again the focus is usually on  
8           warranty issues.

1 of securities arbitration again, which best mirrors what  
2 it is we're talking about.

3 In securities arbitration, the constitution of  
4 the New York Stock Exchange and the American Stock  
5 Exchange, as well as the NASD, calls for different types  
6 of panels to hear different types dispute. If it's a  
7 customer dispute they'll generally have two public  
8 members versus one that is called industry members on a  
9 three-person arbitration panel or three and two if the  
10 claim is very large.

11 Then also some disputes it is the so-called  
12 public arbitrator proven public because it's a lawyer who  
13 does securities work and he may have worked in the past  
14 for Merrill Lynch, so isn't he obviously bias in favor of  
15 Merrill Lynch. We thought it was best to avoid any  
16 appearance of possible impropriety.

17 If I put -- you know, any franchisee advocate  
18 on -- you know, Susan Kezios, and perhaps she would be  
19 well grounded to do so, may object and say well that's  
20 really a captive franchisee. And to put somebody there  
21 from a franchisee who has 250 fast food restaurants and  
22 is also a franchisor itself, that's not really a  
23 franchisee representative.

24 We wanted to avoid those very types of disputes  
25 going in and that's why we wanted to go with a panel of

1 neutral -- strict neutrals selected by an objective  
2 entity that selects them outside of any NFMP agents.  
3 They are told -- the -- is told we want a panel of  
4 neutrals, absolute neutrals of high qualification. You  
5 screen them, you select them. Okay. But at the end of  
6 the day we're trying to avoid -- franchisor or franchisee  
7 or somebody sitting the middle. We explicitly want to  
8 avoid that.

9 MR. TOPOROFF: Where would these mediations be  
10 heard?

11 MR. KAUFMANN: Around the country. The Center  
12 for Public Resources has -- I forget how many there are  
13 frankly. I think there is seven or eight.

14 MR. TOPOROFF: Any thought given to holding  
15 them in the franchisee's either State of residence or at  
16 a site selected by the franchisee so that we avoid venue  
17 types of issues?

18 MR. KAUFMANN: Not yet. We haven't gotten down  
19 to that fine tuning yet. We were waiting to go through  
20 this process. We're waiting also on certain  
21 organizational things on our end. At the end of the day,  
22 however, it was always contemplated -- let me tell you  
23 what was not contemplated. It was not contemplated that  
24 franchisees from around the country would have to drag  
25 their behinds to New York City, let's say, to have these

1 mediations conducted.

2 We knew they were going to be conducted in each  
3 of the regions in which the franchisee was situated.  
4 After that we haven't fine tuned it. Should we go to the  
5 State? Should we go to the city? Should we go to the  
6 block?

7 And when I say we, again I'm not speaking for  
8 myself. I do not sit on any governing committee at the  
9 NFMP.

10 MR. TOPOROFF: No. I appreciate that.

11 MR. KAUFMANN: I'm a lawyer who works for the  
12 NFMP. I'm speaking for Clay Small, Pizza Hut, Lowell  
13 Dixon at McDonald's, and Mike Davis of Southland.

14 MR. TOPOROFF: I think there's an issue that  
15 you might want to consider to the extent that if the  
16 Federal Trade Commission that would be referring these  
17 matters to the extent that franchisees have the option of  
18 going to mediation, I mean it's not something that they  
19 had necessarily asked for, and I think to make it as easy  
20 as possible and not to put in yet another system or  
21 process that they have to go through that might require  
22 them to pick up and, like you said, and move -- travel to  
23 New York or wherever. I think that that's a concern.

24 MR. KAUFMANN: Understood.

25 MR. TOPOROFF: So that's a fact that you might

1 want to think about.

2 Before I go around the table and ask people  
3 what other additional questions, comments they might have  
4 on the proposal, I want to just probe a little bit.  
5 Where do you think it would be inappropriate, what  
6 circumstances would be inappropriate for the Commission  
7 to refer a matter to this particular program?

8 MR. KAUFMANN: There's an expression baby feet,  
9 baby steps. I think, just has happened with the  
10 Securities Industry in the 1930s, this notion of the  
11 industry policing itself for the betterment of  
12 franchisors and franchisees and their joint desire at the  
13 times, and I don't mean to offend anybody, defend all  
14 government regulation. There's one that should begin  
15 with a minor or technical rule infraction and of course  
16 what is minor or technical subject to much, much  
17 discussion.

18 But after that it depends on experience, how  
19 the Commission views it, how the NFMP experience turns  
20 out to be. The NFMP, itself, has placed no cap on its  
21 capabilities going forward. It did not design this  
22 program with the idea that this is all we're going to do.  
23 Don't call us about anything more.

24 To the contrary, the major franchisors who  
25 constitute the vast preponderance of NFMP members are

1 willing to undertake any activity to further the interest  
2 of franchising, either franchisor or franchisees, but  
3 franchising because the larger franchisors and their  
4 franchisees -- and we were just discussing this off the  
5 record, have -- I think over the last ten, 15 years many  
6 of them come to the realization that conflict is  
7 unhealthy and, indeed, is crippling to both sides. And  
8 so whether it's Burger King or Schmalt (phonetic) with  
9 its franchisees or McDonald's working things out with its  
10 franchisees this year or listening to their desires, or  
11 any of the host of other major franchisors choosing to  
12 avoid litigation and arbitration and such confrontation  
13 that those two engender and instead going to mediation  
14 which keeps the spirit of the relationship alive.

15 We all understand, major franchisors do and I  
16 believe many franchisees do, that this is the way to go,  
17 cooperation and working on conflicts in a way that  
18 doesn't shred the relationships. So we're not putting  
19 any cap on what it is that one day we may be able to do.  
20 We have a proposal that starts modestly because again  
21 baby feet, baby steps.

22 MR. TOPOROFF: Does anybody at the table have  
23 any questions for David about this model or the proposal  
24 or particularly how it would work? Dale? Dale Cantone?

25 MR. CANTONE: Is it correct that it would be



1 the FTC making the referral to the mediation program? So  
2 wouldn't it be the FTC making the determination as to  
3 what's a technical violation? Do I have that right?

4 MR. KAUFMANN: That's correct. The FTC would  
5 make the reference, but there would have to be some  
6 understanding up front what it is we are and are not  
7 capable of handling. The NFMP doesn't want to start out  
8 as handling what in ordinary circles would be deemed a  
9 class action, going against a franchisor for what is a  
10 major violation of the FTC franchisor. It doesn't have  
11 the experience today to do that and so it wouldn't want  
12 to confront that possibility. We would want to have an

1 Franchise and Business Opportunities, it's not all that  
2 unfeasible that the NFMP would probably work out a  
3 similar arrangement with the States.

4 MR. TOPOROFF: Let me ask you. A thought just  
5 now. Let's say a franchisor has a minor technical  
6 violation -- the program supposedly is retrained and  
7 let's say sometime after, commits or is alleged to commit  
8 some -- violation of the rule. Isn't there an argument  
9 to say these people are clearly on notice, they were  
10 trained, if anything the second go-around they should be  
11 slammed with even a higher civil penalty than they might  
12 otherwise have gotten if the Commission just otherwise  
13 got wind of a particular complaint or situation?

14 MR. KAUFMANN: No comment.

15 MR. TOPOROFF: Okay. Dennis Wieczorek.

16 MR. WIECZOREK: I have a number of comments.  
17 First of all, the FTC scheme is a pure self-regulatory  
18 scheme in comparison to what's being proposed here.  
19 Secondly, the funeral rule offender program is a very  
20 different rule. The Funeral Rule basically calls for a  
21 fairly uncomplicated straight forward disclosure compared  
22 to the UFOC in determining compliance -- I hesitate to  
23 say uncomplicated, but it's fairly straight forward.

24 I don't see either of those as being a basis  
25 for comparing violations of the FTC rule -- provide a

1 reason for a self regulatory initiative.

2 Secondly, minor and technical violations, it  
3 sounds like from what I'm hearing, are violations that  
4 don't involve any kind of consumer injury. The FTC is  
5 charged with redressing consumer injury and if a director  
6 happens to be left off an offering circular, I don't  
7 think that the FTC would be interested in an enforcement  
8 action nor would Dale Cantone or any other State be  
9 interested in an enforcement action.

10 Once you get beyond that you get to a situation  
11 where material numbers of litigation -- pieces of  
litigation are left out or "material omissions occurred

1 violations? Do you have any idea?

2 MR. TOPOROFF: I couldn't hazard to guess.

3 MS. KEZIOS: All right. How much work -- what  
4 size of a workload is it going to relieve the FTC from  
5 taking care of?

6 MR. TOPOROFF: I can't answer that. I can't  
7 answer that. Right now many technical violations we  
8 might -- might come to our attention, but we may choose  
9 to focus our attention on bigger problems, where there is  
10 more widespread injury or in some other sphere where  
11 resources might be required to address travel fraud or  
12 telemarketing fraud or 900 numbers of warranties or auto  
13 leasing or any number of issues at any given time.

14 So part of the concern that we have is as a  
15 practical matter people -- I'll tell you from my personal  
16 experience. People had yelled and screamed at me on the  
17 phone saying I have brought X rule violation to your  
18 attention and you mean to tell me that there's absolutely  
19 nothing that you're going to do. You're the law  
20 enforcer. Who is in charge here? I pay my taxes. Don't  
21 you enforce the law? Who is going to do that?

22 Well, as a practical matter, all law  
23 enforcement agencies, Federal, State and otherwise, have  
24 prosecutorial discretion. And I'm sure Dale would echo  
25 the same thing. We cannot be everywhere all at once.

1           And unfortunately there are certain violations that are  
2           just not going to be redressed as we just don't have the  
3           resources or the manpower at any given time.

4                         So one option is say c'est le vie, you know,  
5           that's life and move on. Another option is to say wait a  
6           second. There is at least this program that the  
7           franchisor could be referred to that can be given  
8           training, that can be monitored to be brought up to  
9           compliance working with the Commission. If there are  
10          consumers that have faced some kind of injury as a  
11          result, they could go into the mediation program and it  
12          could be redressed.

13                        And let me give you a very practical nuts and  
14          bolts example. A lot of times issues like this come up  
15          with competitors, not necessarily injured franchisees. A  
16          competitor calls us and says I'm in full compliance, but

1 other information that showed very clearly that yeah,  
2 this guy -- that's right. There's a principal that  
3 didn't disclose a prior bankruptcy.

4 Now, there was no allegation at all that there  
5 was any injury. We don't know how many people bought the  
6 particular system and there is no complaints. Had I  
7 known about the prior bankruptcy I would never have  
8 bought into this system. It might have been an issue  
9 that no one really cared about. But yes, is it a  
10 violation? Yes, it is a violation.

11 So one option is like I said before, we could  
12 ignore it and say there are better targets, there are  
13 more important consumer protection issues that we need to  
14 address, or another avenue is again what we have asked  
15 for in the ANPR is help us out. Are there avenues or  
16 other programs that we can refer people and maybe a  
17 simple referral to the program from the National  
18 Franchise Mediation Program or whatever could have  
19 brought this matter to the attention of that franchisor  
20 and maybe that franchisor, for whatever reason, said you  
21 caught me or I didn't know or whatever the circumstances  
22 might be and he comes into compliance.

23 If the objective is to make sure that people  
24 are in compliance running around -- instead of running

1 a lot of merit to what the Commission has -- the types of  
2 programs that the Commission has elicited.

3 So it's kind of like a partnership, if you  
4 will, where Dale's concern comes into being of what the  
5 technical minor violator. Obviously that's something  
6 that the Commission would have to weigh and refer where  
7 appropriate, and certainly there's going to be examples  
8 where it is not appropriate. Mind you we're not talking  
9 about business opportunities. Okay.

10 That's a slam business opportunities mind you,  
11 but the proposal that we're considering is strictly for  
12 franchise systems. And there might be, as I mentioned in  
13 my introductory remarks, small time franchise systems,

1 are all details that need to be ironed out. But that's  
2 kind of what we're asking about is for feedback from  
3 people around the room to help us out in determining what  
4 those perimeters might be.

5 MS. KEZIOS: So that the technical or minor  
6 violations, what -- how do you determine those now,  
7 David? How does National Franchise Mediation Program  
8 determine what is technical and minor?

9 MR. KAUFMANN: Certainly if the Commission --  
10 that the -- proposal and that would be a subject of  
11 discussion between NFMP and the Commission. The NFMP is  
12 no more ready to accept major violations of the FTC rule  
13 and take on a major law enforcement role than the FTC is  
14 desirous of seeding that role over to the NFMP. It would  
15 give -- you know, we're -- I mean, the one thing I want  
16 to get straight in response to something Dennis said.  
17 We're not looking here to play around. We're not looking  
18 to have increased FTC actions -- report here there  
19 wouldn't be none.

20 The ANPR is predicated upon a finding of some



1           So obviously the existence of that penalty is  
2 already in place. The question is is there something  
3 that the Commission absent an enforcement proceeding to  
4 proceed. Is it more economic for the commission to say  
5 all right, look. Instead of moving against them to  
6 recover \$10,000 for violation perhaps given the --  
7 governmental resources we refer this to the NFMP.

8           So, Dennis, in response to your suggestion that  
9 this would bring in all sorts of enforcement activity  
10 where before there was none, no, I disagree. The NFMP  
11 looks very carefully at the FTC language involved,  
12 talking about reducing or waiving civil penalties. This  
13 isn't a program that says send us every error franchisor  
14 you have regardless of what its done. If there's no  
15 consumer injury we have at the NFMP no interest in  
16 dealing with it.

17           But, Susan, more to the point or to your point,  
18 there is no bright line distinction of the NFMP -- as to  
19 what constitutes a minor or technical infraction. The  
20 NFMP set forth certain examples in its submission, but  
21 clearly they were only examples. We have to await for  
22 force commission response to see if this program is  
23 acceptable and if it is to really fill in the details as  
24 to what it is the Commission wants to refer -- the NFMP  
25 feel its capable of taking it.

1                   MR. TOPOROFF: On that point let me just say,  
2 this is another area where we would certainly welcome  
3 additional comments. The proposal again is set forth in  
4 comment 26. It's available on the net already so people  
5 could find it on our Website. We are looking for  
6 assistance and feedback to help the Commission frame what  
7 is a minor violation, what should be a technical  
8 violation, what are the appropriate instances that should  
9 be referred to this program. And the flip side, what's  
10 not appropriate.

11                   But the one thing that I have to emphasize is  
12 there is the small business regulatory enforcement  
13 fairness act and that compels the Commission to develop a  
14 program. Now, it's not franchise specific. It applies  
15 to all small business. So that is not something that we  
16 can say, well, we just shouldn't do this.

17                   So what this proposal ties into is many factors  
18 the Commission was looking at and other obligations that  
19 we have. We're just taking those obligations from our  
20 executive orders from the White House and molding it or  
21 incorporating it into the franchise contents. But by no  
22 means have we, Myra, me, Keith Anderson, Eileen  
23 Harrington who isn't here and anybody else at the  
24 Commission , no one has come to any formed conclusions  
25 about how this program or policy should work.

1                   So by all means read through the proposal,  
2                   supplement comments if you want. We are sincerely  
3                   looking for feedback here because if we're going to have  
4                   some kind of proposal like this, we want this to be  
5                   doable, and we want it to be a benefit to franchisees.  
6                   We want it to be beneficial to the franchisors in terms of  
7                   coming around and coming into compliance. And certainly  
8                   the added benefit of mediation could help out where there  
9                   is consumer injury perhaps. So these are all factors.

10                   By no means are we going to resolve all these  
11                   issues today, but please take time and review the  
12                   proposal and get back to us. And I think this is one of  
13                   the issues that we will address again in the next meeting  
14                   in Seattle.

15                   David Kaufmann.

16                   MR. KAUFMANN: I understand one thing from  
17                   Susan. I don't want any misunderstanding. What I said  
18                   before, we meant the NFMP didn't design this program and  
19                   make its omission with the idea that the FTC suddenly has  
20                   an avenue to enforce every possible rule violation.

21                   The notion was if an investigation or receipt  
22                   of complaints by the Commission has spurred the  
23                   Commission to determine, I would commence an  
24                   investigation and/or bring an enforcement proceeding,  
25                   which would result in civil penalties. Then the NFMP is

1 prepared to come in and say well, waive or reduce those  
2 penalties for these violations, minor though they may be,  
3 by referring a franchisor over to the NFMP.

4 So it's not -- and we all know on both sides of  
5 the table that there have been a number of FTC  
6 investigations and enforcement proceedings. And I  
7 mention investigations because frankly they can tie a  
8 franchisor up and possibly spend a considerable amount of  
9 money. FTC investigations on enforcement actions over  
10 what we, I think, all would consider to be relatively  
11 minor violations of the rule. They -- whoever  
12 sufficiently repeated -- the Commission determines to  
13 focus its enforcement activity on those violations.  
14 That's what the NFMP submissions are meant to deal with.

15 MS. KEZIOS: Can I just ask one other thing?

16 MR. TOPOROFF: Sure.

17 MS. KEZIOS: The NFMP has took 101 matters  
18 under consideration. Is that what you said?

19 MR. KAUFMANN: Yes.

20 MS. KEZIOS: And some of them had to do with  
21 development rights of the franchisees and some of that  
22 had to do with encroachment?

23 MR. KAUFMANN: Correct.

24 MS. KEZIOS: Okay. So I'm getting to my minor  
25 and technical violations question in a roundabout way.

1 But I have not heard from any members of the AFA that  
2 they are any of the 101 that have gone through the  
3 program. So that either means they've gone through it  
4 and they're happy and they're not calling or none of our  
5 people have taken part in it.

6 So my next question is do only franchisors who  
7 belong to NFMP get referred over or is it for anybody?

8 MR. SIMON: Neil Simon. If I may, I think  
9 there's some confusion. The FTC has no involvement  
10 whatsoever with the existing NFMP program.

11 MS. KEZIOS: I understand that.

12 MR. SIMON: That is a program in which  
13 franchisors are members and they commit to have their  
14 disputes with their franchisees noted. So it's not  
15 limited to technical or minor or for that matter rule  
16 violations. I think it --

17 MS. KEZIOS: But it's only limited to the  
18 companies that are members of the NFMP?

19 MR. KAUFMANN: Companies -- yes. And --

20 MS. KEZIOS: Currently.

21 MR. KAUFMANN: Members of the NFMP. Let me try  
22 to straighten out organizationally. There is an NFMP  
23 Steering Committee, the group of major franchisors who  
24 created the original National Franchise Mediation  
25 Program.

1 MS. KEZIOS: Right.

2 MR. KAUFMANN: And then there are franchisors  
3 who belong -- who participate in the NFMP mediation  
4 program even though they're not in leadership. These  
5 franchisors must sign contracts binding themselves to  
6 mediate with any franchisee who has a dispute and desires  
7 mediation.

8 MS. KEZIOS: That's under this program or under  
9 the old National Franchise --

10 MR. KAUFMANN: Under the existing -- what you  
11 would call the old and what I would call the existing --

12 MS. KEZIOS: Okay.

13 MR. KAUFMANN: -- National Franchise Mediation  
14 Program.

15 MS. KEZIOS: Okay.

16 MR. KAUFMANN: All right. So we have a  
17 leadership group of franchisors creating the NFMP and a  
18 host of other franchisors who participate in it, although  
19 they're not in a leadership structure.

20 MS. KEZIOS: So are -- if a franchisee has been  
21 determined to have been damaged somehow in this action,  
22 there's no reparations made to that franchisee, is that  
23 what I'm understanding?

24 MR. KAUFMANN: As of today?

25 MS. KEZIOS: Yeah.

1 MR. KAUFMANN: Mediation, as you know, is not  
2 binding.

3 MS. KEZIOS: Yes.

4 MR. KAUFMANN: The parties are now the  
5 franchisor and the franchisee enforcing -- the question  
6 you ask now is, I think, is going forward if this program  
7 were adopted. Who would the parties and interest --  
8 who's going to be -- who are going to be the parties and  
9 mediation.

10 **(Inaudible voices.)**

11 MR. KAUFMANN: The same two parties -- no, the  
12 same two parties.

13 MS. KEZIOS: Two parties.

14 MR. KAUFMANN: Going forward -- the referred  
15 franchisor and --

16 MS. KEZIOS: I understand that.

17 MR. KAUFMANN: -- franchisee.

18 MS. KEZIOS: But also we're trying to wait --  
19 we're trying to get the franchisors out of paying civil  
penalties. Am I missing something here?

1 MS. KEZIOS: AIA.

2 MR. WIECZOREK: That's where I'm from.

3 MS. KEZIOS: Yeah. Okay.

MR. KAUFMANN: Let me try --



1 franchisees who may be -- and existing franchisees who  
2 might not be -- prospective franchisees who already paid  
3 money and are waiting to go into the system. And there's  
4 all different kinds of factors that have to be waived in  
5 coming up with a redress program. So we're not  
6 necessarily sure it is going to work or be to the  
7 advantage of anybody.

8 So a possible method is to refer those injured  
9 parties to this mediation program. And in that instance,  
10 as I understand it, the parties will be the franchisor  
11 and those injured franchisees.

12 MR. KAUFMANN: That's correct. That's correct.  
13 In fact, it would be -- Susan, that would be a condition  
14 to the franchisor going to the NFMP in lieu of an FTC  
15 enforcement action. If the franchisor agreed to the  
16 compliance retraining and agreed to subject itself to  
17 NFMP mediation with any franchisee who has been directly  
18 -- who has been harmed as a direct and causal result of  
19 the FTC rule violation.

20 And the FTC would make the franchisor exist on  
21 that before referring the franchisor.

22 MR. TOPOROFF: Dennis.

23 MR. WIECZOREK: Actually Matt and John are  
24 before me.

25 MR. TOPOROFF: John Tifford.

1                   MR. TIFFORD: Yeah. I, as you know, was at the  
2                   FTC. Those were the calls I hated the most myself when  
3                   somebody would say why aren't you doing anything when  
4                   I've shown the -- when I've shown you a violation. I  
5                   think it's a very, very difficult situation and I commend  
6                   the Commission to trying to find a way to deal with this  
7                   situation.

8                   I also think we should stop beating up on David  
9                   because this is obviously a work in progress and the fact  
10                  that we don't have the answers to every question doesn't  
11                  mean it shouldn't be entitled to serious consideration.

1 days that you got to count between the time you get an  
2 offering circular and the time you sign somebody up.

3 So in many cases the remedy here may not be at  
4 all appropriate to the nature of the violation that is  
5 going to be referred to this organization or any  
6 organization that might be led.

7 So it's only the question when -- the only time  
8 it has any relationship is when it is a question where  
9 the franchisor didn't really know what the rules were and  
10 should have. And I don't think in most cases that will  
11 be the case.

12 Secondly, the Commission presently -- I don't  
13 know what's wrong with doing nothing and still have the  
14 same policy. If there's an isolated inadvertent good  
15 faith that may be a sloppy violation, the Commission --  
16 that has caused no consumer injury, the Commission at the  
17 present time is a matter of case selection criteria, has  
18 said we're just not going to pursue it.

19 I don't know what's wrong with that and why it  
20 hasn't worked and why we shouldn't continue doing that.  
21 Now, obviously that's a slippery slope, but certainly to  
22 the extent that a franchisor says I'm not going to do  
23 this. I don't care what the rule says. Then we're not  
24 talking about isolated inadvertent errors. We're talking  
25 about a pattern of policy where a franchisor has made a

1 willful determination to violate the rule. That's a  
2 totally different enforcement issue that the Commission  
3 needs to deal with and I don't consider that to be a  
4 technical violation.

5 Third, the Commission presently has in its  
6 rules the concept of an assurance of voluntary  
7 compliance. While it was more a formal program in the  
8 1970s, it's still part of section 1.34 of the  
9 Commission's rules that gives the Commission the ability  
10 on these kinds of isolated inadvertent things to formally  
11 work out a program with the franchisor. It used to be a  
12 rule labeling refer act and it's used on an ongoing basis  
13 and I've spoken to the attorney who administers it at the  
14 FTC and it does work. The Commission presently has it in  
15 its rules and I don't know why they can't continue to do  
16 it. It gives the Commission the opportunity to very  
17 informally, very quickly dispose of these kinds of  
18 issues.

19 And the final point that I would make and the  
20 thing about this program that really, to me, has some  
21 uneasiness here is some of the implications that arise  
22 for franchisors who go through this program and  
23 subsequently claim that what they're now doing after they  
24 have gone through this program is exactly what was told  
25 to them during the compliance program.

1           I think that, you know, all of us at this table  
2 I'm sure, or just about all of us, did these compliance  
3 programs. And I'm willing to bet that if all of us sat  
4 at each others programs at the end of the day we would  
5 probably say whatever else we thought of the program, we  
6 could probably find a couple statements that were made  
7 that we wouldn't necessarily agree with or wouldn't have  
8 said the same way.

9           I think that once the Commission has  
10 established the procedure that says go to these people  
11 and, you know, learn and we'll let you go, then they  
12 have, to some extent, taken on the obligations of how  
13 well this program has trained and they've taken on the  
14 responsibility for anything that was said during this  
15 program as being -- having the Commission's --

16           For example, what about the written materials.  
17 Is the Commission going to review the written materials  
18 that are handed out in compliance sections to be sure  
19 that they agree with everything that the compliance  
20 program is going to say to the franchisor? Have they  
21 reviewed the lecture notes? Have they gone over the  
22 transcript or the answers that have been given to  
23 questions?

24           I mean, we don't need a compliance seminar to  
25 tell somebody that you need ten business days between the

1 time you -- you know, you get the offering circular and  
2 the time you sign up. That's not the kind of things that  
3 this compliance seminar is needed for. It's needed for  
4 the kinds of things where some of the answers aren't so  
5 clear. We're talking today about the possibility of  
6 having a first substantive discussion as the triggering  
7 of any disclosure.

8 Now, how in the world is a compliance seminar  
9 going to handle the issue of what's a first substantive  
10 discussion and is the Commission willing to be bound by  
11 whatever answer is given at that thing.

12 It seems to me that that is something that is  
13 really -- it's got a big mine field and I think that as a  
14 public policy issue before the Commission is willing to  
15 sign on to a program like this, they better know where  
16 they stand on these issues and better be ready to be in a  
17 position to sign on to whatever is being said and be  
18 responsible for whatever goes on at these compliance  
19 seminars because I think they're going to have a tough  
20 time disassociating themselves from any statements or  
21 actions that go on in the seminars.

22 MR. TOPOROFF: Dennis. Matt Shay.

23 MR. SHAY: Our comment, I think, to the  
24 question in general -- you know, what Susan pointed out  
25 about this being basically a resource allocation issue

1 and I think we all recognize that, but even the comments  
2 that David made about baby steps and baby feet -- that at  
3 some point there's going to be a general reluctance on  
4 the part of the FTC probably to part with pursuing  
5 certain of these actions and delegating them, if you  
6 will, to the NFMP, which is going to continue to raise  
7 the issue of who handles the most important issues.

8 And I think that being the case there's going  
9 to be one of two things happening. Either we're going to  
10 see a greater number of enforcement actions, which may or  
11 may not be the case, but for you to continue to handle  
12 technical and minor violations you're going to have to  
13 have an increase, I think, of the number of enforcement  
14 actions or you're going to have to delegate away things  
15 that the FTC may not want to delegate away, but may be a  
16 nature of complexity or severity that might not be  
17 appropriate for this program to handle, which then raises  
18 issues about do you create two classes of agreed  
19 franchisees.

20 And you learn about the franchisees who are  
21 affected by issues that have to be referred to the NFMP.  
22 They have an opportunity to directly mediate some sort of  
23 benefits for themselves and what about those franchisees  
24 who agree to buy something that's going to be handled by  
25 the FTC, who mediates for them.

1                    I mean, I just think you're heading down a  
direction hereingôÐÂê



1 consideration has been given to follow on actions. Just  
2 as when the government invites companies for price fixing  
3 or other antitrust violations you then see the plaintiffs  
4 are -- file 50 actions around the United States, each  
5 trying to become the coordinating counsel and likewise  
6 when a matter gets referred, the NFMP will then see  
7 plaintiffs lawyers filing actions on behalf of  
8 franchisees, who also received this improper disclosure  
9 in State Court around the United States. I think that  
10 would be a very big concern.

11 MR. TOPOROFF: Dale Cantone.

12 MR. CANTONE: In Maryland we do have a  
13 mechanism where we enter into informal agreements for  
14 what we would consider technical violations. We don't  
15 have civil penalties. We ask that there be rescission  
16 offers to the extent that that's an appropriate remedy.  
17 It's non-disclosed on the offering circular.

18 We would only do that as a result of  
19 investigating all that we felt was required to  
20 investigate about whether or not there were additional  
21 violations.

22 So I think that in any type of compliance  
23 program or proposal like this it could only work if it's  
24 the end result of still some investigation. I don't  
25 think that any governmental body can refer something even

1 of a technical nature without going through some due  
2 diligence on the part of the governmental agency to make  
3 sure it isn't a widespread problem, that there aren't  
4 hundreds of similar problems.

5 MR. TOPOROFF: We're going to hear from Neil  
6 and then David and then I think we're going to wrap it  
7 up. So, Neil.

8 MR. SIMON: Three quick comments and this is  
9 mostly in regard to things that Matt Shay and Dennis have  
10 said.

11 One, as I understand it, the FTC would not be  
12 agreeing in advance to turn anything over. It would be  
13 completely at the election and completely at the  
14 discretion of the FTC what, if anything, would be turned  
15 over. So there is no broad policy judgement that was  
16 being made at the moment.

17 Two, I am virtually certain that had there been  
18 public discussion like there is right now, but had there  
19 been public discussion before the announcement of the  
20 NFMP program a number of years ago very similar  
21 reservations would have been voiced.

22 MALE VOICE: (Inaudible).

23 MR. SIMON: No, no. I'm talking about the NFMP  
24 that was all of a sudden released. There wasn't any  
25 public discussion of it. But nonetheless, it has had

1 great success in addressing and resolving franchise  
2 disputes.

3 The proposal now before the FTC, I think, is a  
4 logical extension of that program and is an excellent  
5 example of the manner in which the public and private  
6 sectors can work together. I think it is something that  
7 certainly is going to require refinement, but I think it  
8 is something that all of us who would prefer to see  
9 disputes handled in -- between private without any great  
10 intervention of the government that are concerned about  
11 the manner in which our resources are used, including tax  
12 dollars, should be supportive of this and working to --  
13 working to make sure it can succeed. I believe it will.

14 MR. TOPOROFF: David Kaufmann.

15 MR. KAUFMANN: Just let me briefly -- some  
16 remarks. In response to John Tifford and what he was  
17 saying -- Dennis Wiczorek. Let's make it clear. The  
18 NFMP, as Sue Kezios has pointed out, very quickly, very  
19 early on when this was released was a franchisor --  
20 organization. The goal in life was not increase the  
21 number of enforcement actions brought by the FTC against  
22 franchisees over minor or technical violations.

23 To the contrary, the FTC's ANPR is predicated  
24 under the determination already being made that in  
25 following an investigation or an investigation having

1       been concluded following an enforcement action, there's  
2       going to be a civil penalty assessed the franchisor.  
3       That's why the ANPR carefully states whether it would be  
4       advisable to develop a program to reduce or waive civil  
5       penalties for certain violations of the FTC franchise  
6       rule.

7                   So, John, to use your phrase, FTC -- I imagine  
8       the FTC will continue to do nothing. It's when the FTC  
9       -- the NFMP promises that the FTC will continue to do  
10      nothing. It's where the FTC has already positive that  
11      it's going to have to open up a broad scale investigation  
12      or has already completed that and may have to engage in  
13      enforcement activity. In other words, it's when -- when  
14      the FTC has already concluded in its mind that there is  
15      going to be a civil penalty hearing that the matter is  
16      ripe for reference to the NFMP. That's what the ANPR  
17      says and that's what the NFMP is responding to.

18                   With regard, John, to your problem about  
19      compliance training and the FTC standing behind that,  
20      I'll simply note it is the provence of security exchanges  
21      and I'm not sure, Dennis, what you meant by saying their  
22      pure self-regulation. They're under the SEC. They have  
23      to file reports to the SEC on a daily basis. Every time  
24      you change a rule at the Exchange, every time you change  
25      your Constitution, it's all under the SEC, including the

1 Exchange disciplinary and arbitration functions, which is  
2 subject to the SEC as well.

3 But whenever a new member comes in to any  
4 Exchange, the New York, The AMEX, they have to undergo  
5 extensive training that's administered by the Exchange.  
6 So that type of training by industry, self regulators  
7 happens all the time.

8 Lastly -- well, two lastlys. One, Matt Shay  
9 asked who will mediate for non-NFMP franchisees. That is  
10 franchisees where the matter hasn't been referred to the  
11 NFMP. Well, the answer is again according to the ANPR  
12 those franchisors in question would be subject to an FTC  
13 enforcement action and so the answer is the FTC recovers  
14 for those franchisees because we all around here are  
15 representative of franchisors who either have gone to  
16 enforcement actions or entered into consent decrees  
17 calling for restitution to deleteriously affect  
18 franchisees.

19 And lastly, Dennis, in terms of pile on  
20 actions. That is if something is referred to the NFMP  
21 for resolution versus an FTC enforcement action,  
22 plaintiffs lawyers around the country jump in, if they  
23 would they will be less able to do so against a  
24 franchisor who went to NMFP versus a franchisor who went  
25 through an FTC enforcement action.

1                   An FTC enforcement action -- or can be invoked  
2 thereafter.

3                   Here we're talking about mediation. There's no  
4 finding. There's no finding of law. There's no finding  
5 of fact. There are no conclusions. There's no judgement  
6 entered. And so the mere fact that this matter was  
7 referred out for NFMP mediation versus the FTC procuring  
8 a judgement -- that in fact, a franchisor in question  
9 violated some section of the FTC franchisor, quite  
10 frankly was one of the attractions of franchisors as well  
11 the -- attracted to franchisors while we're trying to --  
12 franchisees by offering mediation --

13                   MR. TOPOROFF: Okay. With that I want to  
14 repeat my earlier remarks and that is one way or another  
15 the Commission will develop some kind of system to, at  
16 least, contemplate waiving or reducing civil penalties  
17 again because of executive orders or because of the Small  
18 Business Regulatory Enforcement Fairness Act of 1996.

19                   So I certainly would welcome again any comments  
20 that refine the proposal or substitute proposals or what  
21 have you. The Commission by no means is letting it to  
22 any particular approach. Indeed, I don't think the  
23 Commission has even read the comment that we discussed  
24 today. I certainly have and people in my division who  
25 were looking at the issues have, but I really don't think

1 it has gone any further than that.

2 So please supplement your comments. Provide us  
3 with any additional information that you may have.

4 MALE VOICE: Do we get our Honorians now?

5 MR. TOPOROFF: I want to thank everybody for  
6 being here. This has been very, very helpful. It's been  
7 a long day. I do appreciate it. It really helps us to  
8 focus the issues and to develop the record further.

9 If there are people here today or you know of  
10 others in your firms or whatever that intend to go to the  
11 meeting in Seattle, it would be helpful in the next few  
12 days or weeks when we get back to the office next week,  
13 if you would call Myra or me and let us know that so we  
14 can start to put together a firm participation list.

15 So with that, thank you and we're off the  
16 record.

17 (Whereupon, at 5:00 p.m., the  
18 meeting was concluded.)

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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

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3           DOCKET/FILE NUMBER:     R-511003  4           CASE TITLE:     FRANCHISE RULE  5           MEETING DATE:     SEPTEMBER 18, 1997  

6

7                   I HEREBY CERTIFY that the transcript contained  
8           herein is a full and accurate transcript of the notes  
9           taken by me at the hearing on the above cause before the  
10          FEDERAL TRADE COMMISSION to the best of my knowledge and  
11          belief.

12

DATED:   SEPTEMBER 30, 1997

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RUSS PUZACK

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C E R T I F I C A T I O N   O F   P R O O F R E A D E R

18

19                   I HEREBY CERTIFY that I proofread the transcript for  
20          accuracy in spelling, hyphenation, punctuation and  
21          format.

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DONNA N. REA

25