

July 2001

FEDERAL TRADE COMMISSION

Enforcement of the Franchise Rule



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Abbreviations

AAFD	American Association of Franchisees and Dealers
AFA	American Franchisee Association
DOJ	Department of Justice
FTC	Federal Trade Commission
IFA	International Franchise Association
ITA	International Trade Administration
NASAA	North American Securities Administrators Association
NFC	National Franchise Council
SBA	Small Business Administration



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United States General Accounting Office
Washington, DC 20548

July 31, 2001

The Honorable Thad Cochran
The Honorable Susan Collins
The Honorable Charles E. Grassley
United States Senate

This report responds to your request that we examine various issues associated with the regulation of franchises and business opportunity ventures, which represent large and growing segments of the retail and service industries in the United States. In general, franchises are business arrangements that require payment for the opportunity to sell trademarked goods and services (e.g., fast food establishments), whereas business opportunity ventures (or business opportunities) do not involve a trademark, but require payment for the opportunity to distribute goods or services with assistance in the form of locations or accounts (e.g., vending machine routes).

The Federal Trade Commission's (FTC) Trade Regulation Rule on Franchising and Business Opportunity Ventures (hereafter called the Franchise Rule)¹ requires franchise and business opportunity sellers to disclose financial and other information to prospective purchasers before they pay any money or sign an agreement. In addition, FTC enforces section 5 of the FTC Act, which addresses unfair or deceptive acts or practices.² Over the past several years, Congress and others have debated the need for a federal statute to generally regulate franchises, including issues that arise between franchisors and franchisees after the franchise agreement is signed. Much of the debate centers on the relative bargaining power franchisees have when dealing with their franchisors over various issues, such as the location of new franchised outlets or the termination of franchise relationships without good cause and advance, written notice.

¹FTC's Trade Regulation Rule, entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (16 C.F.R. Part 436), became effective October 21, 1979, and is generally referred to as the Franchise Rule.

²Section 5 of the FTC Act is found at 15 U.S.C. § 45.

As requested, this report builds on our 1993 report that addressed FTC's enforcement of its Franchise Rule³ and discusses various matters pertaining to franchise relationship issues. For purposes of this report, we refer to franchise relationship issues or problems as those that arise after the franchise agreement has been signed (i.e., post-sale). Specifically, our objectives were to describe (1) FTC's efforts to enforce its Franchise Rule, including FTC's analysis of complaints and actions taken regarding franchises and business opportunity ventures; (2) FTC's efforts to communicate and coordinate its franchise and business opportunity enforcement activities with selected state regulatory officials; and (3) the availability of data on the extent and nature of franchise relationship problems. We are also providing information on the views of FTC staff, franchise trade association officials, and selected state regulatory agency officials regarding the need for federal legislation on franchise relationships.

To meet our objectives, we obtained and analyzed data⁴ from and discussed these issues with FTC staff responsible for enforcing the Franchise Rule; obtained and analyzed information from franchise and business opportunity regulatory officials in the nine states that have both franchise and business opportunity disclosure laws (California, Illinois, Indiana, Maryland, Michigan, Minnesota, South Dakota, Virginia, and Washington); and discussed franchise relationship issues with officials from franchise trade associations. We also discussed franchise relationship issues with officials from Iowa, as it has been recognized by franchise trade officials as having the most comprehensive franchise relationship law of all the states. We conducted our work between August 2000 and June 2001 in accordance with generally accepted government auditing standards. (App. I discusses our objectives, scope, and methodology in greater detail.)

³*Federal Trade Commission: Enforcement of the Trade Regulation Rule on Franchising* (GAO/HRD-93-83, July 13, 1993). Among other things, the report provided information on FTC's enforcement of the Franchise Rule during fiscal years 1989 through 1992. We did not compare FTC's current efforts to enforce the Rule with information in that report because of the differences in the scope of our work and changes in the way FTC processes complaints and conducts investigations.

⁴Data on franchise and business opportunity complaints were available through June 1999 from FTC's franchise and business opportunity database, which was drawn from the Consumer Information System, FTC's general complaint database. FTC's investigation data were available for all of 1999, and case data were available through 2000.

Results in Brief

FTC has focused most of its Franchise Rule enforcement resources on business opportunity ventures because, according to FTC staff, problems in this area have been more pervasive than problems with franchises. For example, from January 1993 through June 1999, FTC reported that it received 3,680 business opportunity and franchise complaints, 92 percent of which involved business opportunities and the remaining 8 percent pertained to franchises. From its analysis of complaints and other case generation activities, FTC opened a total of 332 investigations from 1993 through 1999, most of which pertained to business opportunities. Also, from 1993 through 2000, FTC brought 162 cases to court for violations of the Franchise Rule and/or section 5 of the FTC Act. Of these, 88 percent involved business opportunities and the remaining 12 percent pertained to franchises. For each of the 162 cases brought to court, FTC obtained some type of relief, including injunctions, civil penalties, or monetary redress for investors. FTC staff told us that limited resources and other law enforcement priorities prevented FTC from pursuing every meritorious complaint and investigation involving franchises and business opportunities. They said that FTC generally pursued those cases it believed would have the greatest likelihood of financial recovery for franchise and business opportunity purchasers or the greatest deterrent effect for potential violators.

We could not determine why FTC closed many of the business opportunity and franchise investigations it had opened. Our review of the 79 files for investigations that FTC closed from 1997 through 1999 for which it took no further legal action showed that, while supervisory approval had been obtained for closing each investigation, only 2 of the 79 files documented the reasons why the investigations were closed. FTC staff told us that it is likely these investigations were closed either because of a lack of sufficient evidence of wrongdoing or the subject was out of business. However, FTC staff did not have any documentation to support their explanation because FTC did not require staff to document why franchise and business opportunity investigations were closed. Based on our work, FTC has subsequently revised its procedures to require staff to document the reason(s) for closing franchise and business opportunity investigations that result in no further legal action.

FTC uses various means, such as annual law enforcement meetings and periodic conference calls, to communicate and coordinate its franchise and business opportunity enforcement activities with the states. Responses to our survey of regulatory officials in the nine states that have both franchise and business opportunity disclosure laws indicated that FTC's current communication and coordination activities have been primarily focused on business opportunity issues. The state officials had

mixed views on the effectiveness of these activities, with business opportunity officials generally commenting more favorably than franchise officials.

The extent and nature of franchise relationship problems are unknown because of a lack of readily available, statistically reliable data—that is, the data available are not systematically gathered or generalizable. According to FTC staff, data FTC has collected, while limited, suggest that franchise relationship problems are isolated occurrences rather than prevalent practices. Franchise trade association officials pointed to indicators or anecdotal information to support their views regarding franchise relationship problems, but they were not aware of any statistically reliable data on the extent and nature of these problems. Likewise, none of the nine states we contacted—eight of which have franchise relationship laws—had readily available, statistically reliable data on the extent and nature of franchise relationship problems.

Absent such data, opinions varied as to the need for a federal statute to regulate franchise relationships. FTC staff told us that the data they have collected are not sufficient to enable them to make an informed opinion about the need for federal franchise relationship legislation. Franchise trade association officials had divergent views on the need for a federal statute. For example, officials from one association that represents franchisees told us a federal statute is needed to address the franchisees' lack of bargaining power in the franchise relationship and because existing laws do not effectively address relationship issues. In contrast, officials from another franchise association that represents both franchisors and franchisees told us a federal statute is not needed because franchise relationship issues are matters of contract law that should continue to be addressed at the state level and because they believe pre-sale disclosure is the best way to protect prospective franchisees. We suggest that if Congress believes it needs empirical data before considering franchise relationship legislation, it could commission a study that would (1) design and implement an approach for collecting empirical data on the extent and nature of franchise relationship problems and (2) examine franchisor and franchisee experiences with existing remedies for resolving disputes.

The Chairman of the Federal Trade Commission and the Acting Administrator of the Small Business Administration (SBA) were provided a draft of this report for comment. FTC concurred with the findings in this report but was silent about any role it could play in further study of franchise relationship issues. The SBA Acting Administrator said that SBA has used its limited resources to perform studies of discreet franchise

issues in the past, but implied that additional resources would be needed to gather data and study franchise relationship issues.

Background

Franchises and business opportunity ventures represent large and growing segments of the retail and service sectors in the United States and are rapidly replacing more traditional forms of small business ownership in the U.S. economy. According to the International Franchise Association (IFA), about 75 industries—such as those involving fast food, service, maintenance, and lodging—operate within the franchise format to distribute goods and services to consumers. IFA estimates that there are 1,500 business-format franchises⁵ that operate more than 320,000 franchised units in the United States. IFA estimates that these franchises account for 50 percent of all retail sales and generate \$1 trillion in sales annually in the United States. Data on the number and overall value of business opportunity ventures were not available, in part, because according to FTC staff, there is no national association or attorney group that represents business opportunities.

Federal and State Protections for Prospective Franchise and Business Opportunity Purchasers

In 1950, fewer than 100 companies used franchising in their marketing operations, but with the rapid expansion of franchising in the 1960s, federal and state governments began to see the need to protect prospective franchise purchasers. In 1971, FTC announced it would initiate a proceeding concerning the promulgation of a trade regulation rule on franchise sales and pre-sale disclosures. Public hearings on franchising commenced in 1972, and in 1978, FTC issued its final Franchise Rule, which took effect in October 1979. The Rule, which has the full force and effect of federal law, was promulgated in response to widespread evidence of unfair or deceptive acts or practices in connection with the sale of franchises and business opportunities.

FTC provided the following distinctions, consistent with the Franchise Rule, between a franchise and a business opportunity:

- A **franchise** requires payment of at least \$500 for the opportunity to sell trademarked goods and services with significant assistance or control of the franchisor. An example of a franchise is a fast food restaurant chain.

⁵According to IFA officials, business-format franchises offer a trademark and/or logo as well as a complete system for doing business. IFA did not have data on other formats of franchising, such as product distribution arrangements in which the dealer is identified with the manufacturer (e.g., automobile).

To buy a franchise, the prospective purchaser would pay a required fee for the opportunity to sell the chain's products. In turn, the chain would help the purchaser by (1) arranging for a store location, (2) providing training on how to prepare the products, and (3) providing advertising, among other things. The purchaser would agree to abide by the chain's standards for cleanliness, quality, uniforms, and so on.

- A **business opportunity** requires payment of at least \$500 for the opportunity to distribute goods and services of the seller with assistance in the form of locations or accounts. Business opportunities are less structured than franchises and impose fewer ties between the sellers and buyers. An example of a business opportunity is the purchase of vending machine routes, where the purchaser would pay a required fee for the opportunity to sell the company's products (e.g., soft drinks, snack foods) through vending machines. The purchaser would buy the vending machines and products from the company, and the company would inform the purchaser of specific stores or locations in which to place them.

The Franchise Rule is designed to enable prospective franchise and business opportunity owners to protect themselves before investing by providing them with the information needed to assess potential risks and benefits, make meaningful comparisons with other investments, and further investigate the business. This information is contained in detailed disclosure documents that must be provided to prospective purchasers at least 10 business days before they pay any money or legally commit to a purchase. The document includes financial and other information about the seller, the business, and the business relationship, including

- the name, address, and telephone number of other purchasers;
- a fully audited financial statement of the seller;
- the background and experience of the business' key executives;
- the seller's litigation history;
- the cost of starting and maintaining the business; and
- the responsibilities the buyer and seller will have to each other once the franchise or business opportunity is bought, including termination and renewal rights.

Regarding the latter, the Franchise Rule requires the seller to disclose basic information about its policies and practices, including matters such as termination and renewal rights. However, the Franchise Rule does not prescribe the terms and conditions for carrying out those policies and practices.

The Franchise Rule requires disclosures only to prospective purchasers. Franchise and business opportunity sellers do not register or file their

disclosure documents with FTC, and FTC generally does not review or approve disclosures, advertising, or agreements. FTC's Bureau of Consumer Protection enforces the Franchise Rule. According to FTC staff, during fiscal years 1997 through 1999, the Bureau spent an average of 13 workyears, or about 6 percent of its approximately 221 workyears, on Franchise Rule activities and enforcement.

In addition to the Franchise Rule, FTC enforces section 5 of the FTC Act, which declares unlawful unfair or deceptive acts or practices in or affecting commerce.⁶ Section 5 also provides that FTC does not have authority to declare an act or practice unlawful (FTC's "unfairness" jurisdiction) unless three specific criteria are met: (1) the act or practice causes or is likely to cause substantial injury to consumers, (2) the injury is not outweighed by countervailing benefits to consumers or to competition, and (3) the act or practice is not reasonably avoidable by consumers. According to FTC staff, in exercising its authority, FTC brings "deception" cases in many consumer protection fields, including the sale of franchises and business opportunities.

In general, only FTC, not private parties, can enforce violations of the Franchise Rule or FTC Act. The FTC Act provides FTC with a broad range of remedies for violations, including injunctions, civil penalties, and refund of money to franchise and business opportunity purchasers. Also, in 1998, in conjunction with the National Franchise Council (NFC),⁷ FTC approved, on a trial basis, an Alternative Rule Enforcement Program to resolve technical or minor violations of the Franchise Rule that otherwise would be referred to the Department of Justice for civil penalty action. Franchisors FTC refers to the program are trained in Franchise Rule compliance and are monitored for a period of years. Moreover, potentially injured consumers are notified about the Franchise Rule violation and have the opportunity to resolve any claim, and possibly seek redress, against the franchisor through mediation. Violations involving fraud or unfair or deceptive business practices are not candidates for the program. As of April 2001, nine companies had been referred to the Alternative Rule Enforcement Program.

⁶Section 5 of the FTC Act also declares unlawful unfair methods of competition in or affecting commerce (FTC's antitrust jurisdiction). Our review did not include FTC's involvement in this area.

⁷NFC—a nonprofit organization of major national franchise systems—administers the Alternative Rule Enforcement Program, including training and monitoring activities. The CPR Institute for Dispute Resolution conducts mediations related to the program.

States also have a role in regulating the sale of franchises and business opportunities. California passed the first franchise disclosure law in 1970. Today, 15 states have specific franchise disclosure laws and 24 states have specific business opportunity disclosure laws that are designed to protect prospective purchasers. Like the federal Franchise Rule, these state laws require franchise and business opportunity sellers to provide each prospective purchaser with a pre-sale disclosure document containing financial and other information. Unlike the Franchise Rule, some of these state laws require franchisors and business opportunities to file their disclosure documents with a designated state agency to review for accuracy and/or completeness.

In 1995, as part of its continuing review of trade regulation rules, FTC announced that it was beginning to explore the need to revise the Franchise Rule. In October 1999, FTC published proposed revisions to the Rule, which focus exclusively on the sale of franchises. According to FTC, the proposed revisions would reduce inconsistencies in federal and state disclosure requirements governing franchise sales, address changes in the marketing of franchises—such as the sale of franchises through the Internet—and provide expanded disclosures concerning franchise relationships. FTC intends to conduct a separate rulemaking proceeding for business opportunities once it has completed the Franchise Rule review process because FTC views business opportunities as distinct business arrangements that require separate disclosure requirements. For example, FTC staff noted that many of the current Franchise Rule’s pre-sale disclosures do not apply to the sale of most business opportunities, which typically involve fairly simple contracts or purchase agreements. Because of pending comment periods and subsequent FTC review and approval activities, FTC staff told us they could not provide specific information on when the revised Rule would be issued.

Federal and State Protections Over Franchise Relationships

FTC’s Franchise Rule only addresses how a franchise or business opportunity is sold to a prospective purchaser. It generally does not regulate the nature of the agreement a prospective franchise or business opportunity venture purchaser may sign or changes in the relationship after the initial contract has been signed. FTC staff told us that FTC generally lacks the authority to intervene in private franchise contracts and related relationship issues.⁸ Rather, these issues are generally

⁸According to FTC staff, post-sale relationship issues generally do not pertain to business opportunities because business opportunity problems predominately involve pre-sale rather than post-sale issues.

considered matters of contract law that traditionally have been governed at the state level. Currently, 17 states have enacted franchise relationship laws of general applicability to govern the franchise relationship after the agreement has been signed.⁹ These laws vary in their scope, with Iowa's relationship law recognized as the most comprehensive.

State franchise relationship laws generally provide for a private right of action that permits franchisees to bring lawsuits for violations under their respective state's particular law. States that do not have specific disclosure or relationship laws have other laws to protect consumers, such as general consumer protection or fraud statutes. These other laws give parties the right to file a lawsuit directly in state court. (App. II lists the states that have business opportunity disclosure, franchise disclosure, and/or franchise relationship laws.)

Currently, federal laws governing franchise relationships are specifically limited to the automobile and petroleum industries. Under the Automobile Dealers Day in Court Act of 1956, a franchise automobile dealer can bring an action in U.S. District Court against its automobile manufacturer to recover damages caused by the manufacturer's failure to act in good faith in (1) performing or complying with any of the terms or provisions of the franchise agreement or (2) terminating, canceling, or not renewing the franchise.¹⁰ Under the Petroleum Marketing Practices Act of 1978, a franchisor engaged in the sale or distribution of motor fuel is prohibited from terminating a franchise during the term of the franchise agreement unless the termination or nonrenewal is based on grounds specified in the law.¹¹ The act mandates a 90-day advance notice of the termination or nonrenewal, unless under the circumstances, it would be unreasonable to provide 90 days' notice. The act also provides for franchisees to file a lawsuit against franchisors in U.S. District Court for failure to comply with the act's requirements. The legislative histories of both acts indicated that they were needed to remedy the disparity of power between the franchisor and the franchisee.

⁹In addition to the 17 states with general franchise relationship laws, all 50 states have enacted franchise relationship laws covering specific industries, such as motor vehicles, farm equipment, and alcoholic beverages.

¹⁰15 U.S.C. §§ 1221–1225.

¹¹The act contains three titles and is found at 15 U.S.C. § 2801 et seq. For this report, we focused on the title I franchise relationship provisions found at 15 U.S.C. §§ 2801–2806.

As mentioned earlier, Congress and others have debated whether a federal statute is needed to generally regulate franchising, particularly in regard to franchise relationship issues. Much of the debate has centered on the relative bargaining power franchisees have when dealing with their franchisors over various issues, such as the location of new franchise outlets or the termination of franchise relationships without good cause and advance, written notice. Various bills have been introduced in Congress that would have statutorily applied federal regulation to franchises in general. Among other things, these proposals would have expanded federal jurisdiction to include issues involving the relationship between franchisees and franchisors after the franchise agreement is signed. One bill, H.R. 3308, the Small Business Franchise Act of 1999, would have “established minimum standards of fair conduct in franchise sales and franchise business relationships.” According to the bill, the purpose of the act would be “to promote fair and equitable franchise agreements, to establish uniform standards of conduct in franchise relationships and to create uniform private Federal remedies for violations of Federal Law.” (App. III provides additional information on federal and state laws and regulations related to franchise relationship issues.)

FTC’s Complaints and Enforcement Activities Focused Mostly on Business Opportunities

FTC has focused most of its franchise and business opportunity enforcement activities on business opportunity ventures because, according to FTC staff, problems such as fraud and other types of misrepresentation are much more prevalent with business opportunities than with franchises. In fact, complaints about business opportunity ventures, including those about fraudulent activity, have been much more common than those about franchises. FTC also focused most of its franchise and business opportunity investigations and court cases on business opportunities. From 1993 through 1999, FTC opened 332 investigations, most of which entailed business opportunity issues. From 1993 through 2000, FTC filed 142 business opportunity and 20 franchise cases in court and obtained some sort of relief in all of them. Although FTC has been successful with the cases it has pursued, we could not determine why FTC closed some of the business opportunity and franchise investigations it had opened because FTC did not require its staff to document why investigations are closed.

Most Complaints Pertained to Business Opportunities

From January 1993 through June 1999, FTC reported that it received 3,680 business opportunity and franchise complaints, of which 3,392 (92 percent) pertained to business opportunities and 288 (8 percent) pertained

to franchises.¹² According to FTC staff, although the complaint data in its database are the most comprehensive available, they do not necessarily provide a complete picture of all complaints that came to FTC from 1993 through June 1999. The FTC staff added that, for many reasons, complete data for earlier years (especially 1993 and 1994) do not exist. As a result, the FTC staff said that they would be reluctant to extrapolate from the complaint data that complaints have increased significantly since 1993. They added that more complete data for determining trends would be complaints filed in 1997 and beyond. Table 1 shows all of the business opportunity and franchise complaints FTC reported it received each year from 1993 through June 1999.

Table 1: Business Opportunity and Franchise Complaints FTC Reported Receiving Each Year, 1993 through June 1999

Complaint	1993 ^a	1994 ^a	1995 ^a	1996 ^a	1997	1998	1999 ^b	Total
Business opportunity	30	79	570	277	759	1,089	588	3,392
Franchise	5	2	9	9	53	108	102	288
Total	35	81	579	286	812	1,197	690	3,680

^aAccording to FTC staff, data for these years were not complete and FTC would be reluctant to extrapolate from the data that complaints have increased since these years.

^bAs of May 2001, FTC-analyzed business opportunity and franchise complaint data were available only through June 30, 1999.

Source: FTC.

According to FTC staff, the growth in the number of complaints documented during 1997 through June 1999 could be attributable to a number of things, including changes in the way FTC collects and compiles complaint data. For example, in 1998, FTC established a toll-free hotline and published a Web-based on-line complaint form, which allow consumers to report problems and allegations about such factors as abuses related to the Franchise Rule. In addition, FTC has received more complaints in recent years because it now has agreements with many groups—such as state Attorney General Offices and regional Better Business Bureaus—that collect and refer complaints for input into FTC’s Consumer Sentinel complaint database.

¹²In addition to the 3,680 franchise and business opportunity complaints, the FTC franchise and business opportunity complaint database contained 832 other complaints FTC classified as “miscellaneous” because they could not be clearly determined to relate to either franchises or business opportunities.

FTC staff provided us with the results of FTC's analysis of the 288 franchise complaints it received from January 1993 through June 1999. FTC's analysis showed that 134 of the 288 franchise complaints did not contain sufficient information to determine the specific allegation that was being made. Of the remaining 154 complaints, FTC's analysis showed that

- 13 alleged problems involving pre-sale disclosure issues covered by the Franchise Rule, such as failure to provide disclosure documents;
- 96 contained allegations pertaining exclusively to post-sale issues that are not covered by the Franchise Rule, such as threats to terminate a franchise relationship or failure to provide a promised franchise location; and
- 45 contained allegations involving both pre-sale disclosure issues covered by the Rule and post-sale issues not covered by the Rule.

According to FTC's Franchise Rule Coordinator, FTC has reviewed franchise and business opportunity complaints on a regular basis and has used more sophisticated methods as they have become available. From 1993 through 1997, for example, the Franchise Rule Coordinator said he manually prepared detailed monthly and annual reports of complaints and enforcement activities for distribution throughout FTC. In 1998, when FTC improved its data reporting and retrieval capabilities via its Consumer Response Center, the Franchise Rule Coordinator stopped preparing formal reports. Instead, he said he reviewed database files on a regular basis to identify potential investigations and trends, while other FTC staff also reviewed complaint data for investigative potential, especially in connection with law enforcement sweeps.¹³

The Franchise Rule Coordinator said that, beginning in January 2000, he requested monthly reports to aid him in reviewing franchise complaints. Consequently, since March 2000, FTC has generated monthly reports of all franchise complaints, which the Coordinator said he personally reviews for investigative potential. FTC has not analyzed each of the individual business opportunity complaints it has received, but FTC staff said that they believe that almost all of the business opportunity complaints represent pre-sale concerns about either fraud or misrepresentation—such as false or unsubstantiated earnings claims—that fall under FTC's jurisdiction. The Franchise Rule Coordinator told us that FTC uses other means to evaluate business opportunity complaints. For example, he said that (1) staff from the Consumer Response Center review the business opportunity complaint data to look for patterns and practices of violations,

¹³Sweeps are focused law enforcement efforts that target a specific law violation or problem industry.

(2) analysts in FTC's Division of Planning and Information review complaint data for trends, and (3) federal and state enforcement officials discuss complaints during periodic conference calls with FTC staff.

Most Investigations and Court Cases Focused on Business Opportunities

Since 1993, FTC focused most of its franchise and business opportunity investigations and court cases on business opportunities. According to FTC staff, these enforcement efforts were directed more heavily on business opportunities than franchises because FTC received more complaints on business opportunities and because fraud and other types of misrepresentation are much more likely to occur with business opportunities.

Investigations

FTC data showed that, from 1993 through 1999, FTC opened a total of 332 franchise and business opportunity investigations, of which 109 (33 percent) clearly involved business opportunities and 59 (18 percent) involved franchises. According to FTC's Franchise Rule Coordinator, the remaining 164 (49 percent) investigations could not be clearly categorized from the information FTC had available because the investigating attorney did not note or was not able to determine whether the business was a franchise or a business opportunity. He also told us that although it is likely that more than 90 percent of these 164 investigations involved business opportunities, he could not provide exact numbers because FTC's focus is on whether or not some type of violation occurred, not the type of business. Table 2 provides information on the number of franchise and business opportunity investigations FTC opened during 1993 through 1999.

Table 2: Business Opportunity and Franchise Investigations FTC Opened, 1993-99

Investigation	1993-94	1995-99	Total
Business opportunity	20	89	109
Franchise	43	16	59
Not categorized ^a	46	228	164
Total	109	223	332

^aAccording to FTC's Franchise Rule Coordinator, FTC could not categorize some of the investigations as relating to either franchises or business opportunities because attorneys did not note or were unable to determine the type of business on FTC records or could not determine the type of business under investigation. However, he said that it is likely that more than 90 percent of these investigations involved business opportunities.

Source: FTC.

In regard to the fluctuations in the number of investigations FTC has opened from 1993 through 1999, FTC staff noted that the number of franchise investigations FTC opened decreased from 43 during 1993-94, to

16 during 1995-99. The FTC staff stated that the reasons for the decrease include the following.

- Between late 1994 and early 1995, FTC recognized that business opportunities represented a much larger problem than franchises. As a result, FTC began to focus its enforcement efforts on business opportunities.
- Franchise cases are much more complex than business opportunity matters and consume a significant amount of law enforcement resources. There are practical limits to the number of franchise investigations that staff can pursue at any one time because they are resource-intensive.

FTC staff told us that the number of business opportunity and franchise investigations opened do not directly correlate with the number of complaints because (1) investigations are opened as a result of sweeps and other internal case generation activities, such as reviews of the Internet and newspapers, that are not necessarily complaint-based and (2) not all complaints get investigated. Regarding the latter, FTC staff explained that many complaints do not result in an investigation because they do not meet FTC's criteria for opening an investigation. For example, depending on the type of problem alleged, the complaint may involve issues outside FTC's jurisdiction. Also, FTC examines such things as the level of consumer injury and the number of consumers affected to determine whether it is in the public interest to open an investigation. Regarding the latter, FTC staff said that individual complaints may not show that a company has engaged in a pattern or practice of illegal conduct that would warrant opening an investigation. According to FTC's analyses of the complaints it has received, the vast majority are isolated matters involving single complaints against companies. Based on these factors, most complaints FTC receives are not investigated. In addition, FTC staff told us that limited resources and other law enforcement priorities prevented FTC from pursuing every meritorious complaint it received involving franchises and business opportunities. (App. IV provides further information on the investigations process and the criteria FTC uses for deciding when to open investigations.)

To better understand how FTC used its resources to carry out franchise and business opportunity investigations, we attempted to determine how long it took FTC staff to process and close investigations using the number of hours they billed for each of the 332 investigations opened from 1993 through 1999. However, information on hours billed was available for only 217 (65 percent) of the 332 investigations FTC opened throughout the period. The 217 investigations included 125 that were closed with no further legal action and 92 that resulted in cases being filed. For the 125

investigations that FTC closed with no further legal action, FTC staff billed from 1 to 3,367 hours, with an average time of 228 hours and a median time of 64 hours. For the 92 investigations for which FTC filed cases, FTC staff billed from 2 to 5,738 hours, with an average time of 887 hours and a median time of 628 hours.

According to FTC staff, the overwhelming majority of the investigations for which no or few hours were billed involved business opportunities. The staff added that the reasons why staff may not have charged any or few hours include that (1) staff determined that the company was out of business, (2) a state or other law enforcement agency was already looking into the matter, (3) staff may not have billed for the time spent on the investigation, or (4) staff may have billed hours to projects that combined investigations (i.e., sweeps) rather than to individual investigations.

FTC staff told us that FTC does not have specific written criteria or standards to measure whether it carried out its investigations in a timely manner. According to FTC staff, the amount of time it takes FTC staff to complete an investigation depends on several factors, including the facts and complexity of the case, the degree of cooperation obtained from the target of the investigation, and the competing demands of the staff responsible for the investigation. The staff told us that FTC's associate directors receive regular updates from staff on pending investigations and that the bureau director also receives this information in regular meetings with the associate directors.

Court Filings

Similar to its complaint and investigation data, most of the cases FTC filed in court for violations of the Franchise Rule and/or section 5 of the FTC Act involved business opportunities. From 1993 through 2000, FTC filed 162 cases in court for violations of the Franchise Rule and/or section 5 of the FTC Act—142 (88 percent) involved business opportunities and 20 (12 percent) involved franchises.¹⁴ Table 3 shows the distribution of business opportunity and franchise cases filed in court from 1993 through 2000 that involved the Franchise Rule and/or section 5 of the FTC Act.

¹⁴Data provided by FTC show that an additional five cases were filed during this time period, but the data did not classify whether these cases pertained to franchises or business opportunities.

Table 3: Cases Involving Business Opportunities and Franchises Filed in Court by FTC Each Year, 1993-2000

Violation	1993	1994	1995	1996	1997	1998	1999	2000	Total
Business opportunity									
Franchise Rule	0	0	23	5	2	2	0	22	54
FTC Act, sec. 5	1	6	1	9	1	4	3	8	33
Both	3	5	12	9	7	10	2	7	55
Subtotal	4	11	36	23	10	16	5	37	142
Franchise									
Franchise Rule	3	2	1	0	0	0	0	0	6
FTC Act, sec. 5	0	0	0	0	0	0	0	0	0
Both	4	2	4	3	0	0	0	1	14
Subtotal	7	4	5	3	0	0	0	1	20
Total	11	15	41	26	10	16	5	38	162

Note: In addition to these cases, FTC also referred eight matters to NFC's Alternative Rule Enforcement Program during the period 1998 through 2000. As of April 2001, FTC had referred one additional matter to this program. As mentioned earlier, FTC approved this program on a trial basis in 1998 to resolve technical or minor violations of the Franchise Rule that otherwise would be referred to the Department of Justice for civil penalty action. Franchisors referred to the program are trained in Franchise Rule compliance and are monitored for a period of years. Also, potentially injured consumers are notified about the Franchise Rule violation and have the opportunity to resolve any claim, and possibly seek redress, against the franchisor through mediation.

Source: FTC.

Not all of the investigations that FTC opened resulted in cases being filed in court. According to FTC staff, limited resources and other law enforcement priorities prevented FTC from pursuing every meritorious investigation involving franchises and business opportunities. The staff added that FTC generally pursues those court cases that it believes have the greatest likelihood of financial recovery for franchise and business opportunity purchasers or have the greatest deterrent effect for potential violators. Among the other criteria FTC uses to decide which cases to pursue are whether (1) the problem is an isolated event or part of a pattern or practice; (2) there is a viable, meaningful remedy; or (3) there are alternatives to federal intervention. (See app. IV for further information on FTC's case selection criteria.) All litigated cases have resulted in such relief as court injunctions, civil penalties against franchisors, or monetary redress for investors. (App. V provides information on each case involving franchises and business opportunities that FTC filed in court from 1993 through 2000.)

Unclear Why FTC Closed Investigations Without Further Action

We reviewed a sample of files for business opportunity and franchise investigations FTC closed without taking further legal action to determine why FTC closed those investigations. We reviewed all 79 files for investigations FTC closed from 1997 through 1999 for which it took no

further legal action. Specifically, we attempted to gather information on (1) the date the investigation was opened, (2) the reasons for closing the investigation, and (3) the date the investigation was closed. We reviewed all documentation in the file, including the Matter Initiation Notice, Matter Update Notice, and Matter Profile.¹⁵

Our results showed that, while supervisory approval had been obtained for the opening and subsequent closing of each of the investigations, only 2 of the 79 files contained documents showing the reasons why the investigations were closed. Thus, it was not clear why FTC did not take further legal action on the other 77 business opportunity and franchise investigations that it closed during the period. FTC staff told us that it is likely these investigations were closed either because of a lack of sufficient evidence of wrongdoing or the subject was out of business. However, the FTC staff did not have any documentation to support their explanation. According to the Comptroller General's *Standards for Internal Control in the Federal Government*,¹⁶ all transactions and other "significant" events need to be clearly documented, and the documentation should be readily available for examination.

During our review, we informed FTC staff that our report would likely contain a recommendation that FTC develop and implement procedures to require FTC staff to document the reasons why franchise and business opportunity investigations are closed. At that time, FTC staff told us that there was little, if any, historical value in reviewing past closed investigations of this type. The staff added that FTC staff has always been required to justify a recommendation to close an investigation in oral discussions with the assistant or associate directors who have responsibility for approving such requests. However, after further consideration, FTC staff determined that documenting the oral discussions was not unreasonable. Accordingly, in June 2001, the Associate Director for the Bureau of Consumer Protection's Division of Marketing Practices issued a memorandum to all Marketing Practices staff to inform them of revised procedures related to franchise and business opportunity investigations that are closed without filing an action in court. More specifically, the revised procedures specify that each and every Matter Update Notice closing a franchise or business opportunity investigation must state the reason(s) why the investigation is being closed. FTC also

¹⁵These forms are used by FTC staff to document information regarding investigations and are generally found in the investigation files.

¹⁶See [GAO/AIMD-00-21.3.1](#) (Nov. 1999).

modified its Matter Update Notice to include check boxes setting forth the most common reasons for closure.

Selected State Officials Have Mixed Views on the Effectiveness of FTC's Communication and Coordination Efforts

FTC uses various means, such as law enforcement summits and conference calls, to communicate and coordinate its franchise and business opportunity enforcement activities with the states. Regulatory officials from the nine states with franchise and business opportunity disclosure laws had mixed views about the effectiveness of FTC's efforts. Generally, state business opportunity regulatory officials viewed FTC's communication and coordination efforts as being more effective than did the state franchise regulatory officials we contacted. This may be due, in large part, to the fact that FTC's communication and coordination efforts with state regulatory agencies during 1998 through 2000 have been primarily focused on business opportunity issues.

In its 1998 annual report, FTC commented

"The Commission works closely with other federal agencies, states, and local authorities in a variety of coordinated law enforcement efforts and task forces, including individual cases involving fraud and deceptive advertising, efforts to boost industry compliance with rules and regulations, and consumer and law enforcement training programs."¹⁷

FTC also reported that by sharing information and resources, joint efforts effectively target issues that have direct impact on consumers. According to FTC's Franchise Rule Coordinator, FTC staff regularly communicate and coordinate business opportunity and franchise enforcement activities with state business opportunity and franchise regulatory officials through various means, including annual law enforcement summits, joint FTC-state enforcement actions, monthly telephone conference calls, and the Consumer Sentinel complaint database.

We surveyed the eight business opportunity and nine franchise regulatory officials in the nine states that have both business opportunity and franchise disclosure laws to obtain their views on the effectiveness of FTC's efforts to communicate and coordinate enforcement activities in their states, and we received responses from all of them.¹⁸ From our

¹⁷"Annual Report of the Federal Trade Commission for Fiscal Year Ended September 30, 1998."

¹⁸Only eight state business opportunity regulatory officials were contacted because Virginia has not designated an agency to enforce its business opportunity law.

survey, 13 of the 17 state regulatory officials reported that, overall, FTC's efforts to communicate and coordinate enforcement activities during calendar years 1998 through 2000 were either "very effective" or "somewhat effective."

All eight business opportunity regulatory officials who responded reported that FTC's overall communication and enforcement coordination efforts in 1998 through 2000 were effective. Specifically, five officials reported that FTC's efforts were "very effective," and the other three officials reported that FTC's efforts were "somewhat effective." One state business opportunity regulatory official commented that informal communication and joint enforcement actions have been highly useful in promoting effective communication and networking opportunities. The majority of the state business opportunity regulatory officials we contacted have participated in annual law enforcement summits, monthly conference calls, and joint FTC-state law enforcement actions—all of which facilitate communication and coordination.

In comparison with the state business opportunity regulatory officials, state franchise regulatory officials viewed FTC's communication and coordination efforts as being less effective. Specifically, five of the nine state franchise regulatory officials we contacted viewed FTC's communication and coordination efforts as being "somewhat effective," and the remaining four viewed FTC's efforts as being "not effective" because of their limited interaction with FTC on franchise issues. One franchise regulatory official commented that since annual summits and monthly conference calls focus primarily on business opportunity issues, they are generally not effective in assisting officials that enforce state franchise laws. In general, the survey indicated that state franchise regulatory officials are interested in more interaction with FTC, and among the suggestions were for FTC to (1) provide better feedback on the inquiries made and complaints referred by states, (2) take more franchise enforcement actions, and (3) promote more interaction through an electronic mail list. According to FTC's Franchise Rule Coordinator, FTC has recently begun to work with state franchise regulators to develop an electronic mail list.

Appendix VI provides further information on (1) the various means FTC uses to communicate information and coordinate business opportunity and franchise enforcement activities with state regulatory officials and (2) state regulatory officials' views of the effectiveness of specific FTC efforts to communicate and coordinate enforcement activities during calendar years 1998 through 2000.

Views Are Mixed on the Need for FTC Reviews of Disclosure Documents

Our survey of state regulatory officials showed that support for FTC to perform reviews of disclosure documents is mixed. While a majority of the business opportunity officials who responded to our survey would like to see FTC take on this responsibility, a majority of the state franchise regulatory officials who responded did not see a need for FTC to review disclosure documents.

Specifically, we asked state business opportunity and franchise regulatory officials in the nine states that have both business opportunity and franchise disclosure laws whether FTC should review all or a random sample of disclosure documents for accuracy and/or completeness.¹⁹ Our survey results showed that, of the eight state business opportunity regulatory officials who responded to our survey, five responded that FTC should perform such reviews, two responded that disclosure document reviews should be left to state agencies, and the remaining official expressed no opinion. Of the nine state franchise regulatory officials who responded to our survey, two responded that FTC should perform such reviews, five responded that disclosure document reviews should be left to state agencies, and the remaining two officials expressed no opinion.

According to FTC staff, FTC does not have a mandate nor the resources to review randomly selected or all disclosure documents. FTC staff further stated that because selected states already review disclosure documents, requiring FTC to perform such reviews would be costly and consume resources that could be better spent on other law enforcement activities. An official representing the North American Securities Administrators Association (NASAA) commented that state governments are generally better prepared to perform disclosure document reviews than is the federal government (i.e., FTC).

Implementation of the Coordinated Review Project

In 2000, NASAA implemented a project to coordinate and streamline the franchise disclosure registration and review process. Eleven of the 12 states that require registration of disclosure documents and perform disclosure document reviews are part of the coordinated review project.²⁰ The project is designed so that franchisors can register their disclosure documents in some or all registration states at one time; it is not

¹⁹Of the nine states included in our survey, eight states perform reviews of franchise disclosure documents and seven states perform reviews of business opportunity disclosure documents.

²⁰The 11 states participating are Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, and Washington. California is the only state that reviews disclosure documents that is not participating.

mandatory, rather the franchisor must opt for it. The project is based on the premise that most franchisors do not mind responding to state franchise examiners' comments regarding disclosure documents, but they want assurances that a disclosure document approved in one state will be approved in another.²¹ Disclosure documents approved through the review process are deemed to be in compliance with franchise disclosure laws in the states conducting the coordinated reviews. Therefore, except for California (the only review state not participating in the process), NASAA would deem the approved disclosure documents suitable for submission to franchisees nationwide. This would include all states that do not have a franchise disclosure law.

Statistically Reliable Data on Franchise Relationship Problems Do Not Exist

The extent and nature of franchise relationship problems are unknown because neither FTC, franchise trade associations, nor state regulatory agencies have readily available, statistically reliable data—that is, the data available are not systematically gathered or generalizable—that would indicate the full scope of these problems. Based on the data it has collected, FTC recognizes that some franchisees experience franchise relationship problems or are otherwise dissatisfied with their franchise purchase. FTC staff maintain, however, that the data FTC has compiled, while not comprehensive, suggest that franchise relationship problems are isolated incidents and are not prevalent across all franchises. Various franchise trade association officials pointed to indicators or anecdotal information to support their views regarding franchise relationship problems, but none had any statistically reliable data on the extent and nature of these problems. Further, selected state regulatory officials did not have readily available, statistically reliable data on the extent and nature of franchise relationship problems. It may be possible to collect empirical data on the extent and nature of franchise relationship problems through a study of franchisors and franchisees—but there could be limitations to obtaining such data, as well as cost and time considerations. Nonetheless, such data might provide valuable insights as to whether a federal statute is needed to generally regulate franchise relationships.

²¹ According to a NASAA official, the most common complaint franchisors have is that state franchise registration requirements are not uniform and that the disclosure guidelines are interpreted differently from state to state.

FTC Data Do Not Reveal Full Extent and Nature of Franchise Relationship Problems

The data FTC has obtained to date, including franchisees' complaints and comments it received during its process for revising the Franchise Rule, indicate that franchise relationship problems occur. However, according to FTC staff, these data tend to suggest that they are isolated incidents that are not prevalent across all franchises. For example, FTC complaint data showed that, from January 1993 through June 1999, FTC received 141 franchise complaints that contained allegations involving one or more franchise post-sale issues. Moreover, FTC data showed that few franchisors received more than one complaint in that the 141 complaints involved 102 separate franchisors, and that only 23 of the 102 franchisors received more than one complaint.

FTC's current assessment that franchise relationship complaints are likely isolated incidents seems to contradict an earlier statement made by FTC in its 1999 Notice of Proposed Rulemaking.²² In the notice, FTC stated that there were a "significant" number of complaints from franchisees pertaining to franchise relationship issues. FTC staff told us, however, that FTC's characterization of complaints as "significant" pertained strictly to comments and concerns FTC received during the rulemaking process and are not comparable to the franchisee complaints contained in FTC's complaint database. The staff noted that, based on the information it had at that time, FTC believed that the franchisees' comments and concerns were "significant." The staff added, however, that FTC's subsequent analysis of the rulemaking record tends to confirm that franchise relationship concerns are isolated events involving a few franchisors.

The FTC staff explained that since the Franchise Rule review process began in 1995, FTC has received comments or statements for the record from a total of 96 individual franchisees or trademark-specific franchisee associations. FTC staff noted that nearly half of the 96 submitted comments were identical form letters that discussed their general support for broader franchise relationship controls, but shed little, if any, light on their specific experiences. FTC staff also told us that more than half of the 96 comments raised issues involving only three franchisors. Moreover, the FTC staff told us that there was little consistency among the remaining individual comments, which covered a wide range of franchise relationship issues, such as concerns about franchise renewals, lack of performance, and lack of disclosure to existing franchisees.

²²Federal Trade Commission, Notice of Proposed Rulemaking, 64 Fed. Reg. 57,294, 57,296 (1999).

FTC staff said that, based on the information compiled during the process for revising the Franchise Rule, it was clear that some existing franchisees experience various franchise relationship problems or are otherwise dissatisfied with their franchise purchase. However, while FTC staff told us that FTC data suggest that franchise relationship problems are not widespread, they did not know the extent to which franchisees used other avenues—such as mediation, arbitration, or litigation—to address their concerns. As a result, FTC staff stated that FTC’s data are not sufficient to assess the overall extent of franchise relationship problems.

FTC staff also stated that the isolated instances of franchise relationship problems do not justify FTC conducting a more widespread investigation of relationship issues or developing a new rule that addresses the terms and conditions of franchise contracts. The FTC staff told us that absent evidence of widespread franchise relationship abuses, the prudent approach is to continue to investigate instances of such abuses, where they occur, under FTC’s current unfairness authority (i.e., section 5 of the FTC Act). FTC staff noted, however, that FTC’s unfairness authority generally does not apply to franchise relationship issues. In fact, to date, FTC has conducted only two franchise investigations that were based solely on FTC’s unfairness jurisdiction.²³ Both investigations were ultimately closed because FTC determined there was insufficient evidence to satisfy the section 5 unfairness criteria.²⁴

FTC staff view pre-sale disclosure as the best available vehicle, within FTC’s statutory authority, to address franchise relationship issues. As such, FTC’s 1999 Notice of Proposed Rulemaking proposes to enhance the Franchise Rule’s disclosure requirements to provide prospective franchisees with additional information regarding the relationship before they commit to buying a franchise.²⁵ FTC staff told us that this is consistent with FTC’s long-held view that free and informed choice is the best regulator of the market. According to FTC staff, proposed revisions to the Franchise Rule would, among other things, increase (1) franchisors’

²³FTC staff told us that FTC is currently pursuing allegations of unfair or deceptive acts or practices in one franchise system, but that specific unfairness investigations have not been pursued to date. FTC added that its staff may have also explored unfairness as one of many issues in other franchise investigations.

²⁴Appendix III contains additional information about FTC’s unfairness jurisdiction.

²⁵According to FTC staff, there are several more steps before such a proposal could become a final rule. The next step in the rulemaking process is a staff report to the Commission that will be subject to notice and comment.

disclosures about prior litigation with franchisees; (2) the information available to prospective franchisees concerning source of supply restrictions and the ability to use alternative goods; (3) the disclosures about how sites are selected and the nature of any training programs; and (4) information available about renewals, terminations, and transfers. The proposed revisions to the Rule would not address any issue that arises after franchise agreements have been signed. That is, the changes would relate to pre-sale disclosure, but would provide no additional post-sale protections.

Finally, FTC staff told us that FTC's analysis of complaints and other evidence it has collected is not sufficient to enable them to assess the need for new federal franchise relationship legislation. Rather, FTC staff said that the various franchise trade associations that represent franchisors and franchisees may be in a better position than FTC to explain the competing views on the need for legislation, as well as the consequences flowing from each, and would have the best statistics and policy analyses related to any proposed legislation.

Franchise Trade Associations Lack Statistically Reliable Data on Franchise Relationship Problems

Officials from the four franchise trade associations we contacted—the American Franchise Association (AFA), the American Association of Franchisees and Dealers (AAFD), the International Franchise Association (IFA), and the National Franchise Council (NFC)—told us that they were not aware of any statistically reliable data that quantify the extent and nature of franchise relationship problems.²⁶ Absent such data, the officials provided indicators or anecdotal evidence that supported their particular positions about franchise relationship problems.

For example, the president of AFA—a group that supports a federal statute to generally regulate franchises—said that at the organization's annual Franchisee Leadership Summit in April 2001, the 25 franchisee leaders of independent associations that attended reached consensus that the top concerns were (1) encroachment (the franchisor placing additional franchise locations in close proximity to an existing franchisee); (2) sourcing of supplies (where franchisees are required to buy all products used in their businesses from the franchisor or someone it designates, often at above-market prices); (3) equity/transfer/renewal issues (where franchisees cannot sell the business they own or, upon transfer or resale,

²⁶In general, AAFD and AFA represent franchisees' interests, IFA represents the interests of both franchisors and franchisees, and NFC represents franchisors' interests. Appendix I contains additional information on the four franchise trade associations.

franchisees have to offer the then-current contract with materially different terms); and (4) system compliance, including franchisors' ability to arbitrarily make material changes to the franchise system. AFA did not, however, have any data on the extent to which these problems occur.

In contrast, the senior vice president for government relations and chief counsel of IFA—a group that opposes a federal statute to generally regulate franchises—told us that all “reliable” indicators, such as FTC enforcement data and complaints brought alleging violations of the IFA Code of Ethics, show that there are relatively few franchise relationship problems. The official added that if the more than 1,000 franchises represented by IFA had serious problems, these problems would have surfaced by now. The IFA official told us that while litigation between franchisors and franchisees is relatively infrequent, on balance, termination appears to be the issue more likely to result in litigation than other issues. The official added that other types of issues that arise during the course of the franchise relationship—such as encroachment, transfer, or the general conduct of the parties—are much more likely to be resolved using other dispute resolution processes, such as internal dispute resolution, mediation, or arbitration. IFA did not, however, have any statistically reliable data on the extent to which these types of problems occur.

Some of the franchise trade association officials we contacted told us that one way to assess the extent and nature of franchise relationship problems would be to conduct an extensive review of franchise litigation, such as cases reported in court records, franchisor disclosure documents, or in the Commerce Clearinghouse *Business Franchise Guide*. However, such a review would be costly and time-consuming and because each case is unique and is based on different facts, issues, and circumstances and involves the application of different state laws, the results of such a review would not be generalizable. Moreover, we were informed that such a review would not provide a sound basis from which to draw conclusions regarding the extent of franchise relationship problems because not all franchise relationship disputes are litigated. Some disputes are resolved through arbitration, mediation, or other dispute resolution processes. Our work, including discussions with officials from the American Arbitration Association and the National Franchise Mediation Program, revealed no statistically reliable data on the extent to which arbitration and mediation are used to resolve franchise relationship disputes.

Absent statistically reliable data on the extent and nature of franchise relationship problems, the four franchise trade associations we contacted provided divergent views on franchise relationship problems and the need

for federal franchise relationship legislation. On one hand, in general, AFA and AAFD officials maintain that an imbalance of power exists between franchisors and franchisees, and they contend that franchise contracts are oppressive. They also maintain that current federal and state pre-sale disclosure laws and state franchise relationship laws are ineffective in addressing franchise relationship issues. AFA is a proponent of comprehensive federal franchise relationship legislation, whereas AAFD would prefer legislation that encourages negotiated franchise relationships.²⁷

On the other hand, IFA and NFC officials maintain that franchise relationship issues are matters of contract law that should be addressed at the state level, and they contend that franchisees can obtain relief from problems under well-established common-law doctrines. They also maintain that pre-sale disclosure is the best way to protect prospective franchisees. IFA and NFC are opponents of federal legislation that would regulate franchise relationships. (App. VII contains additional information on franchise trade associations' views on the need for federal franchise relationship legislation.)

State Regulatory Agencies Generally Do Not Collect Data on Franchise Relationship Problems

Franchise regulatory officials in seven of our nine selected states told us their states did not maintain data on franchise relationship problems. Officials in the other two states told us that, while their state had some data on post-sale complaints, the data were either not representative of all such complaints or were not readily available. More specifically, one of the two officials told us that since the state's franchise disclosure law generally does not regulate relationship issues, the complaints received are not representative of all post-sale complaints. The other official told us that the number of post-sale complaints is not readily available because such complaints are not differentiated from pre-sale complaints.

The same officials had mixed views on the need for a federal statute that would regulate franchise relationships. Of the nine officials, three reported that federal legislation is needed, two reported that legislation is not needed, three did not specifically comment on the need for legislation, and one noted that it is a "philosophical" question that depends on the relative bargaining position and strength of the parties involved. Of the three officials who responded that federal legislation is needed, two noted the

²⁷In June 1996, AAFD issued Fair Franchising Standards, which according to AAFD, are designed to promote franchise agreements that address the legitimate business interests of both franchisors and franchisees.

need to deter franchisor abuses or to provide additional franchisee protections in several areas, while the third official noted the need to level the playing field between franchisees and franchisors. Of the two officials who responded that federal legislation is not needed, one noted that franchise relationships are contractual issues under which franchisees currently have a private right of action (to file a lawsuit directly in state court), while the other official did not provide reasons.

Further Study of Franchise Relationship Issues Could Provide Insights Into Extent and Nature of Problems

Our work revealed that empirical data on the extent and nature of franchise relationship problems could be gathered through a study of franchisors and franchisees. While there could be barriers or limitations to obtaining such data, as well as cost and time considerations, such a study could provide valuable insights on the need for a federal statute that covers franchise relationships. In addition to gathering empirical data on the extent and nature of franchise relationship problems, a study could be used to obtain data on franchisor and franchisee experiences with existing remedies for resolving disputes, such as judicial remedies or other dispute resolution processes. When designing a study of this nature, one would have to consider that the results may not be generalizable to the universe of current franchisors and franchisees because of the difficulty in identifying and locating them, especially those in states that do not require franchisors to file their disclosure documents with a state agency. According to FTC staff and trade association officials, there is no comprehensive information on the number and location of franchisors and franchisees. Furthermore, in doing such a study, FTC staff suggested that it may be important to consider the views and experiences of former franchisees—a group that, according to FTC staff, may be difficult to locate.

We also explored which federal agency or agencies have the expertise and would be willing to conduct or oversee a future study on franchise relationship issues. FTC staff told us that FTC lacks the expertise and resources to perform this type of research, and suggested that we contact the Department of Commerce and SBA. An official with the Department of Commerce's International Trade Administration (ITA) told us that, in the 1980s, ITA had prepared an annual report on franchising in the economy. However, the official said that ITA no longer does research on domestic franchise issues and is no longer positioned to conduct this type of research. The official added that a study of domestic franchise relationship issues generally would not be within ITA's core mission, and further noted that ITA does not have the in-house expertise, structure, or resources to conduct or oversee such a study.

In contrast, SBA's Acting Chief Counsel for Advocacy said that, if properly funded, SBA's Office of Economic Research within the Office of Advocacy would be able to contract out and oversee a study of franchise relationship issues. According to SBA, the Office of Advocacy's mission is to study the role of small business in the American economy and to work for policies and programs that will create an environment to foster small business growth and development. SBA's Acting Chief Counsel for Advocacy and the Acting Director of the Office of Economic Research said that SBA has the capability and expertise to develop a Request for Proposal, solicit and evaluate proposals, award and oversee a contract, and review and publish results. The officials added that the Office of Advocacy has contracted for other studies on franchising during the 1990s.²⁸

Conclusions

During our review, we found that FTC did not require its staff to document the reasons for closing franchise and business opportunity investigations that resulted in no further legal action. Our review of all 79 files for investigations FTC closed from 1997 through 1999 for which it took no further legal action showed that, while supervisory approval had been obtained for closing each investigation, only 2 of the 79 files documented the reasons why the investigations were closed. FTC's failure to document the reasons for closing investigations represented an internal control weakness as defined by the Comptroller General's *Standards for Internal Control in the Federal Government*. Given the number of hours FTC staff billed, on average, for investigations that FTC later closed and took no further action, closing an investigation is a significant event, and as such, federal internal control standards require that the reasons for such decisions be documented and readily available for examination. Based on our work and subsequent discussions with FTC staff, FTC revised its procedures to require staff to document the reason(s) for closing franchise and business opportunity investigations that result in no further legal action.

Over the past several years, Congress and others have debated the need for a federal statute to regulate franchises and address problems that can arise after the sale of a franchise. Our work revealed no readily available,

²⁸Other studies contracted for by the Office of Advocacy during the 1990s include "Survival Patterns Among Franchise and Nonfranchise Firms Started in 1986 and 1987," (Dr. Timothy Bates, Wayne State University, 1996); "Differences Between Successful and Unsuccessful Franchisors," (Dr. Scott Shane, Georgia Institute of Technology, 1995); and "Franchising's Growing Role in the U.S. Economy, 1975-2000," (James Trutko, John Trutko, and Andrew Kostecka for James Bell Associates, Inc., 1993).

statistically reliable data on the overall extent and nature of these problems. The absence of such data makes it difficult to determine the nature of any problems and the extent to which they occur, or whether a federal statute is warranted to resolve such problems. Although Congress can consider franchise relationship legislation without this information, a study on the extent and nature of franchise relationship problems—as well as an examination of franchisor and franchisee experiences with existing remedies for resolving disputes, such as judicial remedies or other dispute resolution processes—could provide lawmakers with a better framework or basis for considering whether there is a need for a federal statute that would generally regulate franchise relationships. Such a study could be led by SBA's Office of Advocacy, FTC, or another federal entity, with work performed by an independent research organization. However, potential data limitations, as well as cost and time considerations, are factors that should be considered when weighing the pros and cons of conducting such a study.

Matter for Congressional Consideration

If Congress believes that it needs empirical data before considering franchise relationship legislation, it could commission and fund a study that would (1) design and implement an approach for collecting empirical data on the extent and nature of franchise relationship problems and (2) examine franchisor and franchisee experiences with existing remedies for resolving disputes.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the FTC Chairman and the SBA Acting Administrator. In a letter dated July 16, 2001, which is reprinted in appendix VIII, the FTC Chairman said that our report correctly recognized the nature, focus, and jurisdiction of FTC's enforcement activities relating to the Franchise Rule. He also noted that based on comments we provided during the course of our review, FTC has revised its procedures to document the reasons for closing franchise and business opportunity investigations that result in no further legal action. The FTC Chairman was silent on FTC's potential involvement in the study mentioned in the Matter for Congressional Consideration.

In a letter dated July 16, 2001, which is reprinted in appendix IX, the SBA Acting Administrator said that SBA has a longstanding record of assisting franchisees through financial assistance, technical assistance, and business counseling. He stated that SBA's Office of Advocacy has conducted studies on franchising activity and noted that, as discussed in our draft, the Office of Advocacy is mentioned as being able to conduct such a study if additional funds were appropriated for this purpose.

However, he also pointed out that the franchise data necessary to support such a study does not presently exist—the data are either dated or limited in scope—and would need to be created before a study could be conducted.

We recognize that there could be barriers or limitations to obtaining data on the extent and nature of franchise relationship problems, as well as cost and time considerations. These are factors that should be considered when weighing the pros and cons of conducting such a study. We also recognize that federal agency involvement in this study will likely require that additional funds be appropriated. However, such a study could provide a better framework for considering whether there is a need for federal franchise relationship legislation, especially since the absence of such data makes it difficult to determine the extent and nature of franchise relationship problems.

In addition to the above comments, FTC provided technical comments, which we incorporated in this report, where appropriate. We also contacted officials with the various trade associations to verify the information they provided and incorporated their comments, where appropriate.

We are providing copies of this report to the Chairman and Ranking Minority Member, Senate Committee on Commerce, Science, and Transportation; Chairman and Ranking Minority Member, Senate Committee on Small Business; Chairman and Ranking Minority Member, House Committee on Energy and Commerce; and the Chairman and Ranking Minority Member, House Committee on Small Business. We are also sending copies of this report to the Chairman of the Federal Trade Commission and the Administrator of the Small Business Administration. We will also make copies available to other interested parties upon request.

Please contact me or John Mortin on (202) 512-8777 if you or your staff have any questions. Other key contributors to this report were Nelsie Alcoser, Christopher Conrad, Eric Erdman, Susan Michal-Smith, and Gregory Wilmoth.



Richard M. Stana
Director, Justice Issues

Appendix I: Objectives, Scope, and Methodology

Our objectives were to describe (1) FTC's efforts to enforce its Franchise Rule, including FTC's analysis of complaints and actions taken regarding franchises and business opportunity ventures; (2) FTC's efforts to communicate and coordinate its franchise and business opportunity enforcement activities with selected state regulatory officials; and (3) the availability of data on the extent and nature of franchise relationship problems. We also obtained information on the views of FTC staff, franchise trade association officials, and selected state regulatory agency officials regarding the need for federal legislation on franchise relationships.

To address these objectives, we performed our work primarily at FTC headquarters in Washington, D.C. and with franchise trade association and regulatory officials in Washington, D.C., Chicago, IL, and Baltimore, MD. We also contacted franchise and business opportunity regulatory officials in the nine states that have both franchise disclosure and business opportunity disclosure laws (California, Illinois, Indiana, Maryland, Michigan, Minnesota, South Dakota, Virginia, and Washington).

We discussed franchise relationship issues with officials from various associations that represent or deal with franchisors and/or franchisees—the American Arbitration Association, the American Association of Franchisees and Dealers (AAFD), the American Bar Association's Forum on Franchising, the American Franchise Association (AFA), FRANDATA Corporation (a supplier of information to and about franchises), the International Franchise Association (IFA), the International Society of Franchising, the North American Securities Administrators Association (NASAA), the National Franchise Council (NFC), and the National Franchise Mediation Program. We also discussed franchise relationship issues with state legislative officials and attorneys representing franchisors and franchisees in Iowa since Iowa has been recognized by franchise trade officials as having the most comprehensive franchise relationship law of all the states.

To address the first objective concerning FTC's efforts to enforce its Franchise Rule, including FTC's analysis of complaints and the actions it took regarding franchises and business opportunities, we met with staff from FTC's Division of Marketing Practices in the Bureau of Consumer Protection and its Office of the General Counsel. Specifically, we gathered and analyzed information and documentation on FTC's regulatory practices, enforcement, and oversight of franchises and business opportunity ventures. We also obtained and reviewed applicable laws, regulations, and FTC documents pertaining to the history of FTC's efforts to promulgate, revise, and enforce compliance with its Franchise Rule.

Further, we reviewed FTC's Operating Manual to determine FTC's policies and procedures for initiating and carrying out Franchise Rule investigations.

As agreed with your staffs, we focused on the business opportunity and franchise complaints FTC received and investigations and court cases FTC initiated from 1993 through the most recent date available¹ and differentiated, where possible, between (1) franchises and business opportunities and (2) pre-sale disclosure and post-sale relationship issues. In regard to complaints, we analyzed the business opportunity and franchise complaints FTC received from January 1993 through June 1999,² to determine the number of business opportunity and franchise complaints FTC received, as well as whether the individual franchise complaints involved a pre-sale disclosure or a post-sale relationship issue.³ Our analyses of the complaint data relied on FTC's separation of the franchise complaints from the business opportunity complaints. We did not independently verify the accuracy of FTC's categorization of the complaints or the completeness of the complaint data FTC provided. However, we did verify that the complaint data FTC provided during our review was consistent with data published in a June 2001 FTC report entitled, *Franchise and Business Opportunity Program Review 1993-2000: A Review of Complaint Data, Law Enforcement and Consumer Education*. According to FTC staff, this report was prepared as part of FTC's efforts to conduct a separate rulemaking proceeding for business opportunities once it has completed the Franchise Rule review process.

Regarding FTC's investigation and case activities, we reviewed the criteria FTC uses to determine when to act on complaints it receives, and in general, the reasons why FTC does or does not open an investigation based on complaints. We also determined the number, type, and outcomes

¹Data on franchise and business opportunity complaints were available through June 1999 from FTC's franchise and business opportunity database, which was drawn from the Consumer Information System, FTC's general complaint database. FTC's investigation data were available for all of 1999, and case data were available through 2000.

²According to FTC staff, the complaint information in its database represents the most comprehensive business opportunity and franchise complaint information that is available, but may not necessarily be a complete picture of all complaints FTC received. For various reasons, complete data are not available for earlier years, and data were not captured consistently across all years.

³FTC had not individually analyzed each business opportunity complaint, but FTC staff stated that most business opportunity complaints represent pre-sale concerns about either fraud or misrepresentation.

of the business opportunity and franchise investigations FTC initiated each year from 1993 through 1999; the criteria FTC uses to decide which investigations to open and which court cases to file; and the reasons why FTC did or did not take action on closed investigations. We also obtained information on the number, type, and outcomes of the business opportunity and franchise cases that FTC filed in court each year during 1993 through 2000. However, we did not independently verify FTC's process for deciding which cases to investigate and which to pursue in the courts and, therefore, do not know whether FTC took action on the most appropriate and promising cases. Finally, we sought to determine the extent to which FTC documented the reasons for closing the investigations, by examining the 79 investigation files for those business opportunity and franchise investigations closed from 1997 through 1999 for which FTC took no further legal action. Specifically, we used a structured data collection instrument to gather information from each of the 79 investigation files on (1) the date the investigation was opened, (2) the source of the investigation (i.e., sweep, consumer complaint, etc.), (3) the potential problem or violation being investigated, (4) the reason(s) for closing the investigation, and (5) the date the investigation was closed. As part of our review, we reviewed all documentation in the file, including the Matter Initiation Notice, Matter Update Notice, and Matter Profile.

We did not compare the complaint data provided by FTC with the complaint data reported in our 1993 report⁴ primarily because, according to FTC staff, they had not analyzed the individual franchise complaints cited in the 1993 report to remove inquiries from actual complaints, and the 1993 report did not differentiate between business opportunity and franchise complaints. Furthermore, we did not compare the data collected from FTC on FTC Franchise Rule investigations with the results of our 1993 report because the 1993 report did not differentiate between franchise and business opportunity investigations. In addition, FTC no longer carries out investigations the way it did in 1993. For example, FTC used to distinguish between initial phase and full phase investigations, but it no longer makes that distinction.

To address the second objective concerning FTC's efforts to communicate and coordinate its franchise and business opportunity enforcement activities with selected state regulatory officials, we interviewed FTC staff to identify FTC efforts to assist states in enforcing franchise and business opportunity laws. Then, using a structured data collection instrument, we

⁴See [GAO/HRD-93-83](#), (July 1993).

contacted business opportunity and franchise regulatory officials in the nine states that have enacted both franchise disclosure and business opportunity laws. Specifically, we contacted cognizant officials⁵ from the following agencies within each of the states:

- **California.** Office of the Attorney General, Consumer Law Section; and the Business, Transportation and Housing Agency, Department of Corporations;
- **Illinois.** Office of the Attorney General, Franchise Bureau; and the Office of the Secretary of State, Securities Department;
- **Indiana.** Office of the Attorney General; and the Office of the Secretary of State, Securities Division;
- **Maryland.** Office of the Attorney General, Securities Division;
- **Michigan.** Office of the Attorney General, Consumer Protection Division;
- **Minnesota.** Department of Commerce, Enforcement Division;
- **South Dakota.** Department of Commerce and Regulation, Securities Division;
- **Virginia.** State Corporation Commission, Division of Securities and Retail Franchising; and
- **Washington.** Department of Financial Institutions, Securities Division.

The views of state regulatory officials from these agencies are not generalizable to other states.

As part of our audit work addressing FTC's coordination efforts, we also explored the issue of whether FTC should perform reviews of franchise and business opportunity disclosure documents—a function FTC does not currently perform. To address this issue, we contacted business opportunity and franchise regulatory officials from the nine states listed above, as well as from NASAA. Further, we discussed the feasibility of FTC performing such reviews with staff in FTC's Division of Marketing Practices within the Bureau of Consumer Protection and in its Office of the General Counsel.

To address the third objective concerning the availability of data on the extent and nature of franchise relationship problems, we interviewed staff from FTC's Division of Marketing Practices within the Bureau of Consumer Protection and its Office of the General Counsel. We also

⁵We specified that the data collection instrument should be completed by the person most knowledgeable about their agency's relationship with FTC concerning business opportunity or franchise issues.

interviewed officials from four franchise trade associations (AAFD, AFA, IFA, and NFC), whose membership, in general, consists of the following.

- AAFD primarily represents the rights and interests of franchisees. AAFD has about 6,000 members, including franchisees who own and operate more than 14,000 franchised outlets.
- AFA primarily represents the rights and interests of small business franchisees. AFA represents about 14,000 small business owners of more than 30,000 franchised outlets.
- IFA primarily represents the rights and interests of franchisors and franchisees. IFA represents about 800 franchisor members, 2,000 individual franchisee members, and 30 franchisee associations and councils representing another 30,000 franchised outlets.
- NFC primarily represents the rights and interests of large franchisors (i.e., companies with franchise systems of more than 200 units that have been operating for at least 5 years in compliance with applicable franchise laws, rules, and regulations). NFC represents 16 companies that operate over 40 national franchise systems.

Further, we contacted officials from franchise regulatory agencies in the nine selected states, as well as officials from various franchise associations, including the American Arbitration Association, the American Bar Association's Forum on Franchising, FRANDATA Corporation, the International Society of Franchising, NASAA's Franchise and Business Opportunity Project Group, and the National Franchise Mediation Program. We also contacted cognizant FTC staff and officials from franchise trade associations and selected states to gather their views on the need for federal franchise legislation. Moreover, we interviewed FTC staff, an official from the Department of Commerce's International Trade Administration, and officials from the Small Business Administration's Office of Advocacy to determine if their agency has the expertise and would be willing to conduct or oversee a future study on franchise relationship issues.

Finally, we researched FTC's role in addressing post-sale relationship issues, including the scope and applicability of section 5 of the FTC Act, and interviewed FTC staff about their role regarding these issues. We also reviewed the legislative histories of federal franchise laws covering the automobile and petroleum industries and reviewed the 17 state franchise relationship laws of general applicability that were identified in the Commerce Clearinghouse *Business Franchise Guide*. We did not, however, compare the laws or analyze their appropriateness. Further, we reviewed the transcript from a congressional hearing on franchise relationship issues, and we reviewed the Small Business Franchise Act of 1999 (H.R.


3308), as introduced in the 106th Congress, which, if passed, would have established federal jurisdiction over franchise relationship issues. In addition, we interviewed the state senator from Iowa who was involved in passing Iowa's franchise relationship law and franchise attorneys who lobbied for and against it.

We conducted our work between August 2000 and June 2001 in accordance with generally accepted government auditing standards. We discussed the results of our work with responsible FTC staff and SBA officials and have incorporated their comments, where appropriate. We also contacted officials at AAFD, AFA, IFA, and NFC to verify information they provided and incorporated their comments, where appropriate.

Appendix II: States With Business Opportunity, Franchise Disclosure, and/or Franchise Relationship Laws

Table 4: Listing of States With Business Opportunity, Franchise Disclosure, and/or Franchise Relationship Laws

State	Business opportunity law	Franchise disclosure law	Franchise relationship law
Arkansas			●
California	●	● ^a	●
Connecticut	●		●
Delaware			●
Florida	●		
Georgia	●		
Hawaii		● ^a	●
Illinois	●	● ^a	●
Indiana	●	● ^a	●
Iowa	●		●
Kentucky	●		
Louisiana	●		
Maine	●		
Maryland	●	● ^a	
Michigan	●	●	●
Minnesota	●	● ^a	●
Mississippi			●
Missouri			●
Nebraska	●		●
New Hampshire	●		
New Jersey			●
New York		● ^a	
North Carolina	●		
North Dakota		● ^a	
Ohio	●		
Oklahoma	●		
Oregon		●	
Rhode Island		● ^a	
South Carolina	●		
South Dakota	●	● ^a	
Texas	●		
Utah	●		
Virginia	●	● ^a	●
Washington	●	● ^a	●
Wisconsin		●	●
Total	24	15	17

 Shaded states have business opportunity, franchise disclosure, and franchise relationship laws.

**Appendix II: States With Business
Opportunity, Franchise Disclosure,
and/or Franchise Relationship Laws**

^aThese 12 states require registration of disclosure documents and have staff that review documents.

Source: GAO's analysis of the state regulations listed in the Commerce Clearinghouse Business Franchise Guide and documents from FTC.

Appendix III: Federal and State Jurisdiction Over Franchise Relationship Issues

Franchising is a form of business relationship based on a contract. Except for the automobile and petroleum industries, federal laws do not address the franchisor-franchisee relationship. During the 1990s, Congress considered several proposals for federal legislation on franchise relationships, but none became law. FTC traditionally does not regulate or set the terms of private contracts in franchising or in any other economic sector. Absent specific federal franchise statutes or regulation, franchise relationships are generally considered matters of contract law that traditionally have been regulated at the state level.

Federal Legislation on Franchise Relationships

Federal legislation on franchise relationships has been enacted for two specific industries—the automobile and petroleum industries. The Automobile Dealers Day in Court Act was enacted in 1956.¹ The act gives a franchise automobile dealer the right to bring an action in U.S. District Court against its automobile manufacturer to recover damages caused by the manufacturer’s failure to act in good faith in (1) performing or complying with any of the terms or provisions of the franchise agreement or (2) terminating, canceling, or not renewing the franchise. The legislative history of the act noted that the concentration of economic power in the automobile industry was so great that legislation was needed to remedy the disparity for franchise dealers to bargain with the manufacturers. More specifically, the legislative history stated the following:

“Hearings conducted by Congress contained numerous instances of automobile manufacturers coercing and intimidating their franchised dealers. A primary source of the manufacturers power over their dealers stems from the unilateral nature of the franchise agreements. Automobile dealers have been subjected to economic duress and intimidation and have been unable to obtain redress in the courts. The bill assures the dealer an opportunity to secure a judicial determination in the courts regardless of the contract terms as to whether the automobile manufacturer has failed to act in good faith in performing or complying with any of the provisions of his franchise or in terminating, canceling or not renewing his franchise.”²

After the oil crisis of 1973, Congress began looking at regulating the franchise relationship between petroleum manufacturers and dealers and, in 1978, enacted the Petroleum Marketing Practices Act.³ The act prohibits

¹15 U.S.C. §§ 1221–1225.

²H.R. Rep. No. 2850, 84th Cong. (1956).

³The act contains three titles and is found at 15 U.S.C. § 2801 et. seq. For this report, we focused on the title I franchise relationship provisions found at 15 U.S.C. §§ 2801–2806.

a franchisor engaged in the sale or distribution of motor fuel from terminating a franchise during the term of the franchise agreement unless the termination or nonrenewal is based on grounds specified in the law. The act mandates a 90-day advance notice of the termination or nonrenewal, unless under the circumstances, it would be unreasonable to provide 90 days' notice. The act provides for franchisees to file a lawsuit against franchisors in U.S. District Court for failure to comply with the act's requirements. Like the Automobile Dealers Day in Court Act, the legislative history of the petroleum marketing act noted a disparity of bargaining power between the franchisor and the franchisee.⁴ More specifically, the legislative history stated the following:

"In recent years the friction between franchisors and franchisees in marketing of motor fuels has become so great that it had threatened adverse impacts upon the Nation's motor fuel distribution and marketing system. Numerous states have initiated various legislative actions to address these petroleum product franchising problems. These actions have unfortunately resulted in an uneven patch work of rules governing franchise relationships which differ from State to State. Needed is a single, uniform set of rules governing the grounds for termination and non-renewal of motor fuel marketing franchises and the notice which franchisors must provide franchisees prior to termination of a franchise or non-renewal of a franchise relationship."

Since 1992, several separate proposals for additional franchise relationship legislation have been introduced in Congress, none of which became law.⁵ For example, the Small Business Franchise Act of 1999 (H.R. 3308), proposed, among other things, a comprehensive scheme for regulating the franchise relationship and included provisions on contract terminations, and transfers; encroachment; the purchase of goods or services from designated sources of supply; and franchisees' rights to associate with other franchisees. The bill also provided franchisees with the right to file a lawsuit against franchisors for violations of the act.

FTC's Jurisdiction Related to Franchise Relationship Issues

As previously mentioned, FTC's Franchise Rule only addresses how a franchise is sold to a prospective purchaser. It generally does not regulate the nature of the agreement a prospective franchise purchaser may sign or changes in the relationship after the initial contract has been signed. FTC

⁴ S. Rep. No. 95-731, 95th Cong. (1978).

⁵ Federal franchise relationship legislation introduced in Congress since 1992 includes H.R. 5233, 102nd Cong. (1992); H.R. 2593 and H.R. 1316, 103rd Cong. (1993); H.R. 1717, 104th Cong. (1995); H.R. 2954, 105th Cong. (1997); H.R. 4841, 105th Cong. (1998); and H.R. 3308, 106th Cong. (1999).

staff told us that FTC generally lacks the authority to intervene in private franchise contracts and related relationship issues.

FTC generally does not have specific statutory authority to intervene in or regulate private contractual matters, including franchise contracts. According to FTC, the only relevant authority it has that could possibly relate to franchise relationships is section 5 of the FTC Act, which declares unlawful unfair or deceptive acts or practices in or affecting commerce.⁶ Section 5 also provides that for FTC to declare an unfair act or practice unlawful (known as FTC's "unfairness" jurisdiction), three specific criteria must be met: (1) the act or practice causes or is likely to cause substantial injury to consumers, (2) the injury is not outweighed by countervailing benefits to consumers or to competition, and (3) the act or practice is not reasonably avoidable by consumers.⁷ According to FTC, given these criteria, its unfairness jurisdiction generally does not give FTC authority to reach the substantive provisions of franchise contracts or otherwise intervene in franchise relationship issues. FTC staff provided further information on FTC's unfairness jurisdiction criteria as discussed below.

- *Substantial injury.* According to FTC staff, in order for FTC to exercise its unfairness jurisdiction over the terms and conditions of franchise contracts, there must be evidence of substantial injury. Complaints alleging oppressive contract terms and conditions generally assert that they cause or threaten to cause significant monetary injury to the complainant. FTC staff, added, however, that they seldom see more than a few atypical complaints of this nature about any particular franchise system. Thus, according to FTC staff, in many cases, the "substantial" injury element of the unfairness criteria cannot be met.
- *Countervailing benefits.* According to FTC staff, a more difficult issue is countervailing benefits. Franchise systems, like all businesses, are influenced by market forces. Consumer tastes change, and competition may arise unexpectedly. Accordingly, franchisors may desire to create contracts that maximize their ability to respond quickly to market forces. For that reason, a franchisor, for example, may wish to reserve the right to offer franchises on a nonexclusive basis or to reserve the right to sell goods and services through alternative channels of distribution. This

⁶15 U.S.C. § 45(a)(1).

⁷15 U.S.C. § 45(n). According to FTC, "unfairness" is a term of art that has a specific legal meaning that has developed over time. FTC's unfairness jurisdiction was codified by Congress, with some revisions, in the 1994 amendments to the FTC Act.

enables the franchisor to move quickly to meet the competition if a new territory opens or distribution method arises. Other terms and conditions are designed to ensure system uniformity, which consumers often expect from a franchise system. Therefore, in many instances, a franchisor's choice of contract terms and conditions are based upon some economic rationale that is designed to benefit consumers and/or the system's existing franchisees. According to FTC staff, the benefits flowing from these contractual terms may, in some cases, outweigh the allegations of "oppression" by complainant franchisees.

- *Unavoidability.* According to FTC staff, when considering the substantive terms and conditions of franchise contracts, unavoidability is the most difficult standard to satisfy. Franchises are discretionary purchases. That is, no aspiring entrepreneur is forced to purchase a franchise in order to be in business. Moreover, franchising is only one method of entering into a business. Franchising also covers a wide variety of economic sectors, and for the most part, there is competition in each sector. Therefore, the market offers many choices for anyone wishing to operate a business. According to FTC staff, under these circumstances, existing franchisees would be hard-pressed to establish that contractual provisions they voluntarily read, agreed to, and signed were somehow unavoidable. The FTC staff added that proving this is an even more daunting task, because prospective franchisees are required to receive a disclosure document at least 10 business days before they sign the franchise agreement or pay any fee. Presumably, every prospective franchisee has the opportunity to (1) review the disclosure document before signing the contract; (2) seek legal, accounting, or marketing counsel; and (3) speak to both former and current system franchisees.⁸ In short, according to FTC staff, it is not FTC's role to second-guess a prospective franchisee's wisdom in signing a particular franchise agreement, as long as the prospective franchisee is forewarned about the legal consequences of his or her actions.

According to FTC staff, isolated instances of miscellaneous relationship issues cannot justify a more widespread investigation of relationship issues, let alone substantive rulemaking that addresses franchise contracts. The staff added that before FTC could consider developing a rule that addresses the substantive terms of private franchise contracts, it would need not only evidence of substantial injury, but also sufficient information that would enable FTC to weigh the alleged injury against any countervailing benefits to the public at large or to competition. In addition,

⁸FTC staff told us it is much more likely to find unavoidability when it comes to a particularly vulnerable group, such as children.

FTC staff noted that FTC would need evidence showing that franchisees cannot reasonably avoid the alleged injury. The staff further stated that while franchisees and their advocates suggest that economic harm to individual franchisees may result from some franchisor practices, they have not shown to date that such injury is substantial and not outweighed by countervailing benefits. Further, FTC staff told us that in at least some instances, prospective franchisees could avoid injury by comparison shopping for a franchise system that offers more favorable terms and conditions and by considering alternatives to franchising as a means of business ownership. Absent evidence on widespread franchise relationship abuses, FTC believes the prudent approach is to continue to investigate instances of such abuses, where they occur, under FTC's current unfairness authority.

According to FTC staff, application of FTC's unfairness jurisdiction in a franchise matter is most likely to occur in a situation in which a franchisor attempts to unilaterally modify a contract or breach a contract with franchisees. They noted that in most instances, such conduct is unavoidable. Nonetheless, for FTC to find unfairness, there still must be substantial injury that is not outweighed by countervailing benefits. To date, FTC has conducted only two franchise investigations that were based solely on FTC's unfairness jurisdiction, both involving an allegation of a franchisor's breach of contract.⁹ Both investigations were ultimately closed because FTC determined there was insufficient evidence to satisfy the section 5 unfairness criteria.

State Jurisdiction

As previously mentioned, franchise relationships are generally considered matters of contract law that traditionally have been governed at the state level. We identified 17 states that have enacted general franchise relationship laws that specifically regulate certain aspects of the relationship after the initial contract has been signed.¹⁰ While these laws vary in their scope, all of them address the termination of a franchise

⁹FTC staff told us that staff are currently reviewing allegations of deceptive and unfair practices in one franchise system, but that no specific unfairness investigations have been pursued to date. They added that FTC staff may have also explored unfairness as one of many issues in other franchise investigations.

¹⁰The 17 states with general franchise relationship laws are Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Virginia, Washington, and Wisconsin. In addition, all 50 states have enacted franchise relationship laws covering specific industries, such as motor vehicles, farm equipment, and alcoholic beverages.

agreement, and all but one (Virginia) address contract renewal. Other areas covered to varying degrees include the transfer of a franchise, encroachment, the purchase of goods or services from designated sources of supply, franchisees' right to associate with other franchisees, and forum selection. Regardless of whether or not a state has a law that specifically covers the franchise relationship, franchisees always have the right to file a civil lawsuit against a franchisor for any contractual disputes. Many states have a "little FTC Act" (modeled after the FTC Act) or some type of general consumer protection or fraud statute that franchisees can use to address contractual disputes. These statutes are referred to in different states, for example, as consumer protection acts, consumer sales acts, deceptive trade practices acts, and consumer fraud acts. The states' franchise relationship laws and other consumer protection or fraud statutes generally allow franchisees to file lawsuits in state court against franchisors for violations of these state laws.

Iowa's Franchise Relationship Law

To gain a better understanding of franchise relationship issues at the state level, we reviewed Iowa's franchise relationship law and interviewed Iowa officials involved in enacting the law. Iowa's law is recognized by franchise trade officials as being the most comprehensive of all the states. Iowa's franchise relationship law includes provisions that prohibit franchisors from

- terminating a franchise without good cause and at least 30 days prior written notice;
- refusing to renew a franchise unless the franchisor has provided 6 months written notice of nonrenewal and either good cause exists or certain circumstances exist, such as the franchisor completely withdraws from the market served by the franchisee;
- rejecting a proposed transfer of a franchise unless the proposed transferee fails to meet the franchisor's reasonable current qualifications for new franchisees and such rejection is not arbitrary or capricious; and
- requiring that franchisees purchase goods or supplies exclusively from the franchisor or designated sources when goods and supplies of comparable quality are available from other sources.

According to officials we met with in Iowa, the most contentious part of Iowa's franchise relationship law relates to encroachment. In general, the law provides franchisees a cause of action to recover monetary damages if a franchisor (1) develops, or grants a franchisee the right to develop, a new franchise outlet in unreasonable proximity to the existing franchisee's outlet and (2) the new outlet has an adverse effect on the gross sales of the existing franchisee's outlet.

An Iowa state senator who played a key role in enacting Iowa's franchise relationship law told us he was unaware of any data on the extent of franchise relationship problems in Iowa. Rather, he noted that Iowa's law was initially passed following an Iowa legislature study of franchise regulation, which included testimony and other statements made by proponents and opponents of franchise legislation. The senator added that the primary reason why Iowa got involved in regulating franchise relationship issues was because of a provision in franchise agreements requiring franchisees operating in Iowa to settle disputes and file lawsuits outside of Iowa. Under Iowa's law, a provision in a franchise agreement requiring franchisees who are located in Iowa to go to other states to settle disputes and file lawsuits is unenforceable.

Appendix IV: Information on FTC's Investigation Process and Its Criteria for Opening Investigations and Pursuing Cases

FTC's Investigation Process

The investigative process under FTC's Franchise Rule involves four major phases: (1) receiving complaints and inquiries about franchisor actions, (2) performing preliminary screens of complaints, (3) conducting investigations, and (4) taking legal actions against franchisors¹ or closing the investigations without taking any legal actions against the franchisors. FTC may begin investigations based on information from external sources, such as consumer complaints, or from internal actions, such as FTC-initiated inquiries. Investigations may result in such actions as FTC filing, through the Department of Justice (DOJ), a consent decree or a complaint in court that may lead to an eventual judicial action against a franchisor or closing the investigation without taking any further action.

FTC's Criteria for Opening Investigations

FTC typically considers a number of factors to determine whether it will open an investigation. According to FTC staff, many investigations stem from business opportunity sweeps, reviews of newspaper advertisements, Internet research, or other internal FTC case generation activities. On the basis of these factors, as well as application of its criteria for screening complaints, most complaints FTC receives are not investigated. According to FTC staff, the factors FTC consider are as follows:

- *The type of problem alleged.* In reviewing a business opportunity or franchise complaint, FTC typically determines first whether the complaint alleges violation of a law enforced by FTC. Many complaints do not constitute violations of any laws enforced by FTC. For example, (1) the franchisor has breached its franchise agreement, (2) the franchisee is dissatisfied with the quality of goods offered for sale, or (3) the franchisee is dissatisfied with the investment and wants to seek a refund. Generally, these problems do not constitute federal law violations, and enforcement by FTC is not warranted.
- *The level of consumer injury and the number of consumers affected.* Because FTC's resources are limited, it seeks to focus on those complaints that will "accomplish the greatest good for the greatest number of consumers." Accordingly, as a matter of policy, FTC generally does not pursue individual consumer complaints or intervene in disputes between individual franchisees and franchisors. Rather, FTC focuses on those companies that exhibit a pattern or practice of violations nationwide.
- *The likelihood of preventing future unlawful conduct.* FTC may also consider the likelihood that any enforcement action will prevent future

¹In lieu of formal legal action, FTC staff may refer a violation to NFC's Alternative Rule Enforcement Program.

unlawful conduct. For example, where would-be defendants are out-of-business, enforcement of the law would be futile.

- *The likelihood of securing redress or other relief.* FTC typically considers whether a law enforcement action will result in securing redress or other relief. In this regard, FTC considers the viability of law enforcement action,² the financial status of the business opportunity seller or franchisor, and any potential injury to existing franchisees.
- *Additional law enforcement considerations.* FTC may consider several additional factors, such as whether (1) the problem can be addressed at the state level, (2) individuals can remedy the problem on their own under existing state laws, and (3) there are serious law violations that can result in substantial consumer injury.

FTC's Criteria for Deciding Which Cases to Pursue

FTC typically considers a number of factors to determine which cases it will pursue through the courts. Some of these criteria are the same factors FTC uses in deciding to open an investigation. For example, among the factors FTC first determines are whether (1) there is an allegation of a violation of law enforced by FTC, (2) the alleged violation is within the applicable statute of limitations, and (3) there is a pattern or practice of such problems. If these factors can be established, FTC can then apply more specific case selection criteria, which include the following:

- *The viability of law enforcement action.* FTC considers such factors as whether (1) the alleged violations are close to the statute of limitations; (2) witnesses can be located, and if so, how cooperative they will be; and (3) evidence is available and sufficient to demonstrate that a law violation occurred.
- *The viability of a meaningful remedy.* FTC considers such factors as (1) whether the company has any assets that could be used to compensate those harmed or pay civil penalties and (2) what the deterrent effect on the company would be.
- *Alternatives to federal intervention.* FTC considers such factors as whether (1) the franchisee(s) can sue under state law and (2) the matter is

²In assessing the viability of a case, FTC determines whether the evidence is sufficient to prove a law violation, including the availability of witnesses, the preservation of documents, and any applicable statute of limitations.

**Appendix IV: Information on FTC's
Investigation Process and Its Criteria for
Opening Investigations and Pursuing Cases**

appropriate for referral to state authorities or to the NFC's Alternative Rule Enforcement Program.

Appendix V: Information on Business Opportunity and Franchise Court Cases Filed by FTC During 1993-2000

Table 5: Summary of Outcomes for the Franchise and Business Opportunity Cases (Franchise Rule and/or Section 5 of the FTC Act) Filed by FTC, 1993-2000

Case name	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy					
	Yes	No	Pending	Sought			Obtained			Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Pending	Yes	No	Pending									
Rule allegations only																		
Franchise																		
U.S. v. Building Inspector of America, Inc.	●			●			●			\$35,000	●				●			
U.S. v. Coverall North America, Inc.	●			●			●			100,000	●				●			
U.S. v. Direct Distributors, Inc.	●			●			●			25,000	●				●			
U.S. v. Gingiss International, Inc.	●			●			●			25,000	●				●			
U.S. v. Hillary's Gourmet Ice Cream	●			●			●			0 ^a	●				●			
U.S. v. Jani-King International, Inc.	●			●			●			100,000	●				●			
Business opportunity																		
U.S. v. 21st Century Systems, Inc.			●	●			●					●					●	
U.S. v. Acme Vending Co.	●			●			●			0	●				●			
FTC v. Ad-Com International, Inc	●			●			●		●				0		●			
U.S. v. All Snax, Inc.	●			●			●			20,000	●				●			
U.S. v. American Coin-Op Services, Inc.			●	●			●		●			●					●	
U.S. v. American Vending Group, Inc.	●			●			●			0	●				●			
U.S. v. America's Radio Transmitter, Ltd.	●			●			●			10,000	●				●			
U.S. v. Astratel, Inc.			●	●			●		●			●					●	
U.S. v. Automatic Merchandising Corp.			●	●			●		●			●					●	
FTC v. Bureau 2000	●			●			●		●				25,000		●			
U.S. v. Cigar Factory Outlet, Inc.			●	●			●		●			●					●	
U.S. v. Cigar Manufacturers Outlet, Inc.			●	●			●		●			●					●	
U.S. v. Delta Distributors Co., Inc.	●			●			●			0	●				●			
U.S. v. Discount Manufacturing, Inc.	●			●			●			0	●				●			
U.S. v. Elite Business Designs, Inc.			●	●			●		●			●					●	
U.S. v. Emily Water & Beverage Co., Inc.			●	●			●		●			●					●	
U.S. v. Firstlight Entertainment, Inc.	●			●			●			10,000	●				●			
U.S. v. Galaxies, Inc.			●	●			●		●			●					●	
U.S. v. Global Gumballs, Inc.	●			●			●			50,000	●				●			
U.S. v. Global Toys Distributors, Inc.	●			●			●			0	●				●			
U.S. v. Great Pacific Vending Corp.			●	●			●		●			●					●	
FTC v. Greenhorse Communications, Inc.	●			●			●		●				0					Recission of contracts or refunds
U.S. v. Greeting Card Depot, Inc.			●	●			●		●			●					●	
U.S. v. Health Wave, Inc.	●			●			●			10,000	●				●			
U.S. v. International Champions, Inc.	●			●			●			0	●				●			
U.S. v. Island Automated Medical Services, Inc.	●			●			●			40,000	●				●			

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy			
	Yes	No	Pending	Sought		Obtained		Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Yes	No									
FTC v. J.P. Meyers Company, Inc.	●			●		●					0		●			
U.S. v. Jumping Java Coffee, Inc.		●		●		●		●				●			●	
U.S. v. Kato Makiko (Infinity Corp.)	●			●		●		0		●				●		
U.S. v. K. V. Hill (Southeastern Photo Supply, Inc.)	●			●		●		297,000		●				●		
U.S. v. Life Systems Associates, Inc.	●			●		●		0		●				●		
U.S. v. Lil' Snacks, Inc.	●			●		●		20,000		●				●		
U.S. v. Douglas C. McGlothlin (International Cigar Consortium)	●			●		●	●	0		●				●		
U.S. v. Modern Management Systems, Inc.	●			●		●		7,000	●					●		
U.S. v. National Marketing, Inc.	●			●		●		15,000	●					●		
U.S. v. National Tech Systems, Inc.	●			●		●		10,000	●					●		
U.S. v. National Vending Consultants, Inc.		●		●		●				●					●	
U.S. v. Nibblers, Inc.	●			●		●		10,000	●					●		
U.S. v. North American Marketing Systems, Inc.		●		●		●				●					●	
U.S. v. Nu-Idea Technologies, Inc.	●			●		●		0	●					●		
U.S. v. Old Dominican Tobaccos, Inc.		●		●		●				●					●	
FTC v. Pioneer Communications of Nevada, Inc.	●		●	●		●	●				72,422			●		
U.S. v. Pro-Plastic Design & Marketing, Inc.	●			●		●		0	●					●		
U.S. v. Protocol, Inc.	●			●		●		0	●					●		
U.S. v. PVI, Inc.	●			●		●		11,000	●					●		
U.S. v. Quartercall Communications, Inc.	●			●		●		10,000	●					●		
U.S. v. Software Concepts, Inc.	●			●		●		0	●					●		
U.S. v. Summit Communications, Inc.	●			●		●		10,000	●					●		
U.S. v. Surface Science Corp.	●			●		●		0	●					●		
U.S. v. Toys Unlimited International, Inc.	●			●		●		15,000	●					●		
U.S. v. United Payphones of America, Inc.	●			●		●		22,000	●					●		
U.S. v. Vending Communications, Inc.		●		●		●				●					●	
U.S. v. Worldwide Coffee, Inc.		●		●		●				●					●	
U.S. v. World Wide Vending Corp.		●		●		●				●					●	
Other																
In the Matter of Blenheim Expositions, Inc. (IFA Expo)	●			●		●	●		●							Consumer education
U.S. v. Entrepreneur Media, Inc.	●			●		●		25,000	●							Consumer education
U.S. v. Shulman Promotions, Inc.	●			●		●		10,000	●							Consumer education

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy						
	Yes	No	Pending	Sought		Obtained		Yes	No	Pending	Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Yes	No												
Section 5 allegations only																			
Franchise																			
Business opportunity																			
FTC v. 2Xtreme Performance International (Polk)	●					●								2,500,000 (1,400,000 suspended)					Ban
FTC v. AmeraPress, Inc.	●					●								500,000		●			
FTC v. AMP Publications, Inc.			●			●							●						●
FTC v. Ed Boehlke (Advantage Marketing)	●					●								0		●			
FTC v. Data Medical Capital, Inc.			●			●			●										●
In re DMC Publishing Group	●					●										●			
FTC v. Edward P. Epstein (Electronic Filing Associates; Electronic Filing Academy)	●					●								0					Recission
FTC v. Financial Freedom Report, Inc.			●			●							●						●
FTC v. FutureNet, Inc.	●					●								1,000,000					Bond
FTC v. Home Professions, Inc.	●					●								27,647 ^b					Recission and ban
In re Homespun Products	●					●								1,040,000 (suspended)		●			
FTC v. Innovative Productions	●					●								0 ^c		●			
FTC v. Innovative Telemedia	●					●								3,594,824		●			
In re LS Enterprises	●					●							●						Bond
FTC v. Mediworks, Inc.	●					●								20,000					Bond
FTC v. Richard C. Neiswonger (Medical Recovery Service, Inc.)	●					●								1,000,000		●			
In re New Mexico Custom Designs, Inc.	●					●								1,200,000 (suspended)		●			
In re Nu -Skin International	●					●							●						Disgorgement (1,225,000)
FTC v. Orion Products Corporation	●					●								1,000,000		●			
In re Russell J. Osborn (The Hairbow Company)	●					●								1,900,000 (suspended)		●			
FTC v. Pace Corp	●					●								16,000,000		●			
FTC v. Para - Link International, Inc.			●			●			●				●						●
FTC v. Precision Communications Administrations, Inc.	●					●								45,008		●			
FTC v. Rapaport Corp. (Holiday Magic)	●					●								40,000		●			
In re Robert Serviss (Excel Communications)	●					●							●						●
FTC v. Star Publishing Group, Inc.	●					●				100,000			●						●
In re Starr Communications, Inc.	●					●							●						●
FTC v. Summit Photographix, Inc.			● ^d			●							●						●
In re William E. Taylor (Sandcastle Creations)	●					●								536,000 (510,000 suspended)		●			

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy			
	Yes	No	Pending	Sought		Obtained		Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Yes	No									
FTC v. United States Business Bureau, Inc.	●			●			●					11,000	●			
U.S. v. Visions Group of America, Inc.	●								22,000	●			●			
FTC v. Vaughn Williams, III (Encore Networking Services)	●			●			●		0			0				Ban
FTC v. Ronald Way (Hawthorne Communications)	●			●			●		25,000	●			●			
Rule & section 5 allegations																
Franchise																
FTC v. Car Checkers of America, Inc.			●	●			●								●	
FTC v. Car Wash Guys International, Inc.			●	●			●								●	
FTC v. Communidyne, Inc.	●			●			●					0				Ban
U.S. v. J.C. Pro Wear, Inc.	●			●			●		65,000	●			●			
FTC v. Independent Travel Agencies of America Association, Inc.	●			●			●					0	●			
FTC v. Richard L. Levinger (Senor Salsa's Gourmet Mexican restaurants)	●			●			●					0				Ban
FTC v. Majors Medical Supply, Inc.	●			●			●					5,000,000 (suspended)				Bond
FTC v. Minuteman Press International, Inc.	●			●			●					3,470,000	●			
FTC v. Mortgage Service Associates, Inc.	●			●			●					0				Bond
FTC v. Robbins Research International, Inc.	●			●			●					221,260				Repurchase of kits
FTC v. Sage Seminars, Inc.	●			●			●					Refunds				Ban
U.S. v. Snelling and Snelling	●			●			●					100,000	●			
FTC v. Tower Cleaning Systems, Inc.	●			●			●					50,000	●			
U.S. v. Tutor Time ChildCare Systems, Inc.	●			●			●		220,000	●			●			
Business opportunity																
FTC v. Advanced Public Communications Corp.			●	●			●						●			
FTC v. Allstate Business Consultants Group, Inc.	●			●			●					0				Ban, Bond
FTC v. American Universal Vending Corp.			●	●			●						●			
FTC v. Ameritel Payphone Distributors, Inc.	●			●			●					40,000	● ^s			
FTC v. Business Opportunity Center, Inc.	●			●			●					191,737	●			
FTC v. Carousel of Toys	●			●			●					0	●			
FTC v. Comtel Communications Global Network, Inc.	●			●			●					0	●			
FTC v. Creative Technology International, Inc. (Georgia Int'l Export Co.)	●			●			●					0	●			
FTC v. Fresh-O-Matic Corp	●			●			●					100,000	●			
FTC v. Genesis One Corp. (Bureau One)	●			●			●					6,100,000	●			
FTC v. Hart Marketing Enterprises Ltd., Inc.	●			●			●					872,882	●			

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy			
	Yes	No	Pending	Sought		Obtained		Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Yes	No									
FTC v. Hi Tech Mint Systems, Inc.			●			●					●				●	
FTC v. iMall, Inc.	●				●		●					4,000,000				Bond
FTC v. Inetintl.com, Inc. (Inet International)	●				●		●					3,991,359				Ban
FTC v. Infinity Multimedia, Inc.	●				●		●					340,000				Ban
FTC v. International Computer Concepts	●				●		●					1,555,729				Ban
FTC v. Douglas J. Irvine (Comtel)	●				●		●					281,737				Ban
FTC v. Jordan Ashley	●				●		●					9,165,567				Ban,bond
FTC v. Joseph Hayes (Retail Sales & Marketing, Inc)	●				●		●					465,000		●		
FTC v. Licensed Products U.S.A., Inc.	●				●		●					5,749,832				Ban
FTC v. Thomas Maher (Internet Business Broadcasting)	●				●		●					613,000		●		
FTC v. Marketing and Vending Concepts			●		●		●				●				●	
FTC v. Marquette, Inc.	●				●		●					146,750 (settlement) 3,253,000 (default)				
FTC v. MegaKing, Inc.			●		●		●				●				●	
U.S. v. Megatrend Telecommunications	●				●		●		15,000	●					●	
FTC v. MII Investment Corp.			●		●		●				●				●	
FTC v. Mini Snacks, Inc.	●				●		●					100,000			●	
FTC v. Mini-TV USA, Inc.	●				●		●					0			●	
FTC v. National Consulting Group, Inc.	●				●		●					90,000			●	
U.S. v. Robert M. Oliver (U.S. Consumer Protection Agency)	●				●		●					0		●		
FTC v. O'Rourke (Andrisani Family)	●				●		●					6,248,414				Ban,bond
FTC v. Panoramic Multimedia, Inc.	●				●		●					20,000				Ban
FTC v. Parade of Toys, Inc.	●				●		●					12,072,900				Ban
FTC v. P.M.C.S., Inc. ("Physicians Medical Claims Service")			●		●		●				●				●	
FTC v. Public Telco Corp	●				●		●					2,368,938				Ban
U.S. v. QX International, Inc.	●				●		●					4,000,000 (suspended)				Ban
FTC v. James L. Roche (Allied Snax)	●				●		●					0				Ban
FTC v. Steve Shelton (Electronic Healthcare Products)	●				●		●					180,000				Bond
FTC v. Showcase Distributing, Inc.	●				●		●					0				Bond
FTC v. Silver Shots, Inc., (Second Income)	●				●		●					3,900,000		●		
FTC v. Southeast Necessities, Inc. (Dr.'s Choice)	●				●		●					360,000		●		

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

	Court injunction			Asset freeze			Civil penalty			Monetary redress			Other remedy						
	Yes	No	Pending	Sought		Obtained		Yes	No	Pending	Amount	Yes	No	Pending	Amount	Yes	No	Pending	Other
				Yes	No	Yes	No												
FTC v. Stillwater Vending, Limited			●			●				●								●	
FTC v. William Szabo (Gold Leaf Publishing)	●				●			●					28,172			●			
FTC v. Target Vending Systems	●				●			●					4,000,000			●			
FTC v. Telecard Dispensing Corp	●				●			●					0						Ban,bond
FTC v. TeleCommunications of America, Inc.	●				●					17,500		●				●			
FTC v. Touchnet, Inc.	●				●			●					0						Recission of contracts
FTC v. Transworld Enterprises, Inc.			●		●				●									●	
FTC v. Unitel Systems, Inc. (Universe of Toys)	●				●			●					360,000			●			
FTC v. Raymond Urso	●				●			●					3,950,000						Ban,bond
FTC v. Vendall Marketing Corp	●				●			●					140,000						Ban
FTC v. Vendors Financial Services, Inc.	●				●			●					515,000						Ban
FTC v. Marvin Wolf	●				●			●					31,362,576						Bond
FTC v. Worldwide Marketing and Distributing Co., Inc.	●				●			●					1,400,000						Bond
FTC v. X.Clusiv Vending, Inc.	●				●			●					0			●			
Other cases																			
FTC v. Success Motivation Institute ("SMI/USA")	●				●					350,000		●							Ban
U.S. v. Kenneth Sterling (Southern Coffee Inc.)	●				●			●				●							Criminal indictment

Legend
Y = Yes
N = No
P = Pending

Note: Case information is current as of April 2001.

^aThe Commission may agree to accept no civil penalty or redress where the defendant's financial statement shows an inability to pay. In such instances, the final order permits the Commission to reopen the matter to impose a civil penalty award or redress if the defendant misrepresented his or her financial condition.

^bThe defendants would be required to pay \$2.9 million in the event they are found to have made omissions or misrepresentations about their financial condition.

^cThe defendants would be required to pay \$194,000 in the event they are found to have made omissions or misrepresentations about their financial condition.

^dCompany out of business.

^eThe stipulated judgment and order also provided that Ameritel Payphone would be required to pay \$8 million if they are found to have made omissions or misrepresentations about their financial condition.

Source: FTC.

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Table 6: Information on the Franchise and Business Opportunity Cases (Franchise Rule and/or Section 5 of the FTC Act) Filed by FTC, 1993-2000

Case name and date FTC filed	Description of alleged violations	Investors affected
Rule allegations only^a		
Franchise^b		
U.S. v. Building Inspector of America, Inc.; April 13, 1993	Failure to disclose current officers and background information, litigation history, and bankruptcy history, failure to comply with Rule's earnings claims requirements	80
U.S. v. Coverall North America, Inc.; February 25, 1994	Rule compliance; failure to disclose franchisee information; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	2,591
U.S. v. Direct Distributors, Inc.; July 13, 1993	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	290
U.S. v. Gingiss International, Inc.; May 7, 1993	Making of earnings claims without a reasonable basis	209
U.S. v. Hillary's Gourmet Ice Cream (Hillary's Services, Inc.); April 13, 1994	Rule compliance; failure to provide earnings claims document	Unknown
U.S. v. Jani-King International, Inc.; July 20, 1995	Failure to disclose litigation history, and names, addresses, and telephone numbers of existing franchisees; failure to provide an earnings claims document	900
Business opportunity		
U.S. v. 21st Century Systems, Inc.; February 2, 2000	Rule compliance; failure to provide disclosure document and comply with Rule's earnings claims requirements	Unknown
U.S. v. Acme Vending Co.; July 10, 1995	Rule compliance; failure to provide an earnings claim document and to comply with Rule's earnings claims requirements	250
FTC v. Ad-Com International, Inc.; March 1, 1996	Rule compliance; failure to provide earnings claims document; violation of FTC's 900 Number Rule	120
U.S. v. All Snax, Inc.; September 27, 1996	Failure to disclose required information, including the business experience of directors and executive officers, litigation, names and addresses of franchisees, and statistical information about franchisees; failure to provide an earnings claim document and to comply with Rule's earnings claims requirements	177
U.S. v. American Coin-Op Services, Inc.; February 7, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. American Vending Group, Inc.; July 10, 1995	Rule compliance; failure to furnish an earnings claims document and to comply with Rule's earnings claims substantiation requirements	100
U.S. v. America's Radio Transmitter, Ltd.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Astratel, Inc.; February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Automatic Merchandising Corp.; February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
FTC v. Bureau 2000 International (Malibu Media); March 1, 1996	Rule compliance; failure to provide earnings claims documents	500
U.S. v. Cigar Factory Outlet, Inc.; February 11, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Cigar Manufacturers Outlet, Inc.; February 11, 2000	Rule compliance; failure to provide earnings claims and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Delta Distributors Co., Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	20

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
U.S. v. Discount Manufacturing, Inc.; February 11, 2000	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Elite Business Designs, Inc.; February 7, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Emily Water & Beverage Co., Inc.; February 7, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Firstlight Entertainment, Inc.; July 11, 1995	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Galaxies, Inc.; February 7, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Global Gumballs, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	1,200
U.S. v. Global Toys Distributors, Inc; July 30, 1997	Rule compliance; failure to provide an earnings claims document	Unknown
U.S. v. Great Pacific Vending Corp.; February 14, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
FTC v. Greenhorse Communications, Inc.; April 20, 1998	Rule compliance; failure to provide an earnings claims document	1
U.S. v Greeting Card Depot, Inc.; February 22, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Health Wave Inc.; July 11, 1995	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. International Champions, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Island Automated Medical Services, Inc.(Diversified Data Services; Med Star USA; Star Funding Group); July 11, 1995	Rule disclosure; failing to provide an earnings claim document and to comply with Rule's earnings claims requirements	1,300
FTC v. J.P. Meyers Company, Inc.; March 4, 1996	Rule disclosure, failure to provide earnings claims document	100
U.S. v. Jumping Java Coffee, Inc.; February 11, 2000	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Kato Makiko (Infinity Corp.); July 21, 1995	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. K. V. Hill (Southeastern Photo Supply, Inc.); February 7, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Life Systems Associates, Inc.; July 10, 1995	Rule compliance; failure to provide an earnings claim document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Li'l Snacks, Inc.; July 10, 1995	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements	17
U.S. v. Douglas C. McGlothlin, (International Cigar Consortium); February 9, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Modern Management Systems, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. National Marketing, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	100
U.S. v. National Tech Systems, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
U.S. v. National Vending Consultants, Inc.; February 7, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Nibblers, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. North American Marketing Systems, Inc.; February 11, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Nu-Idea Technologies, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Old Dominican Tobaccos, Inc.; February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
FTC v. Pioneer Communications of Nevada, Inc.; March 1, 1996	Rule compliance; failure to provide an earnings claims document	100
U.S. v. Pro-Plastic Design & Marketing, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims documents and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Protocol, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	500
U.S. v. PVI, Inc. (Photo Vend Intl); September 1, 1998	Rule compliance; failure to provide earnings claims document	Unknown
U.S. v. Quartercall Communications, Inc.; July 10, 1995	Rule compliance; failure to provide an earnings claim document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Software Concepts, Inc.; April 18, 1995	Rule compliance; failure to provide identifying information about existing franchisees; failure to provide an earnings claims document	300
U.S. v. Summit Communications Inc.; July 11, 1995	Rule compliance; failure to provide identifying information about existing franchisees; failure to provide an earnings claims document	Unknown
U.S. v. Surface Science Corp.; July 17, 1995	Rule compliance; failure to provide identifying information about existing franchisees; failure to provide an earnings claims document	Unknown
U.S. v. Toys Unlimited International, Inc.; July 29, 1997	Rule compliance; failure to provide earnings claims document	100
U.S. v. United Payphones of America, Inc.; February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Vending Communications, Inc.; (Interactive Communications Services, Inc.); February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v. Worldwide Coffee, Inc.; February 11, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
U.S. v World Wide Vending Corp.; February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements	Unknown
Other		
In the Matter of Blenheim Expositions, Inc. (IFA Expo); December 22, 1994	Misrepresentations about results of Gallup Poll on franchisee success	Unknown
U.S. v. Entrepreneur Media, Inc.; December 21, 1994	Rule compliance; failure to provide earnings claims document	Unknown
U.S. v. Shulman Promotions, Inc.(Own Your Own Business Shows); December 21, 1994	Rule compliance; failure to provide earnings claims document	Unknown
Section 5 allegations only		
Franchise		
Business Opportunity		

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. 2Xtreme Performance International (Polk; Usasurance Group, Inc.; Akahi Corp.; AKAHI.COM, CORP.; Afew, Inc.); December 9, 1999	Misrepresentations about potential earnings	50,000
FTC v. AmeraPress, Inc. (Voxcom Sales, LLC; The Home Business Group); February 17, 1998	Misrepresentations about potential earnings	25,000
FTC v. AMP Publications, Inc. (Computer & Web Publications, Inc., Nationwide Financial Publications, Inc.); February 1, 2000	Misrepresentations about potential earnings; availability of work from companies with an established business; availability of refunds	Unknown
FTC v. Ed Boehlke (Advantage Marketing); November 4, 1996	Misrepresentations about potential earnings, availability of jobs	50,000
FTC v. Data Medical Capital, Inc. (Medco); October 14, 1999	Misrepresentations about potential earnings; availability of work	12,000
In re Timothy R. Bean ("DMC Publishing Group"); June 10, 1996	Misrepresentations about potential earnings	Unknown
FTC v. Edward P. Epstein (Electronic Filing Associates; Electronic Filing Academy.); January 12, 1998	Misrepresentations about potential earnings	650
FTC v. Financial Freedom Report, Inc. (FreeCom Communications, Inc.; Elevaa, Inc.; Silent Salesforce, Inc.; American Home Business Association, Inc.; FFR Marketing, Inc.); June 4, 1996	Misrepresentations about earnings potential, testimonials, and references	150,000
FTC v. FutureNet, Inc. (FutureNet Online, Inc.); February 17, 1998	Misrepresentations about earnings potential	40,000
FTC v. Home Professions, Inc. (Nationwide Medical Billing; Telesalescenter.com; Home Professions and ProClaim Software); February 1, 2000	Misrepresentations about potential earnings; nature of software purchased; availability of work; refund policy	10,000
In re Homespun Products; March 17, 1994	Misrepresentations about potential earnings	26,000
FTC v. Innovative Productions; February 10, 2000	Misrepresentations about potential earnings; commissions paid; refund policy	10,000
FTC v. Innovative Telemedia; March 4, 1996	Misrepresentations about potential earnings	600
In re LS Enterprises (Freepromo.com; Enterprise Publications; LRS Publications; Internet Promotions, LLC; Cyberpromoters.com); July 13, 1999	Misrepresentations about potential earnings, no reasonable basis for earnings claims	Unknown
FTC v. Mediworks, Inc.(United Medical Associates; United Legal & Medical Associates; Medipros); February 1, 2000	Misrepresentations about potential earnings; availability of clients; refund policy	30,000
FTC v. Richard C. Neiswonger (Marketing Systems; S&K Group, Inc.; Medical Recovery Service, Inc.); November 13 1996	Misrepresentations about potential earnings; profit sharing; references	1,200
In re New Mexico Custom Designs, Inc.; March 17, 1994	Misrepresentations about potential earnings	40,000

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
In re Nu-Skin International; April 7, 1994	Misrepresentations about potential earnings	Unknown
FTC v. Orion Products Corporation (Natural Choice-USA; Antares Corporation); July 19, 1996	Misrepresentations about potential earnings and references	6,000
In re Russell J. Osborn (The Hairbow Company); March 17, 1994	Misrepresentations about potential earnings	50,000
FTC v. Pase Corp; June 13, 1994	Misrepresentations about potential earnings, level of necessary effort	195,000
FTC v. Para-Link International, Inc. (AAA Family Centers, Inc., The Liberty Group of America, Inc.); October 16, 2000	Misrepresentations about potential earnings, availability of referrals-clients; omissions about unauthorized practice of law, limited passage rate on qualifying tests	Unknown
FTC v. Precision Communications Administrations, Inc.; November 5, 1996	Misrepresentations about potential earnings, support services	50
FTC v. Rapaport Corp. (Holiday Magic; National Information Bureau; Mayfair Gift Company); November 12, 1993	Misrepresentations about potential earnings, demand for products	Unknown
FTC v. Robert Serviss (Excel Communications); June 12, 1996	Misrepresentations about potential earnings	Unknown
FTC v. Star Publishing Group, Inc. (National Consumer Services); February 2, 2000	Misrepresentations about potential earnings; affiliation with U.S. government; refund policy; nature of program	85,000
FTC v. Starr Communications, Inc.; June 12, 1996	Misrepresentations about potential earnings	Unknown
FTC v. Summit Photographix, Inc.; February 19, 1998	Misrepresentations about potential earnings and exclusive territories	3,000
In re William E. Taylor (Sandcastle Creations); March 17, 1994	Misrepresentations about potential earnings	15,000
FTC v. United States Business Bureau, Inc.; July 10, 1995	Misrepresentations about independence and reliability of reports provided to prospective franchisees	40
U.S. v. Visions Group of America, Inc.(Soho Technologies, Inc.); October 18, 2000	Misrepresentations about potential earnings; violations of Cooling Off Rule	Unknown
FTC v. Vaughn Williams, III (Encore Networking Services; Warner Communications Systems & Co); February 1, 2000	Misrepresentations about potential earnings; availability of work; refund policy	Unknown
FTC v. Ronald Way ("Hawthorne Communications"); January 27, 1997	Misrepresentations about false earnings, success, and testimonials	20,000
Rule and section 5 allegations		
Franchise		
FTC v. Car Checkers of America, Inc. (Auto Checkers of America, Inc.); February 8, 1993	Failure to disclose truthful information about existing franchisees; failure to provide earnings claims documents; making inconsistent statements; misrepresentations about references, potential earnings, prior success, advertising expenses, necessary experience, omissions about use of services and licensing requirements	35
FTC v. Car Wash Guys International, Inc. (Wash Guy.Com, Inc.); July 31, 2000	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings; that purchasers would receive a "turn-key" business with initial and ongoing support	Unknown
FTC v. Communitydyne, Inc.; October 4, 1993	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about product reliability and benefits (insurance discounts)	192

**Appendix V: Information on Business
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by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. Independent Travel Agencies of America Association, Inc. (Travel Industry Council); February 14, 1995	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential earnings, access to and support from suppliers, licensing, and benefits	7,000
U.S. v. J.C. Pro Wear, Inc.; March 21, 1994	Rule compliance; failure to provide an earnings claims document and to comply with Rule' s earnings claims requirements; misrepresentations about compliance with FTC requirements	180
FTC v. Richard L. Levinger (Pizza Chef; Senor Salsa's Gourmet Mexican restaurants; Blazers All American Barbeque); May 9, 1994	Failure to disclose financial condition, litigation history, refund policy, franchisee names and addresses and franchisee statistics; failure to provide earnings claims document; failure to make refunds; making contradictory statements; misrepresentations about potential earnings, initial investment, and refund policy	450
FTC v. Majors Medical Supply, Inc.; November 14, 1996	Rule disclosure; failure to provide earnings claims document; Misrepresentations about initial startup costs and earnings	100
FTC v. Minuteman Press International, Inc. (Speedy Sign*** Rama USA); June 4, 1993	Failure to disclose transfer fee; failure to provide an earnings claims document; making inconsistent statements; misrepresentations about profits and earnings projections	1,700
FTC v. Mortgage Service Associates, Inc. (MSA Nationwide Field Services, Inc.; J.D. Raffone Associates, Inc.); July 11, 1995	Failure to disclose litigation history, names and addresses of franchisees and statistical data; failure to provide an earnings claims document; misrepresentations about potential earnings and commissions; making contradictory statements	Unknown
FTC v. Robbins Research International, Inc.; May 6, 1995	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings	50
FTC v. Sage Seminars, Inc.; August 9, 1995	Rule compliance; failure to provide earnings claims document; misrepresentations about investment recovery, potential earnings, and support and assistance	Unknown
U.S. v. Snelling and Snelling; May 12, 1993	Failure to provide earnings claims document; misrepresentations about potential earnings	180
FTC v. Tower Cleaning Systems, Inc.; August 16, 1996	Rule compliance; failure to disclose terminations, reacquisitions, nonrenewals, and cancellations; failure to provide an earnings claims document; failure to return deposits; misrepresentations about potential earnings	900
U.S. v. Tutor Time Child Care Systems, Inc.; July 22, 1996	Failure to disclose litigation, criminal and other background information; misrepresentations about potential earnings, delivery date, and site selection	Unknown
Business opportunity		
FTC v. Advanced Public Communications Corp.; February 7, 2000	Rule compliance; failure to provide an earnings claim document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings; profitable locations; and delivery date	Unknown
FTC v. Allstate Business Consultants Group, Inc.; July 10, 1995	Failure to provide an earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings claims and references	200
FTC v. American Universal Vending Corp.(Universal Vending, Inc.; Universal Payphone Systems, Inc.); February 14, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings and profitability of locations	Unknown
FTC v. Ameritel Payphone Distributors, Inc.; February 10, 2000	Rule compliance; failure to provide earnings claim document and to comply with Rule's earnings claims requirements; Misrepresentations about potential earnings and profitability of locations	900
FTC v. Business Opportunity Center, Inc.; July 10, 1995	Failure to disclose the names and addresses of existing franchisees; failure to provide an earnings claims documents; unsubstantiated earnings claims; misrepresentations about FDA approval or recognition and product efficacy claims	Unknown

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. Carousel of Toys; July 29, 1997	Rule compliance; failure to give an earnings claims document; misrepresentations about potential earnings; omissions about costs	80
FTC v. Comtel Communications Global Network, Inc.; November 4, 1996	Rule compliance; failure to provide earnings claim document; misrepresentations about potential earnings	600
FTC v. Creative Technology International, Inc. (Georgia International Export Co., Inc.; L&S Manufacturing, Inc.; System One Telecom); November 4, 1996	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, references, locators' success, and location replacement policy	30
FTC v. Fresh-O-Matic Corp; February 14, 1996	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential income and site location assistance.	2,000
FTC v. Genesis One Corp. (Bureau One); March 4, 1996	Rule compliance; failure to provide earnings claims document; misrepresentations about potential income	5,900
FTC v. Hart Marketing Enterprises Ltd., Inc. (G.M. and Associates); February 3, 1998	Rule compliance, failure to furnish earnings claims document; misrepresentations about potential earnings; profitable locations; and references	70
FTC v. Hi Tech Mint Systems, Inc.; August 18, 1998	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings; sources of income; success of locators; profitable locations	700
FTC v. iMall, Inc.; April 5, 1999	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings	Unknown
FTC v. Inetintl.com, Inc. (Inet International); March 25, 1998	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings and company references	300
FTC v. Infinity Multimedia, Inc.(Quality Marketing Associates, Inc.); June 24, 1996	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings, recovery of investment, profitability of prior purchasers, references, and locators' success	300
FTC v. International Computer Concepts; August 17, 1994	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings, references, exclusive territories, locations, assistance, training, and ongoing support, and refund policy	135
FTC v. Douglas J. Irvine (D.J.I. Manufacturing; Comtel Data Systems, The Comtel Group); April 12, 1994	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings, references, locators, failure rates, and prior litigation	645
FTC v. Jordan Ashley (Jordan Ashley Galleries; Jordan Ashley Publishing; American Heartbeats; and American Celebrations; Gold Coast Developers, Inc.; and National Vending Systems, LTD., Inc.); November 16, 1993	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings, initial investment, exclusive territories, availability of locations and replacement policy, and references	1,000
FTC v. Joseph Hayes (Retail Sales & Marketing, Inc.; Automated Guest Directories, Inc.); November 4, 1996	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential earnings, nature of business, locations, and assistance	70
FTC v. Licensed Products U.S.A., Inc. (Equipment Wholesalers of America, Inc.; Sports Centers of America, Inc.; American Marketing Systems, Inc.); July 30, 1997	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings and profitable locations	100
FTC v. Thomas Maher (Internet Business Broadcasting); February 19, 1998	Rule compliance, failure to provide an earnings claims document; misrepresentations about potential earnings and refund policy	100

**Appendix V: Information on Business
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Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. Marketing and Vending Concepts; February 15, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings and profitability of locations	Unknown
FTC v. Marquette, Inc.; July 12, 1995	Rule compliance; failure to provide earnings claims document; misrepresentations about earnings potential, company services, references, and exclusive territories that purchasers will receive exclusive territories	600
FTC v. MegaKing, Inc. (Bizz Ad Advertising, Inc.); February 7, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings; profitability of locations	150
U.S. v. Megatrend Telecommunications (Tri-Star Marketing Corp.); November 5, 1993	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about market, locations, ease of replacement, and assistance	300
FTC v. MII Investment Corp.; September 1, 1998	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential sales and earnings	18
FTC v. Mini Snacks, Inc.; April 17, 1995	Rule compliance; failure to provide earnings claims documents; Misrepresentations about investment recovery and earnings, locations, maintenance and repair, locators' success, delivery times	900
FTC v. Mini-TV USA, Inc.; July 25, 1995	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings and locations	100
FTC v. National Consulting Group, Inc.; January 12, 1998	Rule compliance, failure to furnish an earnings claims document; misrepresentations about potential earnings, selling requirements, and assistance	1,000
U.S. v. Robert M. Oliver (U.S. Consumer Protection Agency; Consumer Protection Agency of Bay County); June 8, 1998	Rule compliance; failure to provide an earnings claims document; misrepresenting that the defendants are agencies of the United States or state or local governments	Unknown
FTC v. O'Rourke (Andrisani Family) ^o June 22, 1993	Rule compliance; failure to provide earnings claims document and to comply with Rule's earning claims requirements; misrepresentations about potential earnings, exclusive territories, profitable locations, references, and assistance and training	3,000
FTC v. Panoramic Multimedia, Inc. (Mackie Services, Inc.); July 10, 1995	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential earnings, value of goods sold, and references	300
FTC v. Parade of Toys, Inc.; July 25, 1997	Rule compliance; failure to provide an earnings claims document; misrepresentations about potential earnings; omission of cost information	1,000
FTC v. P.M.C.S., Inc. ("Physicians Medical Claims Service"); November 5, 1996	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, availability of accounts, and assistance	600
FTC v. Public Telco Corp; July 10, 1995	Rule compliance; failure to provide earnings claims document, misrepresentations about potential earnings, references, locations, location replacement policy, cancellation policy, and assistance	300
U.S. v. QX International, Inc.; February 20, 1999	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, references, exclusive territories, locators' success, and advertising assistance	400
FTC v. James L. Roche (Allied Snax); May 21, 1996	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, assistance and training, account generation	100
FTC v. Steve Shelton (Electronic Healthcare Products; National Electronic Healthcare Corp; Medi-Bill Systems); December 17, 1997	Failure to disclose names and addresses of purchasers and purchaser statistics; failure to provide an earnings claims document; misrepresentations about potential earnings	1,200

**Appendix V: Information on Business
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Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. Showcase Distributing, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, references, locators' success, and location costs	400
FTC v. Silver Shots, Inc., (Second Income); July 11, 1995	Rule compliance; failure to provide earnings claims documents; misrepresentations about potential earnings, locators' success, availability of locations, and compliance with applicable state laws	424
FTC v. Southeast Necessities, Inc. (Dr.'s Choice; Allstate Locating, Inc.); September 7, 1994	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential earnings, references, locations and replacement policy	300
FTC v. Stillwater Vending, Limited (Global Locating Services); August 7, 1997	Rule compliance; misrepresentations about potential earnings, references, profitable locations, quality of vending machines, delivery dates, initial inventory	Unknown
FTC v. William Szabo (Gold Leaf Publishing); March 1, 1996	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings	50
FTC v. Target Vending Systems (East West Vending Systems, Inc.); February 8, 2000	Rule compliance; failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings and profitability of locations	Unknown
FTC v. Telecard Dispensing Corp; September 29, 1998	Rule compliance; failure to furnish earnings claims document; misrepresentations about potential earnings, exclusive territories, and profitable locations	3,000
FTC v. TeleCommunications of America, Inc.; July 10, 1995	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, references, locators' success, and start-up costs	400
FTC v. Touchnet, Inc (Touchtone Telecommunications & Advertising, Inc.); February 11, 1998	Rule compliance; failure to provide earnings claims document; misrepresentations concerning potential earnings	500
FTC v. Transworld Enterprises, Inc. (ATM International); February 15, 2000	Rule compliance; failure to provide an earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings, profitable locations, and availability of support	201
FTC v. Unitel Systems, Inc. (Universe of Toys); August 1, 1997	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings and references	180
FTC v. Raymond Urso (Bridgeport & Associates; Prestige Advertising, Inc.; Maria K. Associates; National Better Business Bureau); August 18, 1997	Rule compliance; failure to furnish an earnings claims document; misrepresentations about potential earnings, references, and profitable locations	500
FTC v. Vendall Marketing Corp. (Vendall Manufacturing; Vendall Corp.); January 10, 1994	Rule compliance, failure to provide earnings claims document and to comply with Rule's earnings claims requirements; misrepresentations about potential earnings, locations, locators' services, maintenance and repair; delivery, complaint resolution history	3,500
FTC v. Vendors Financial Services, Inc. (T&H Management, Inc.); August 24, 1998	Rule compliance, failure to provide an earnings claims document; misrepresentations about potential earnings, exclusive territories, references, and profitable locations	300
FTC v. Marvin Wolf ^d March 3, 1994	Rule compliance; failure to provide earnings claims document; misrepresentations about potential earnings, exclusive territories, locations, references, and assistance	3,189

**Appendix V: Information on Business
Opportunity and Franchise Court Cases Filed
by FTC During 1993-2000**

Case name and date FTC filed	Description of alleged violations	Investors affected
FTC v. Worldwide Marketing and Distributing Co., Inc.(Tital Management Corp.; Mammoth Holding Co.; Remote Assembly Corp.; Popcorn Supply Co.; Popcorn Flavors, Int'l; Royal Imperial Ltd., Int'l; Popcorn Distributors, Inc.; Maize Vending Associates); July 10, 1995	Rule compliance; failure to furnish an earnings claims document; misrepresentations about potential earnings; maintenance requirements; and references	650
FTC v. X.Clusiv Vending, Inc.; August 7, 1995	Rule compliance; failure to provide earnings claims document; Misrepresentations about potential earnings, locators' success, discount prices, and exclusive territories	350
Other cases		
FTC v. Success Motivation Institute ("SMI/USA"); October 22, 1993	Violations of previous court order; unsubstantiated earnings claims; failure to disclose turnover rate information.	2,500
U.S. v. Kenneth Sterling (Southern Coffee Inc.); May 18, 1999	Criminal contempt for violating court order prohibition Rule violations and section 5	Unknown

Note: Case information is current as of April 2001.

^aRule violation cases, which seek civil penalties, are generally filed by the Department of Justice on behalf of FTC.

^bDuring 1998-2000, eight Franchise Rule matters were referred to NFC's Alternative Rule Enforcement Program.

^cC&B Products, Inc.; Gourmet Mini Cookies, Inc.; Intimate Apparel; Lipo Reduction Systems, Inc.(formerly Career Dynamics, Inc.); Lockheart Advertising Agency, Inc.; Rainbow Polishing & Appearance Systems, Inc.; Security Products International, Inc.; A & Q Enterprises, Inc.; C & A Industries, Inc.; C & C Advertising, Inc.; J.C.P., Inc.; Karma's Skin Systems, Inc.; Rain Forest Natural Products, Inc.; American Beverage Corporate; Broscorp, Inc.; Grocery Shopping Association of America, Inc.; Interstate Locators, Inc.; Yardpro, Inc.

^dAction Games Technologies, Inc.; Allstates Leasing, Inc.; American Manufacturing Industries, Inc.; Burger Quik, Inc.; Coin Management, Inc.; Corporate Travel Services, Inc.; DBJ I, Inc.; DLW Distributors; Entertainment Enterprises, Inc.; GBC Enterprises, Inc.; E-Z Vend; Kick Start; Multi Vend; Research America; Snack Vending USA; Sun & Fun Vacation Club; Vend-A-Nutt; Honor America, Inc.; Indoor Amusement Games, Inc.; Jameson & Adams, Inc.; Magnum Vending Corp.; North American Pharmaceutical, Inc.; TV Ventures; Northwest Marketing, Inc.; Cascade Vending and/or Quick Vend; Novelty Plush, Inc.; Debbie's Amusements; Prizes Unlimited; Olympic Entertainment, Inc.; Olympic Games International; Omni Investors Group, Inc.; Omni Marketing Group, Inc.; Outreach America, Inc.; Juice De Lite; Raks-4-Kids; Pizza King, Inc.; Family Entertainment; Pizza Royale, Inc.; Project America, Inc.; R&J Vending, Inc.; S&M Manufacturing Corporation; S&M Industries, Inc.; Treat Vendor, Inc.; U-Vend, Inc.; Boca Amusements; United Capital, Inc.

Source: FTC.

Appendix VI: FTC's Efforts to Communicate and Coordinate Business Opportunity and Franchise Enforcement Activities

FTC communicates information and coordinates enforcement activities with state business opportunity and franchise regulatory officials through various means, including annual law enforcement summits, joint FTC-state enforcement actions, monthly telephone conference calls, and the Consumer Sentinel complaint database. FTC staff commented that by sharing information and resources, joint efforts effectively target issues that have direct impact on consumers. To gather information on the effectiveness of FTC's efforts to communicate information and coordinate enforcement activities with state regulatory officials from calendar year 1998 through 2000, we contacted the eight business opportunity and nine franchise regulatory officials in the nine states that have both business opportunity and franchise disclosure laws to obtain their views on the effectiveness of FTC's efforts to communicate and coordinate enforcement activities in their states, and we received responses from all of them.¹ The survey results showed that state business opportunity regulatory officials tended to view FTC's communication and coordination efforts as being more effective than did the state franchise regulatory officials.

FTC's Communication and Coordination Efforts

FTC communicates information and coordinates enforcement activities with state business opportunity and franchise regulatory officials through various means. The sections that follow provide information on the means of communication FTC has used in recent years.

Annual Law Enforcement Summits

Since 1995, FTC and NASAA have jointly sponsored annual franchise and business opportunity law enforcement summits. According to FTC staff, the summits provide a vehicle for FTC and state business opportunity and franchise regulatory officials to communicate and coordinate law enforcement priorities for the coming year. Summit participants have included representatives from state agencies responsible for business opportunity and franchise issues, including Offices of State Securities Commissioners, Attorneys General, and other law enforcement agencies. These summits cover such issues as improving FTC-state working relationships, trends in the business opportunity and franchising industries, and planning joint FTC-state enforcement actions.

¹Only eight state business opportunity regulatory officials were contacted because Virginia has not designated an agency to enforce its business opportunity law.

Appendix VI: FTC’s Efforts to Communicate and Coordinate Business Opportunity and Franchise Enforcement Activities

Joint FTC-State Law Enforcement Actions

FTC periodically conducts joint investigations and sweeps with state and federal law enforcement officials. From 1995 through 2000, FTC conducted five joint sweeps that included participants from the Department of Justice, as well as selected state agencies responsible for business opportunity and franchise enforcement issues. These five sweeps resulted in 45 FTC cases filed, 44 DOJ cases filed, and 163 state enforcement actions.² All five sweeps involved business opportunities. According to FTC staff, the types of problems found with franchises—such as the lack of proper disclosure—do not generally lend themselves to sweeps. Table 7 provides further information on the five FTC-state coordinated sweeps conducted from 1995 through 2000.

Table 7: Information on FTC-State Coordinated Sweeps, 1995-2000

Sweep	Industry targeted	Participants involved	Actions taken
Project “Telesweep” (1995)	Business opportunities (e.g., vending machines, amusement games, pay telephones, and display racks)	FTC, DOJ, and 20 state agencies	Court cases filed by FTC 11 DOJ 21 State agencies 59
Operation “Missed Fortune” (1996)	Business opportunities, work-at-home schemes, and pyramid schemes	FTC and 25 state agencies	Court cases filed by FTC 11 State agencies ^a 23
Project “Trade Name Games” (1997)	Business opportunities (e.g., in-store carousel racks)	FTC and 8 state agencies	Court cases filed by FTC 6 State agencies 12
Operation “Vend Up Broke” (1998)	Business opportunities (e.g., vending machines)	FTC, DOJ, and 10 state agencies	FTC 4 DOJ 1 State agencies ^a 36
Project “Biz-illion\$” (1999-2000)	Business opportunities (e.g., vending machines), work-at-home schemes, and pyramid schemes	FTC, DOJ, and 29 state agencies	Court cases filed by FTC 13 DOJ 22 State agencies ^a 33

^aMay include court and administrative actions, e.g., requests for injunctions filed in state courts, investigative subpoenas, cease and desist orders, violations of anti-fraud statutes, failure to file disclosure documents, and failure to register a business opportunity venture.

Source: GAO analysis of FTC press releases on sweeps.

Monthly Telephone Conference Calls

Since 1995, FTC has held monthly telephone conference calls with various state business opportunity and franchise regulatory officials to exchange information and discuss ongoing and prospective enforcement actions.

²State enforcement actions may include court and administrative actions.

FTC staff said that 25 to 30 state agencies usually participate in these conference calls. According to FTC staff, the conference calls focus on improper patterns or practices that the participants have uncovered in performing their enforcement functions. The FTC staff added that since most of the complaints and problems that are brought to the attention of the participants involve business opportunities, the conference calls generally do not involve discussions of franchise enforcement issues.

**On-line Access to FTC
Complaint and
Enforcement Data**

Consumer Sentinel is an on-line central repository for consumer complaints relating to consumer and Internet fraud and identity theft, maintained by FTC's Division of Planning and Information. According to FTC staff, Consumer Sentinel is also a vehicle for sharing information with state law enforcement agencies concerning business opportunity and franchise complaints, investigations, and court cases. More than 250 federal, state, local, and international law enforcement agencies have direct online access to Consumer Sentinel data; however, FTC cannot easily determine the extent to which state agencies actually use this resource.

FTC staff commented that Consumer Sentinel capabilities enhance their ability to promote communication and joint enforcement actions with agencies. For example, Consumer Sentinel users can be alerted if other users have information on a company or type of scheme by submitting an on-line "alert" form. Consumer Sentinel also allows users to receive periodic updates, based on their specific search criteria, and also obtain contact information on any Consumer Sentinel law enforcement member.

**Franchise and Business
Opportunity Project Group**

In addition to its own sponsored events, FTC participates in NASAA's Franchise and Business Opportunity Project Group throughout the year. The project group focuses on improving franchise disclosure requirements and improving communication among states and FTC concerning franchise and business opportunity enforcement actions. The project group consists of FTC's Franchise Rule Coordinator and state regulatory officials who serve on a rotating basis.³ The project group provides an electronic mail service for NASAA members to exchange information on complaints and investigation matters. The chair of the project group stated that by working together with FTC, member states have the opportunity to participate in more (and more creative) actions than the states would

³The 2000 Project Group consisted of state officials from Maryland, New York, Rhode Island, Virginia, and Washington.

normally have the resources to undertake. The chair added that FTC's involvement in the project group has been an important tool for discussing franchise issues since FTC's monthly telephone calls primarily focus on business opportunity issues.

State Regulatory Officials' Views on the Effectiveness of FTC's Efforts

Our survey of business opportunity and franchise regulatory officials in those states that have both franchise and business opportunity disclosure laws showed that state business opportunity regulatory officials tended to view FTC's communication and coordination efforts as being more effective than did the state franchise regulatory officials.

State Business Opportunity Officials' Views

State business opportunity officials generally believed that FTC's communication and coordination efforts were effective. The state officials found the joint FTC-state enforcement actions (e.g., sweeps and investigations) and informal communication (e.g., electronic mail, telephone calls, and faxes) to be the most effective. Table 8 provides further information on the eight state business opportunity officials' views of the effectiveness of FTC's various communication and coordination efforts from 1998 through 2000.

Table 8: State Business Opportunity Officials' Views of the Effectiveness of FTC's Efforts to Communicate and Coordinate Enforcement Activities During 1998-2000

FTC efforts	Very effective	Somewhat effective	Not effective	Not applicable ^a
Overall view of the effectiveness of FTC's efforts to communicate and coordinate enforcement activities	5	3	0	0
Annual FTC-NASAA law enforcement summits	4	2	0	2
FTC regional meetings, working groups, and other meetings	1	1	0	6
Monthly or periodic FTC conference calls	4	3	0	1
Joint FTC-state enforcement actions (e.g., sweeps and investigations)	6	2	0	0
Online access to FTC complaint and enforcement data	3	3	0	2
Informal communication (e.g., electronic mail, telephone calls, and faxes)	6	2	0	0

^aThe state agency did not participate in the event or use the FTC database.

Source: GAO analysis of comments provided by eight state business opportunity regulatory officials.

State Franchise Officials' Views

State franchise regulatory officials generally believed that FTC's communication and coordination efforts were less effective than their business opportunity counterparts. The difference in opinion may be due, at least in part, to the fact that many of the state franchise officials had not participated in many of the events or used FTC's database. The state officials found the annual law enforcement summits to be the most effective communication and coordination activity used by FTC. Table 9 provides further information on the nine state franchise officials' views of the effectiveness of FTC's communication and coordination efforts from 1998 through 2000.

Table 9: State Franchise Officials' Views of the Effectiveness of FTC's Efforts to Communicate and Coordinate Enforcement Activities During 1998-2000

FTC efforts	Very effective	Somewhat effective	Not effective	Not applicable ^a
Overall view of the effectiveness of FTC's efforts to communicate and coordinate enforcement activities	0	5	4	0
Annual FTC-NASAA law enforcement summits	1	5	1	2
FTC regional meetings, working groups, and other meetings	0	1	1	7
Monthly or periodic FTC conference calls	0	2	1	6
Joint FTC-state enforcement actions (e.g., sweeps and investigations)	0	3	1	5
Online access to FTC complaint and enforcement data	1	1	0	7
Informal communication (e.g., electronic mail, telephone calls, and faxes)	2	3	0	4

^aThe state agency did not participate in the event or use the FTC database.

Source: GAO analysis of comments provided by nine state franchise regulatory officials.

Appendix VII: Views of Officials From Franchise Trade Associations on the Need for Federal Franchise Legislation

The franchise trade associations we contacted provided divergent views on the need for federal legislation on franchise relationships. Proponents of federal legislation maintain, among other things, that legislation is needed to address the franchisees' relative lack of bargaining power in the franchise relationship and contend that current federal and state pre-sale disclosure laws and state franchise relationship laws are ineffective in addressing franchise relationship issues. Opponents, however, maintain that franchise relationships are matters of contract law that should be addressed at the state level and contend that pre-sale disclosure is the best way to protect prospective franchisees. The following sections provide more specific information on the views of the American Franchise Association (AFA)—a leading proponent of federal franchise relationship legislation—and the International Franchise Association (IFA)—a leading opponent of such legislation.

AFA Views on Why Federal Franchise Legislation Is Needed

According to AFA officials, the gross disparity in financial strength and legal power between franchisors and franchisees has led to increasingly onerous contracts and problems in franchise relationships. The officials explained that it is their view that franchise contracts are increasingly heavy-handed and oppressive to the degree that they would not be seen as commercially reasonable in any other context. The officials believe that these contracts are, in fact, creating a barrier to small business entrepreneurs entering retail businesses.

AFA officials told us that the biggest problem with franchise contracts is that franchisors reserve to themselves absolute decision-making power over a wide variety of matters during the entire term of the contract. The officials explained that a prospective franchisee may do his or her due diligence, investigate the system, talk to franchisees, and be comfortable in signing the current franchise agreement. The officials noted, however, that most franchise agreements allow the franchisor to materially and unilaterally make changes to the franchise relationship, which can significantly alter the economic conditions for franchisees. They stated that these wholesale changes are made during the term of the franchise agreement through the prevalent use of operations manuals that franchisors reserve the right to amend at any time. The officials added that even more extensive changes are made when the agreement is up for renewal or when the franchise business is being sold.

According to AFA officials, common examples of contract provisions that give rise to such changes are the franchisor's

- reserving the right to increase advertising or royalty fees or impose assessments;
- ability to change the operating policy manual, which can encompass fundamental financial and capital requirements and with which the franchise agreement obligates the franchisee to comply;
- ability to place additional locations in close proximity to an existing franchisee (encroachment);
- ability to distribute products and services through alternative modes of distribution (e.g., direct-shipping of products through catalogues, the Internet, and alternate retailers) and/or another brand name;
- reserving the right to be the sole supplier of goods and services used or sold from the franchisee's business, often charging above-market prices to their captive franchisees; and
- option to purchase the business when the franchise agreement has expired or is terminated with the provision that the sale price will not be fair market value, but the depreciated value of assets or other such formulas that wholly deny the franchisee the ability to enjoy the fruits or his/her labor.

AFA officials told us that, while these types of unilateral actions may increase a franchisor's overall revenues, they can significantly impact a franchisee's profitability and the value of the business. The officials added that some of the unilateral changes to franchise relationships involve issues that no franchisee could have anticipated upon the initial signing of the contract. In other words, they said that a franchisee may be bound by changes to the relationship that, had they known, they never would have signed the agreement in the first place. AFA officials also told us that some franchise agreements do not allow for contract renewal at all, and if they do, provide that it will be "according to the then current and materially different terms and conditions." They added that there is nothing in these provisions that say these terms and conditions will be "commercially reasonable" or any other provision for basic fairness. Further, the officials noted that the "patchwork quilt" of federal and state pre-sale disclosure laws and state franchise relationship laws does not effectively address problems in the franchise relationship. According to AFA officials, since FTC staff maintain that FTC generally lacks the authority to intervene in private franchise contracts and related relationship issues, AFA members feel they have no alternative but to seek a legislative solution to their problems.

AFA believes that federal franchise relationship legislation is needed to address what they consider to be the franchisors' pervasive misuse of power and to alleviate the inconsistent treatment of franchisees within the states. As such, AFA was a primary proponent of the Small Business

Franchise Act of 1999 (H.R. 3308), as introduced in the 106th Congress, which (1) proposed minimum standards of conduct in franchise business relationships¹ and (2) addressed other aspects of the franchise relationship, including contract renewals, terminations, and transfers; the location of new franchises in relation to existing franchises; the purchase of goods or services from sources other than the franchisor; and franchisees' rights to associate with other franchisees. The bill also provided franchisees with the right to file private civil lawsuits for violations of the act. AFA officials maintain that even if most or many franchisors do not abuse their position and power, effective federal standards are still needed to discourage franchise abuses.

IFA Views on Why Federal Franchise Legislation Is Not Needed

According to IFA officials, franchising works because entrepreneurs benefit from the flexibility to structure franchise relationships in the manner that works best for their product, service, or industry. The officials noted that franchise agreements must reserve to the franchisor effective rights to impose discipline on the network in order to (1) ensure a uniform look and quality for the product or service offered by the franchise, (2) maintain system standards for the benefit and value of both the franchisor and the great majority of its franchisees who voluntarily comply with such standards, and (3) protect the consumer from unsafe or otherwise substandard outlets.

IFA officials also told us that franchisor-imposed changes to the franchise relationship are in the nature of fine-tuning—such as adding a new menu item, initiating a new safety procedure, upgrading software, and the like—and do not affect the terms and conditions of the franchise agreement. In short, IFA officials said that while franchisors reserve decision-making power over a wide variety of matters during the course of the franchise relationship, that control is what creates value in the form of a uniform brand, market penetration, and customer loyalty—reasons why franchisees invest in the first place. The officials added that the franchisor's control over network operations is addressed in the disclosure document that is provided to prospective franchisees before they enter into the franchise relationship.

IFA officials told us that current pre-sale disclosure requirements strike the right balance between legitimate consumer protection and

¹Minimum standards of conduct included in the proposed legislation consisted of a duty of good faith, a duty of due care (or competency), and a fiduciary duty on the part of the franchisor with respect to accounting and advertising programs.

overregulation. The officials noted that pre-sale disclosure laws are the most effective means by which to ensure productive and successful franchise relationships. In particular, they believe that disclosures of (1) current and past litigation involving the franchise system and (2) the names and addresses of both current franchisees, as well as those franchisees who have left the system within the past fiscal year, should provide any franchise investor with the resources necessary to ascertain the prevalence of relationship issues in a particular franchise system.

According to IFA officials, three primary concerns have guided members of the association in their decision to oppose federal and state franchise relationship legislation.

- Many duties and obligations contained in franchise relationship legislative proposals are undefined or ambiguous, which would create confusion and uncertainty in franchise relationships and touch off an unprecedented increase in litigation.² This would result in increased operating costs for franchise companies, the majority of which are small businesses that are not in a position to absorb these additional costs.
- Franchising is a source of economic opportunity and empowerment for women, minorities, and future generations of small-business owners. Franchise relationship legislation would discourage franchise growth and, as a result, have a disproportionate impact on these groups.
- It is virtually impossible to craft a “one size fits all” solution to the wide variety of franchise business practices involving companies operating in about 75 different industries. There is no common “relationship” legislation that can practically and predictably apply to these many different industries, operating in many different geographical markets, and at many different levels of system maturity and market penetration.

Regarding the latter, IFA officials explained that because franchising is not an industry—but rather a method of distributing goods and services that is utilized by about 75 different industries—“one size fits all” legislation such as the Small Business Franchise Act of 1999 (H.R. 3308) and similar franchise relationship proposals are impractical and unworkable. The officials noted that such legislation contemplates that all franchised concepts and all franchise relationships can be regulated with a uniform law. The officials added that this view of franchising is flawed because it fails to recognize the fundamental difference between business format

²According to IFA officials, undefined or ambiguous duties and obligations include “unreasonable proximity,” “skill or knowledge,” “material provision,” “due care,” and “legitimate business reason.”

franchising—a concept that is employed by many heterogeneous businesses operating in a wide variety of dissimilar industries—and other forms of product distribution that are utilized by a very few homogeneous businesses operating in a single industry (such as automobile dealers or petroleum marketers). For these reasons, among others, IFA officials believe that it is inappropriate to make comparisons between proposals to regulate business format franchising and laws that govern manufacturing and distribution relationships such as the Automobile Dealers Day in Court Act or the Petroleum Marketing Practices Act. The officials added that there are virtually no barriers to entry to creating a franchised business, and with very few exceptions, business format franchises do not manufacture products for redistribution by their franchisees. As a result, the franchise relationship is very different from manufacturer-dealer or distributor relationships.

IFA officials told us that federal legislative proposals, such as the Small Business Franchise Act of 1999, cede too much power to the government and the courts to alter the intent of the parties that have entered into a contract. The officials added that allowing interference in the contract process would severely impair the interpretation of those agreements. The officials also told us that the “minimum standards of fair conduct” contained in legislative proposals would materially alter provisions of existing state law and reverse numerous decisions establishing common law rights and obligations. IFA officials believe that to the extent there are differences between parties in franchising, those differences should be resolved through expanded forms of self-regulation, such as the IFA Ombudsman program, the National Franchise Mediation Program, the IFA’s Franchise Basics and Franchise Sales Compliance educational programs, and the IFA Code of Ethics and enforcement mechanism.

Appendix VIII: Comments From the Federal Trade Commission



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Chairman

July 16, 2001

Richard M. Stana
Director, Justice Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Stana:

The Federal Trade Commission appreciates the opportunity to review and comment on the draft report entitled: *Federal Trade Commission: Enforcement of the Franchise Rule* (GAO-01-776) (Report), submitted by the General Accounting Office on June 29, 2001. The Report discusses various aspects of the Commission's enforcement of its Franchise Rule, 16 C.F.R. Part 436.

Since last August we have worked cooperatively with GAO by providing information about the FTC's Franchise Rule program. The Report correctly recognized that the FTC shifted the focus of its law enforcement efforts in this program from franchises to business opportunities in response to increased complaints and evidence of consumer injury caused by business opportunities. It notes that the FTC has worked with a number of states and other agencies to conduct law enforcement sweeps of business opportunities. The Report also notes that the FTC may not have jurisdiction over every franchisor-franchisee disagreement. In addition, based on the comments we received from GAO, we have revised our procedures to document the reasons for closing franchise and business opportunity investigations that result in no further legal action. We appreciate GAO bringing this issue to our attention. Finally, the Report recognizes that the purpose of the Commission's Franchise Rule is to provide adequate pre-sale disclosures to potential franchisees.

The Commission has a rulemaking proceeding underway to review the Franchise Rule. Accordingly, we cannot, at this time, comment on any substantive aspects of the Rule and its implementation. See 64 FR 57294 (Oct. 22, 1999). We look forward to working with GAO staff on other topics.

By direction of the Commission.

Timothy J. Matis
Chairman

Appendix IX: Comments From the Small Business Administration



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

July 16, 2001

Mr. John Mortin
Assistant Director, Justice Issues
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Mortin:


Thank you for allowing the U.S. Small Business Administration (SBA) to comment on the draft report, "Federal Trade Commission: Enforcement of the Franchise Rule (GAO-01-776)."

As you know, SBA has a longstanding record of assisting franchisees. Through our business loan programs, SBA has provided financial assistance to franchisees for many years. For example, in FY 2000, SBA guaranteed 3,159 7(a) franchise loans for \$1,037,338,286. In 1998, SBA established a Franchise Registry to facilitate the processing of such assistance. SBA also offers technical assistance and business counseling to franchisees both directly and through its various resource partners.

In addition, SBA's Office of Advocacy has conducted studies on franchising activity. On pages 28 and 29 of this report, the Office of Advocacy is mentioned as being able to conduct a new franchising study if additional research funds were appropriated for this purpose. However, the franchise data necessary to support such a study does not presently exist and would need to be created before a study could be conducted. Existing franchise data is either dated or limited in scope. The Office of Advocacy has used its limited resources in the past, and will in the future, to research discreet franchise issues.

If you have any questions or wish to further pursue this area, please contact Louise Wilson, at (202) 205-7101.

Sincerely,


John Whitmore
Acting Administrator



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