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Written Statement for Hearing, “Small Business Franchising: An Overview of the Industry, SBA’s Role, and Legislative Proposals,” March 16, 2022, U.S. Senate Committee on Small Business and Entrepreneurship

Chairman Cardin, Ranking Member Paul, and distinguished members of the Committee, thank you for inviting me to testify at this hearing. Franchising has been the focus of most of my research as a professor of business law for 34 years. My vita and short bio provide more information about my background as an attorney and educator, including – of greatest relevance – my work related to U.S. and international franchise law. Besides writing several dozen law journal articles and some book chapters on a variety of franchise law topics, my work in franchise law has extended to occasional stints as an expert, to membership in the American Bar Association’s Forum on Franchising and in a multidisciplinary academic organization, the International Society of Franchising, and to occasional teaching of franchise and distribution law at universities both here and abroad.

I very much appreciate the opportunity to “testify” some with this writing, as I know the Committee’s time is quite valuable and oral testimony is necessarily limited in both time and scope. Even for this theoretically unlimited written statement, I will try to overcome the fact that I am “doubly blessed” (both a lawyer *and* a professor), and endeavor to keep things relatively brief.

An Overview of the Franchising Business Model

The franchise business model is a widely used arrangement that permits businesses to expand quickly and inexpensively into various markets both domestically and internationally.¹ For example, in the United States, franchised businesses account for roughly 40% of all retail sales,² with over 780,000 operating franchised units directly employing about 8.3 million people

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¹ The American concept of franchising is expanding rapidly throughout the world, with an increasing share of international commerce. See Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191, 196–97 n.23 (2010) (detailing the numerous statistics indicating the phenomenal growth of franchising worldwide, both throughout Europe and such diverse and important national economies as those of Australia, Brazil, China, India, and Japan). That growth has expanded to the developing world. It is believed that this growth, in various markets worldwide, both mature and developing, is driven both by the attraction of franchising for domestic brands and also for foreign-based brands seeking to expand outside of their saturated “home” territories.

² This is an estimate long touted by various sources. At the very least, franchising’s share of the total retail economy, since at least the year 2001, has been one-third. ROGER D. BLAIR & FRANCINE LAFONTAINE, *THE ECONOMICS OF FRANCHISING* 26-27 n.28 (2005); Emerson, *supra* note 1, at 196-197. For earlier statistics, see U.S. DEP’T OF COMMERCE MINORITY BUS. DEV. AGENCY, *FRANCHISE OPPORTUNITIES HANDBOOK* vii (1995); Robert W. Emerson, *Franchising Covenants Against Competition*, 80 IOWA L. REV. 1049, 1050-51 n.4

and indirectly accounting for close to twice that many jobs.³ Furthermore, these franchised businesses create an economic output of \$1.6 trillion dollars and account for 5.8% of the U.S. GDP.⁴

Franchising provides a method for businesses to expand quickly and inexpensively into various markets. A business [the franchisor] accomplishes this task by licensing its name and trademark as well as selling its goods or its particular business format to independent franchisees in exchange for payment of a royalty. The franchisee also benefits from such an arrangement. By entering into a franchising relationship, a franchisee can effectively run its own business without having to invest substantial time and money trying to perfect a new good or business method. That is, franchisees benefit from their franchisor's knowledge, experience, research, development, capital, and reputation.⁵

Essentially, franchising allows the franchisee to effectively run its own business without having to invest substantial time and money trying to perfect a new product or business model.⁶ Typically, franchisees own and operate a business "in accordance with conditions and procedures prescribed by the franchisor, who in turn advertises, advises, perhaps lends capital, and/or otherwise assists the franchisees. The franchise network generally consists of a system-wide marketing plan and/or a 'community of interest' between the franchisor and its franchisees."⁷

As with many things in life, the experience and perspective of the parties to a franchise contract can vary tremendously; some franchisees remain quite happy or at least content with their investment decision, while others in time are filled with regret. Of course, in business relationships (and a franchise is, in essence, a business *relationship*), the parties' level of satisfaction, or not, is likely to have a strong correlation to the profitability, or not, of their dealings.

(1995) (citing numerous sources concerning the rapid growth of franchising in both the 1980s and the early 1990s).

³ David L. Steinberg, *Franchise Industry Facts*, <https://franchiselawyer.com/franchise-legal-resources/franchise-industry-facts> (citing INTERNATIONAL FRANCHISE ASSOCIATION).

⁴ *A Look at How Franchises Impact the Economy*, FRANCHISE DIRECT (January 28, 2020), <https://www.franchisedirect.com/information/a-look-at-how-franchises-impact-the-economy>.

⁵ Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 641-642 (2013). See generally Int'l Franchise Ass'n, *What Are the Advantages and Disadvantages of Owning a Franchise?*, FRANCHISE.ORG, <https://www.franchise.org/faqs/basics/what-are-the-advantages-and-disadvantages> (last visited March 14, 2022); BLAIR & LAFONTAINE, *supra* note 2, at 9-13; ELIZABETH CRAWFORD SPENCER, *THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY*, 7-9 (2010). A study of 100 randomly selected fast food franchises found the median initial franchising fee to be \$25,000. In the same study, the median royalty payment was 5% of revenue. Emerson, *supra* note 5, at 689.

⁶ Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193, 203 (2012/2013).

⁷ ROBERT W. EMERSON, *BUSINESS LAW 348* (Barron's Educ. Series, Inc., 6th ed. 2015).

Although many commentators believe there is a higher survival rate for franchised businesses than for new, independent businesses, there are, compared with completely independent operations, many additional costs associated with franchising, such as initial fees and continuing charges (royalties). Thus, a bottom-line question for a prospective franchisee is this: ‘What can the franchisor do for me that I cannot do for myself?’ Only if the services, trademarks, goods, and other items obtained from the franchisor cannot be lawfully produced on one’s own, and only if they are truly of long-term economic worth, should one pay the franchisor to join its network as a franchisee.⁸

The right match of franchisor and franchisee can produce a long, mutually beneficial arrangement for both parties: franchisors receive the franchisees’ money and efforts, spread some of the risk of loss to the franchisees, and obtain – at lower cost and perhaps higher efficiency – an expanding sales or services network, while franchisees “can start a business despite limited capital and experience” as well as benefit from the franchisor’s business expertise and the goodwill of the franchise product or trade name (the brand).⁹ Some other advantages for the franchisee are equally well-known:

‘Owning a franchise allows you to go into business for yourself, but not by yourself.’ A franchise provides franchisees (an individual owner/operator) with a certain level of independence where they can operate their business . . . [and perhaps benefit from] a pre-sold customer base which would ordinarily takes years to establish. A franchise increases your chances of business success because you are associating with proven products and methods[, perhaps attracting customers due to a system-wide, contractually-mandated] level of quality and consistency.¹⁰

A prospective franchisee should attend to the sometimes severe, often numerous disadvantages of franchising that may outweigh the benefits. Due diligence and the counsel of professionals (lawyers, accountants, etc.) are certainly highly recommended,¹¹ something that

⁸ *Id.*

⁹ *Id.* at 348-349. The franchisor’s “business expertise” may constitute “support” for the franchisee: pre-opening (e.g., site selection, design, construction, finance, and training) and ongoing (e.g., training, advertising, operating procedures, assistance and supervision, increased spending power, and potential bulk purchasing). INT’L FRANCHISE ASS’N, WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF OWNING A FRANCHISE? <https://www.franchise.org/faqs/basics/what-are-the-advantages-and-disadvantages> (last visited March 14, 2022).

¹⁰ INT’L FRANCHISE ASS’N, *supra* note 9.

¹¹ Robert W. Emerson, *Fortune Favors the Franchisor: Survey and Analysis of the Franchisee’s Decision Whether to Hire Counsel*, 51 SAN DIEGO L. REV. 709, 723–24 (2014) (citing franchisor lawyers and other franchise law commentators to note the likelihood that unrepresented franchisees will not understand their complex franchise agreements). *See also* Robert W. Emerson, *Transparency in Franchising*, 2021 COLUM. BUS. L. REV. 172, 219-223 (2021) (discussing how potential franchisees sometimes opt for franchise law advice and related guidance from online services, particularly LegalZoom, including the charges for these services as well as the problems with and litigation against LegalZoom and other online providers of documents and legal assistance).

franchisors should encourage, perhaps via a new requirement in the FTC Rule.¹² Of course, retaining a lawyer is not required. And – in fact- many prospective franchisees do not obtain the professional advice that they need.¹³

The disadvantages of franchising need to be as well-understood as the advantages. These actual or at least potential serious problems with franchising should be contemplated by franchise applicants, who should receive the advice of counsel, hopefully well before a franchise applicant might be bound to a “bargain”:

The franchisee is not completely independent. Franchisees are required to operate their businesses according to the procedures and restrictions set forth by the franchisor in the franchise agreement. These restrictions usually include the products or services which can be offered, pricing and geographic territory. For some people, this is the most serious disadvantage to becoming a franchisee. In addition to the initial franchise fee, franchisees must pay ongoing royalties and advertising fees. Franchisees must

¹² There are certain disclosures or warnings that could be put more starkly, in hopes of really capturing the prospective franchisee’s attention. I recommended such measures in order to counter the tendency of a large percentage of people who, whether actively or passively, refrain from hiring counsel before signing a franchise agreement.

[I]t may be argued that the best method for dealing with uncounseled franchisees, in conformity with a regulatory framework suitable to providing additional protections, is to require more from the franchisor, such as disclosing more information to prospective franchisees about the importance of seeking independent counsel. New disclosures could take the form of an acknowledgement that the franchisee is fully aware of the potential issues that could arise from not seeking counsel in the franchise negotiation process and the signing of the agreement. The acknowledgement need not constitute the waiver of a franchisee’s right to sue the franchisor for misrepresentations or otherwise but should emphasize the need to have lawyers review the documents and thereby negate the current impact of uncounseled franchisees on franchised networks and the courts. The notice would explicitly remind would-be franchisees that what they are about to sign merits the expert guidance of a franchise attorney. For example, the warning could say:

Before agreeing to become a franchisee, you should consult with an experienced franchise lawyer. As a practical matter, including a long-term savings of time and money, your hiring that lawyer at the outset is almost always a ‘must.’

Do not trust in your ability, or the ability of others, to decide whether you need a lawyer’s assistance for something this important. Just as a new but persistent physical ailment should lead you, as a matter of personal health, to do more than just treat it yourself but to see a medical doctor, so you, when buying a franchise, should not ‘go it alone.’ To proceed without a lawyer, you simply do not know enough about this franchise, the legal nature of the franchise documents, and the many relevant laws.

The nature of professional expertise (medicine, law, etc.) is that even an otherwise very smart and experienced individual, if not a professional in that field, needs professional assistance. Also, your lack of training and experience in law likely makes you unable to assess whether and how a legal expert (a franchise lawyer) could help you. So, no matter how smart or experienced you may be generally or even for this particular type of business, you probably cannot accurately weigh the costs of ‘going it alone’ versus paying for legal counsel. Very often in hindsight, a franchisee who failed to hire a lawyer deeply regrets that he or she did not hire a lawyer at the outset.

If properly formulated and distributed, such a warning could operate quite well. Franchisees would not just be better advised; the result would include the beneficial side effects of fairer franchise agreements and reduced litigation.

Emerson, *Fortune Favors the Franchisor*, *supra* note 11, at 769-770.

¹³ See Emerson, *Fortune Favors the Franchisor*, *supra* note 11, at 715 & n.29, 718 (noting that franchisors often recommend that franchisees seek counsel but also that, at closings, counsel represented only 26.07% of franchisees).

be careful to balance restrictions and support provided by the franchisor with their own ability to manage their business. A damaged, system-wide image can result if other franchisees are performing poorly or the franchisor runs into an unforeseen problem. The term (duration) of a franchise agreement is usually limited and the franchisee may have little or no say about the terms of a termination.¹⁴

Indeed, other areas of franchise law likewise may be viewed as, in their effects, imploring franchisors to try to ensure that a little bit of disclosure does not relieve franchisees and their advisors from reading, retaining and reflecting upon what is in a disclosure. For example, as noted in Senator Cortez Masto's April 2021 Report, "seeing a brand listed in the Small Business Administration Franchise Directory, provides a sense of legitimacy, which can lead to undue belief in the viability of the brand."¹⁵ There are, of course, many other matters to consider.

Many Non-Disclosure Reforms Are Possible in Franchising

There are a number of reforms, either legislative or in regulations, that would clarify the franchise law, make it more uniform, or simply rectify an imbalance that disfavors the franchisee. Among these proposals are the following:

1. There should be a private right of action with respect to violations of the FTC Franchise Rule.
2. As found in about ten states, a franchisee right of association should be guaranteed either uniformly (in all of the states) or via a national law.¹⁶ Note that the proposed law would not necessarily grant to franchisee groups (e.g., associations or advisory councils) the right to compel the franchisor to engage in collective bargaining with an association. Instead, the reform would be a Norris-LaGuardia Act equivalent: franchisees having the right to join an association without fear of an actual discharge, a constructive discharge, or some other discriminatory behavior.
3. Absent a compelling reason, arbitration clauses should not be enforced against a franchise party that wants to sue or defend a case in court.

¹⁴ INT'L FRANCHISE ASS'N, *supra* note 9.

¹⁵ OFFICE OF SENATOR CORTEZ MASTO, STRATEGIES TO IMPROVE THE FRANCHISE MODEL: PREVENTING UNFAIR AND DECEPTIVE FRANCHISE PRACTICES 11 (April 2021) (hereinafter, "STRATEGIES TO IMPROVE THE FRANCHISE MODEL").

¹⁶ Even when franchisees may recognize the usefulness of acting collectively and supporting one another, that recognition is unlikely to produce any action that overturns any strongly pro-franchisor power imbalance. See Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1556-1566 (1990) (arguing for the need for state right of association laws and federal antitrust law reforms bolstering the franchisees' right to act collectively); Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?*, 118 PENN ST. L. REV. 99, 104, 119-128 (2013) (concluding that for many reasons of law, psychology, and economics, franchisees are unlikely to avail themselves of opportunities to form or join franchisee associations); Warren S Grimes, *The Sherman Act's Unintended Bias Against Lilliputians: Small Players' Collective Action as a Counter to Relational Market Power*, 69 ANTITRUST L.J. 195 (2001) (noting that antitrust law unfairly disfavors franchisees and other smaller businesses); Warren S. Grimes, *Market Definition in Franchise Antitrust Claims: Relational Market Power and the Franchisor's Conflict of Interest*, 67 ANTITRUST L.J. 243 (1999) (noting that franchisees and franchisors have differing interests often of great importance when parties turn to, or defend against, antitrust claims).

4. A number of persons working as brokers¹⁷ between a franchisor and the potential franchisee have been accused of misrepresentation,¹⁸ with the commission nature of the brokerage being viewed as encouraging sales of franchises over advise to prospective purchasers.¹⁹ This is an area where franchisees and franchisors tend to agree that tighter laws could be enacted. As I understand it, regulatory initiatives have in the past few years been put into place in California and other states. These initiatives may well serve as a guidepost for a revision to the FTC Rule, a clarion call to federal regulators, or even action by Congress.²⁰

5. In the loan and guaranty context, there should be more upfront, bold warnings, such as concerning the SBA's Franchise Directory. There should be more information about the process for issuing, or not, a loan or a guaranty of the loan.

6. The parol evidence rule should not serve as a means to strike evidence outside the four-corners of a franchise contract that was allegedly procured through the franchisor's or its agent's misstatements.²¹

7. Franchisors should be restricted from making unilateral changes to the Operations Manual or other documents ancillary to the franchise contract insofar as those changes are instituted without good cause or, even if undertaken for sufficient reasons, would impose onerous (excessive) costs upon franchisees, such as for changes to work hours, a remodeling of the store location, or other

¹⁷ Bibby Group, *Is Your Guide a Franchise Broker or Franchise Consultant?* (June 1, 2021), <https://www.bibbygroup.com/franchise-brokers-vs-franchise-consultants/> ("The franchise broker (by any other name) represents franchisors, not buyers, and is paid a fee (or commission) if a franchise buyer chooses one of the franchisees with whom they have contracted for their services."). Bibby goes on to contend that a franchise consultant, on the other hand, "charges buyers a fee to advise and protect them and their best interests. The most important aspect of this protection is serious franchise due diligence that breaks down and analyzes a franchise offering." *Id.* Bibby says, "You will not find a commissioned broker breaking down a franchise they represent and pointing out its flaws. They're paid to sell a concept, not critique it." *Id.*

¹⁸ See The Franchise Maker, *Franchise Legal Problems Due to Sales Misrepresentations*, <https://www.thefranchisemaker.com/learningcenter/franchise-legal-problems-due-to-sales-misrepresentations/> (last visited March 14, 2022) (contending that over 60% of all franchise litigation stems from franchise sales misrepresentation, and in effect placing much of the blame on franchise brokers who have duped both the franchisor and the franchisee).

¹⁹ As stated by the Bibby Group:

The broker will introduce prospects to franchises they might otherwise not see. But there are at least three negatives. One, there will be a barrage of introductions that can create more confusion than clarity. Two, the broker will only make introductions to franchises with whom they have a fee arrangement. And three, there will be no due diligence performed. Prospective buyers will be presented with *blue sky and happiness* as opposed to the investigative steps that should be part of buying a franchise.

Bibby Group, *supra* note 17.

²⁰ For a rosy view of the work of franchise brokers, see Franchise Brokers Ass'n, *Franchise Broker or Consultant?* (July 22, 2020), <https://www.franchiseba.com/franchise-consultant-vs-franchise-broker/#:~:text=Franchise%20brokers%20are%20hired%20by,their%20valued%20services%20for%20free.>

²¹ Robert W. Emerson, *Franchising and the Parol Evidence Rule*, 50 AMERICAN BUS. L.J. 659 (2013).

modifications to the franchise system “rules.” Many factors would need to be considered in terms of proportionality, time, revenues and expenses.²²

8. Non-disparagement clauses should be prohibited inasmuch as they (1) harm the exchange of information between current franchisees, (2) impede the efforts of prospective franchisees seeking to learn about the business from current franchise owners, and (3) violate the fundamental norms of open, robust speech, necessary for a free society, and is extremely useful for smart business planning and the effective execution of those plans.

9. All Franchise Disclosure Documents (FDDs) should be maintained on an easily accessible website, perhaps maintained by the FTC or through a government contractor.

There are other substantive areas of law that could be clarified, but – over time – common law jurisprudence may have the nuance and depth that legislation may not accomplish. In other words, a statute could set a basic standard, but – importantly – leave the courts and regulators to deal with specific fact patterns.

Here are three important examples:

Statutes on termination (good faith and fair dealing, good cause, etc.) likely could be drafted simply as an attempt to ensure due process for franchisees who have been terminated or who have voluntarily left a franchise network.²³

Statutes on ownership of goodwill could, again, be enacted to deal with a procedural issue - providing for a transfer of rights process for some recognition of the equity to which a franchisee is entitled. As with termination, the precise delineation of how to resolve the substance may be best left to commentators, courts, accountants, and others.²⁴

Statutes on non-competes could be crafted to include rules covering extreme examples of poaching and encroachment, but the delineation of principles for a court to follow with respect to the usual substantive law issues would likely either be too basic (just a repetition of standards found in the case law) or too involved to legislate without extensive groundwork undertaken beforehand.²⁵

²² See Robert W. Emerson, *Franchising Lessons in the Age of Incivility: Operations Manuals and Trade Secrets*, 29 *Texas Intell. Property L.J.* 305 (2021).

²³ A few of my articles touching upon these matters are: Robert W. Emerson, *The Faithless Franchisor: Rethinking Good Faith in Franchising*, 24 *U. PENN. J. BUS. L.* ____ (issue 2, 2022); Robert W. Emerson & Steven A. Hollis *Bound by Bias? Franchisees' Cognitive Biases*, 13 *OHIO STATE BUS. L.J.* 1 (2019); Robert W. Emerson, *Franchise Terminations: 'Good Cause Decoded'*, 51 *WAKE FOREST LAW REVIEW* 103 (2016); Robert W. Emerson, *Franchising Constructive Termination: Quirk, Quagmire or a French Solution?* 18 *U. Penn. J. Business L.* 163 (2015).

²⁴ A sampling of articles on goodwill and related topics include: Robert W. Emerson & Charlie C. Carrington, *Devising a Royalty Structure that Fairly Compensates a Franchisee for its Contribution to Franchise Goodwill*, 14 *VIRGINIA LAW & BUS. REV.* 279 (2020); Robert W. Emerson, *Thanks for the Memories: Compensating Franchisee Goodwill after Franchise Termination*, 20 *U. PENN. J. BUS. L.* 286 (2017); Robert W. Emerson, *Franchise Savoir-Faire*, 90 *TULANE L. REV.* 589 (2016); Robert W. Emerson, *Franchise Goodwill: "Take a Sad Song and Make It Better"*, 46 *U. MICH. J. LAW REFORM* 349 (2013); W. Michael Garner & Elliot R. Ginsburg, *Nailing the Blob of Mercury: Goodwill in Franchising*, 33 *FRANCHISE L.J.* 149 (2013).

²⁵ See generally *COVENANTS AGAINST COMPETITION IN FRANCHISE AGREEMENTS* (eds. Michael R. Gray & Natalma M. McKnew, 3d ed., ABA Forum on Franchising 2012); Robert W. Emerson, *Franchising Covenants Against Competition*, 80 *IOWA LAW REV.* 1049 (1995).

The Two SBA Bills

The “Small Business Administration Franchise Loan Transparency Act of 2021” (S. 1120) provides in part:

Sec. 4 REQUIRED DISCLOSURES.

(a) IN GENERAL.—Subject to subsection (b), a franchisor, except for a franchisor of a franchise in the lodging industry, that qualifies for guaranteed lending from the Small Business Administration for the franchises of the franchisor shall, at a minimum, disclose in the disclosure document required to be furnished by the franchisor to any prospective franchisee the following information for each of the 3 years preceding the date of the disclosure document: (1) The average and median first-year revenues for all businesses operated under franchises granted by the franchisor, in accordance with the Financial Performance Representation Commentary. (2) The total number of businesses operated under franchises granted by the franchisor that, during the first year of operation, either— (A) ceased operations; or (B) were transferred to a new franchisee. (3) The average and median revenues for all businesses operated under franchises granted by the franchisor, in accordance with the Financial Performance Representation Commentary.

(b) LIMITATION.—A franchisor may not disclose to a prospective or current franchisee, directly or through a third party, any information relating to revenue that conflicts with the information relating to revenue provided under subsection (a) in a disclosure document unless the relevant franchise purchase includes 1 or more businesses under the relevant franchise that are in existence on the date on which the disclosure is made, in which case the franchisor shall disclose to the prospective or current franchisee the relevant information relating to revenue as of the date on which the disclosure is made with respect to those businesses.

SEC. 5. ENFORCEMENT.

The Administrator of the Small Business Administration— (1) shall enforce the requirements under this Act; and (2) may hold a franchisor liable for the balance 19 of any loan obtained through a violation of this Act.

I very much understand the concern motivating this bill. There are indeed outrageous examples of franchisees misled, defrauded, or otherwise caused great suffering and financial harm due to, at the very least, franchisor incompetence (and often malfeasance). However, at this point in time, I am reluctant to support a mandated Financial Performance Representation (“FPR”) for, *inter alia*, these reasons:

1. The FPR, if it is to be mandated, should come from the Federal Trade Commission (“FTC”), not the Small Business Administration. The FTC is the agency with the experience, and

the ties to the franchise law community, to make it the logical administrative “location” for a FPR. While certainly the agencies could coordinate with respect to enforcement and regulations, if the SBA put forth a FPR, I do wonder whether housing a mandated FPR, with penalties, in the SBA opens it up to more challenges on procedural and administrative grounds that would be avoided if emanating from the FTC. But this is not the main reason for my reluctance to endorse S. 1120.

2. The problems that drive the outrage over the suffering of franchisees who bought into a bad system may not have been avoided by a mandated FPR. Incompetent or malfeasant franchisors may not provide the required information, at least in the comprehensive, timely, accurate manner in which it should have been provided. Again, though, this is not what principally motivates my reluctance to endorse S. 1120 (and I am not happy with any argument that, in effect, says a rule should not be passed if the main objection is simply that bad actors likely will not follow the rule).

3. My main objection to S. 1120 is that there is evidence that the non-mandatory nature of the FPR may actually work better as a signaling device to prospective franchisees. As time goes by, the FPR is increasingly being provided – with recent figures indicating that about two-thirds of all Franchise Disclosure Documents (FDDs) now provide an Item 19 FPR (up from about 20% of FDDs when the modified FTC Rule first went into force about a dozen years ago. There is much in the academic literature, by business professors, noting these possible signaling effects.

4. Many of the problems associated with profit representations are the statements apart from an FDD, and often occur regardless of whether an FPR is included in the FDD.

The franchise representative or a sales representative ‘may tell a prospective franchise directly and through subtle means that the FDD has been reviewed and approved by the government and it’s a safe investment.’ FTC’s regulation of FDDs contribute to this problem. For example, the FTC allows – but does not require – franchisors to include financial information in Item 19 of the FDD. Franchisors are also permitted to include in Item 19 a disclaimer to the effect that any other financial information provided outside Item 19 is illegal and should not be relied upon as factual.⁴⁸ In practice, this is a problematic provision; it allows franchisors to connect investors with buyer development agents or brokers, franchise owners, newsletters, or other projections or data without the requirement of accuracy as franchise investors do not understand that financial material provided outside the FDD may not be reliable.²⁶

I very much recognize that this is an extremely serious problem, but I think there are, at least initially, better ways to confront the problem, such as improved administrative enforcement, removal of parol evidence rule or other evidentiary barriers to proof of cases for misrepresentation, and heightened oversight of brokers or other third parties who may engage in bad acts.

²⁶ STRATEGIES TO IMPROVE THE FRANCHISE MODEL, *supra* note 15, at 10 (citations omitted).

5. I do think there may be ways, with respect to the numbers and reporting requirements, to improve Item 20 disclosures about outlet numbers and thereby meet some of the concerns about Item 19 FPRs.

6. If any statements are being made by franchisors or their representatives to lenders or to the SBA in connection to a franchisee's obtaining a loan or loan guaranty, it is difficult for me to comprehend why such statements should be shielded from the franchisee, who will be on the hook for the loan.²⁷ I certainly understand and respect the need for confidentiality, but if banks and the SBA need documents to evaluate a franchise system into which a franchisee will become a dependent party, with its money on the line, I think there should be a very high barrier to overcome in terms of shielding those franchise network related documents from someone whose risks are so much tied to that very network. This, however, is not an area in which I have undertaken research.

As for "SBA Franchise Loan Default Disclosure Act," (S. 2162), I favor that bill. As I understand it, this is not – or at least it should not be – a controversial Act for franchisors, franchisees, or those who represent them. It is an attempt to provide more information – important information – and (just as important) an attempt to afford to prospective franchisees greater accessibility to this information. That is a good thing. Whether people read the disclosures, and what they do with the information, is now often the real issue.

²⁷ *Id.* at 55 n.228 ("In 2014, SBA's Chief Franchise Counsel, Stephen Olear, recommended that franchisors consider providing a projection directly to the lender by passing the franchise investor (the ultimate borrower). ". . . Most importantly in the financing context, the requirements in Item 19 for the preparation of financial performance representations do not apply to information provided directly by the franchisor to lenders of prospective franchisees. Franchisors who do not provide financial performance representations to prospective franchisees but want to provide information to prospective lenders, or who wish to provide additional information to these lenders, are free to do so. This provides franchisors the opportunity to give valuable information to facilitate the financing of its franchisees without being bound by the requirements of Item 19. However, this can introduce a new set of risks the franchisor must be prepared to manage. . . First, any information provided to lenders should only be provide after obtaining a confidentiality and non-disclosure agreement from the lender. . .").