American Franchisee Association
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THESE ARE (JUST SOME OF) THE PROBLEMS FRANCHISEES FACE . . .

WAIVER OF LEGAL RIGHTS

When purchasing a franchise, the franchise agreement will often require the prospective franchisee to waive his/her rights under applicable federal or state franchise laws. Franchisors must be prohibited from requiring franchisees to agree to specific provisions in franchise agreements which are intended to relieve the franchisor of liability or duties imposed by other areas of law.

FREEDOM OF ASSOCIATION

A surprising number of franchisors engage in aggressive intimidation tactics designed to prevent their franchisees from forming or organizing independent associations. Franchisees who are considered "leaders" are often bullied by their own franchisors. Freedom of association is a basic constitutional right that franchisors routinely deny – either contractually or procedurally – to their franchisees.

NO FIDUCIARY DUTY

Fiduciary duties are common in many business transactions. The franchise relationship is particularly well suited for such duties. The parties are of vastly unequal bargaining power; the franchisor has enormously more information than does the franchisee; and a franchisee's business is completely at the mercy of the franchisor. Franchisees feel the franchisor owes a *limited* fiduciary duty and is obligated to perform the highest standard of care when performing bookkeeping, collections, payroll or accounting services on behalf of the franchisee – or when administering an advertising or promotional fund to which the franchisee is required to make contributions.

ENCROACHMENT

It is fundamentally unfair for a franchisor to induce a franchisee to invest to create a business and then establish a competing outlet in sufficient proximity to the existing franchise to cause significant damage or even destruction to the existing franchised outlet. Franchisors must be prevented from encroaching on their own business partners, their franchisees.

BAD FAITH

The duty of good faith is broadly recognized in contract and commercial law. It should be applicable to contractually defined franchise relationships. Good faith does not mean that the express terms of the written document will be modified. It *does* mean that the franchisor will probably be more reasonable, factual and fair in the exercise of discretionary authority under the contract. A franchisor should not be immunized against consequences of its own bad faith just because the courts are reluctant to apply the duty of good faith.

SOURCING OF SUPPLIES

Most franchise relationships mandate that franchisees purchase supplies, equipment, furniture or other items from the franchisor or sources affiliated or approved by the franchisor. Franchisees should be allowed to purchase goods that meet the franchisor's standards from independent, competitive sources. Tying franchisees to certain vendor(s) costs them in the millions of dollars, prevents competition among local vendors and has an adverse impact upon consumers. Franchisors should be controlling the characteristics of items supplied by a vendor and not be allowed to restrain competition in the sourcing of conforming goods.

INFLATED PRICING

Some franchise agreements openly acknowledge that the franchisor has the right to make deals with vendors who sell goods and services to franchisees that are mandated by the franchise agreement. Almost always these vendors provide kickbacks, promotional fees and commissions to the franchisor in return for being allowed to sell their products and services to a captive market. Instead of passing these kickbacks, promotional fees and commissions on to the franchisee to reduce their cost of goods sold and increase their margin, these payments are pocketed by the franchisors.

SIGN A RELEASE TO SELL

When a small business person wants to sell his or her business, they just put a price on the business, find a willing buyer and sell the business. When a franchisee wants to sell his or her business, however, the franchisor often requires, as a condition of completing the sale, that the selling franchisee sign a termination and release form which says the outgoing franchisee gives the franchisor a general release of claims.

TERMINATION WITHOUT CAUSE

Simply stated, franchise agreements should not be arbitrarily terminated. Good cause should exist for the termination.

NON-COMPETE CLAUSES

The franchise relationship almost always includes a post-termination covenant not to compete which does not allow the franchisee to become an independent business owner in a similar business upon expiration of the contract. This has the effect of appropriating to the franchisor all of the equity built up by the franchisee, with no compensation. Franchisees should be allowed to preserve their "sweat equity" and engage in a similar business provided that the franchisee ceases using the franchisor's trademarks and trade secrets and returns all confidential operating materials to the franchisor.

NO PRIVATE RIGHT OF ACTION

Under the current Federal Trade Commission (FTC) Rule on franchising (FTC Rule 436) (16 CFR Part 436), in 38 states, franchisees have no private right of action. In today's world, franchisees actually have to go to the government for redress if their franchisor violates the FTC Rule. A GAO report on the FTC's enforcement activities in franchising found that the FTC acts on less than 6% of all franchise complaints brought to it, going to federal court in just 2% of those instances. Another GAO report on the FTC's enforcement activities in franchising found that the FTC had filed only 1 franchise case in the preceding four years. For a segment of the United States economy that is responsible for over $2 trillion in revenue, and handles hundreds of thousands of contracts annually, one case is grossly disproportionate. If the prohibition against certain activities is a federal issue, then relief should be in federal court. Therefore, franchisees historically have sought privatization of the enforcement mechanism.