

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

FEDERAL TRADE COMMISSION

I N D E X

<u>PRESENTATION</u> :	<u>PAGE</u> :
Charles Lay	4
Spencer Vidulich	16
Caron Slimak	24
John D'Alessandro	34
Marge Lundquist	42
Robert Tingler	53
Susan Kezios	64

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

FEDERAL TRADE COMMISSION

In the Matter of:)
) Matter No. R-511003
FRANCHISE RULE) Volume 2

- - - - -

Friday, August 22, 1997

Federal Trade Commission
55 East Monroe Street, Suite 1860
Chicago, Illinois 60671

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

APPEARANCES:

ON BEHALF OF THE FEDERAL TRADE COMMISSION :

STEVEN TOPOROFF, ESQUIRE

MYRA HOWARD, ESQUIRE

Federal Trade Commission
6th & Pennsylvania Avenue, N.W.
Washington, D.C. 20580
(202)326-3135

For The Record, Inc.
Waldorf, Maryland
(301)870-8025

1 PRESENT:

- 2 CHARLES LAY
- 3 SPENCER VIDULICH
- 4 CARON SLIMAK
- 5 JOHN D'ALESSANDRO
- 6 MARGE LUNDQUIST
- 7 ROBERT TINGLER
- 8 SUSAN KEZIOS

9

10 OBSERVING:

- 11 ERIC ELLMAN
- 12 ADAM SOKOL

13
14
15
16
17
18
19
20
21
22
23
24
25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

P R O C E E D I N G S

MR. TOPOROFF: Good morning. My name is Steven Toporoff and I'm with the Division of Marketing Practices at the Federal Trade Commission. Today is August 22nd, 1997, and we're meeting in Chicago, Illinois. This is the second day of our meeting here in Chicago. Today's meeting is open to the public to make statements for the record concerning any franchise or business opportunity issue they wish.

Before we begin, I want to emphasize that this is a public meeting. Statements are going to be recorded and put on the public record, as well as a transcript copy, an electronic version will be posted on the Internet. So this is public and the transcript will be made public. With that, I'm going to turn over the mike to Charles Lay.

Just for the record, before you begin, could you just state your name and spell it for the record?

MR. LAY: Sure. My name is Charles Lay, that's L-a-y. And I'm from Chicago, Illinois.

MR. TOPOROFF: Please begin.

MR. LAY: What I would like to do first is to give some background. Basically I'm a former franchisee. I was told about this particular public forum by the American Franchise Association, and I would like to just share my experiences as a franchisee, talk a little bit about the disclosure process and the arbitration process and kind of provide some suggestions for

1 improvements.

2 Basically my background, I purchased a small
3 commercial planing franchise called Brite Site in 1993. This,
4 in terms of size, when I say small, the franchise fee was
5 \$20,000. Currently I was one of five original franchisees. The
6 charter franchise was just started that year. And currently
7 none of the franchisees are left in the program; they've since
8 terminated. And two of us are currently suing the franchiser,
9 Brite Site. I'm currently suing the franchise in Small Claims
10 Court and one of the officers, or I should say one of the
11 employees, Joe Marley of the franchise, going through the
12 arbitration process.

13 I think I would like to talk a little bit about my
14 experience with the disclosure process, maybe some things I wish
15 had been identified and what I feel are some deceptive practices
16 that the franchiser was able to use to not fully disclose.

17 When I terminated my franchise in December of '94, I
18 then decided to initiate the arbitration process.
19 Unfortunately, in my franchise agreement, I was required to
20 pursue any legal action only through arbitration. Fortunately,
21 I feel there are a lot of limits in the arbitration process,
22 particularly for small franchises.

23 In my particular case I feel that here in the
24 Chicago area, it's a little hard pressed to get attorneys who
25 will enthusiastically take on a case for the franchisee because

1 typically most of them are involved in representing the
2 franchisers. And most will tell you up front there could be a
3 conflict of interest, but typically also the arbitration
4 process, you're selecting from a group of attorneys, ex-judges,
5 mostly attorneys, who have represented franchisers and it's very
6 difficult, with both sides, you're getting an option of choosing
7 who you will like to be your arbitrator. Typically you're going
8 to end up having someone who has probably worked with the law
9 firm who has represented major franchisers. In that sense, I
10 think the arbitration process doesn't really lend itself, or
11 there can be a conflict of interest.

12 In terms of the disclosure process, I ended up going
13 through arbitration and really had seven different courts where
14 I sued my franchiser for violation of the Illinois Franchise
15 Disclosure Act of 1987. There were a number of key issues. I
16 would just like to highlight why I think there was a good case
17 for non-disclosure. One of the ones is where typically only the
18 officers or the franchiser is required to disclosure. In my
19 particular case, where the director of franchising, the officers
20 or the franchisers is required to disclosure any prior
21 bankruptcy; however, in my particular case, this was a smaller
22 franchise.

23 Brite Site only had one officer, that was Andreas
24 Vascillos, who was at that time and still is the president of
25 the franchise and of the company. However his director of

1 franchising, who is not an officer of the company, does not have
2 to disclose his bankruptcy. In my particular case, after doing
3 some research I later found out that again, he has declared
4 bankruptcy, the former director of franchising. I kind of felt
5 that was a loophole, something I wish I had known prior to
6 purchasing the franchise. Being it was a small operation of
7 five or six people I think that's critical, even though this
8 person is not formally an officer, he did not have to disclose
9 his prior bankruptcy.

10 Another key area where I wish there was disclosure,
11 I later found out that Andreas Vascillos, the owner of the
12 franchise had changed his name. So there were various types of
13 litigation prior to purchasing the franchise that I wish I had
14 known. First, I would just have liked to know that he had
15 changed his name in the past. I think that's important because
16 typically when that's done, it's to hide. Again, that was not
17 disclosed. It was only after I began to do my research, part of
18 the legal process and arbitration process, that I found there
19 was a name change. Then in terms of arbitration, he's not
20 required to disclose that.

21 The other key areas in terms of disclosure. Well, I
22 guess that's really it for disclosure. There were certain
23 claims that were made, verbal claims that were made in terms of
24 projected revenue growth that never could have materialized,
25 that was made. That's kind of one of the key issues I'm showing

1 currently in my arbitration process.

2 What happened in my arbitration process, just to
3 talk about that a little bit also, in arbitration I'm suing the
4 franchiser, Brite Site Inc.; I'm suing the head of the franchise
5 and the director of the franchising. I have the potential
6 settlement with the franchiser; however, I'm continuing to
7 pursue the arbitration process against the director of
8 franchising.

9 While pursuing the settlement, it's very frustrating
10 in terms of getting legal redress against the parties involved.
11 As I said, of the five who originally started, none of us
12 participate in the program. He has since acquired five new
13 franchisees, and I'm assuming they'll probably suffer the same
14 things. There's no mechanism to right now let them know that --
15 well, in the sense he is required to disclose any legal action,
16 but I've since talked to some of the new franchisees and they
17 were not aware of my situation. I don't know how that's
18 enforced here in the State of Illinois, but the deceptive
19 practice that am noticing that basically he'll just churn and
20 continue to get five new ones after these fail. So there's a
21 major concern on my part.

22 I hope by shedding some light on this that, if
23 nothing else, others will be aware and they'll be able to dig a
24 little deeper and find out other methods to determine the
25 franchiser's background.

1 Besides non-disclosure, there's breach of contract
2 and fraud and misrepresentation. But again, I guess my
3 understanding was today was really to talk about disclosure and
4 kind of what I feel are some of the deceptive practices that I
5 feel that were going on, and maybe some suggestions on how it
6 can be improved in terms of better disclosure.

7 Also one of the things that I think would be
8 beneficial is enforcement of the current laws. Right now, I
9 just don't see -- because I did talk briefly with the Attorney
10 General, or one of the Deputy Attorney Generals about maybe
11 pursuing criminal action, but again because of the size I think
12 there's nothing geared towards pursuing the smaller franchisers.
13 I want to make it clear, he did not say not pursue but there's
14 just not a lot of enthusiasm and I'm sure in terms of
15 priorities, there are other bigger items he has to focus on.
16 But it would be nice if there was a cost effective way for
17 smaller franchisees to pursue their claims to get redress in
18 Small Claims Court or again going after these types of smaller
19 franchisers.

20 Other than that, I guess those are the key points I
21 wanted to highlight regarding my experience with disclosure and
22 just wanted to go on the record with that.

23 MR. TOPOROFF: Sure, thank you. Just for background
24 purposes, what is the nature of this franchise system?

25 MR. LAY: This was a commercial planing franchise.

1 Basically it was floor care; you clean the floors of various
2 retailers, like Walgreens or Jewel. What the franchiser would
3 do is, in addition to having his own existing business, he was
4 franchising off businesses that he wanted. He wanted to target
5 the small businesses for the franchisees and then the larger
6 businesses, he would do them himself. But it was all pretty
7 much floor care, commercial cleaning, operations at nighttime.

8 MR. TOPOROFF: One of the proposals that the
9 Commission staff is considering right now is alternatives to law
10 enforcement. One of the proposals has suggested setting up some
11 kind of mechanism to hear franchisee disputes, in particular
12 those that concern disclosure issues. Would you have any advice
13 for us as we consider these various proposals on what a dispute
14 resolution type of program should look like, from your
15 perspective, having through some of this?

16 MR. LAY: I think one of the key things, it needs to
17 be a quick mechanism, a mechanism where these disputes can be
18 heard fairly quickly, resolved fairly quickly. I haven't given
19 a lot of thought about it, but I do know one of the problems
20 either going through Small Claims Court or going through the
21 arbitration process, the franchiser can get numerous delays for
22 any type of reason. I think even if it's an independent arm of
23 the FTC or somewhere where these complaints could be heard
24 quickly, and where, you know, I'm not even concerned with the
25 resolution, but I think for other franchisees, it would be a

1 matter of public record and that there would be a mechanism that
2 could be included in disclosure.

3 Possibly somewhere again where it could be an
4 official type of area, where they could disclosure these
5 disputes. With me, the first thing which I felt was another
6 deceptive practice, he wanted me to sign a non-disclosure
7 agreement regarding this process and I refused to do it.
8 There's certain pressures they can do to get you to sign. I
9 think it's important that if there's a way that this mechanism
10 could be external to the normal legal process, where if I have a
11 dispute I could make it public. Again, I think it's just
12 important that it could be made public so that it could be a
13 permanent part of a franchiser's record versus whether winning
14 or losing a dispute that someone would know what were the issues
15 and the outcome itself.

16 MR. TOPOROFF: You mentioned that the franchiser at
17 one point asked you to sign some kind of non-disclosure. Could
18 you explain that a little bit more?

19 MR. LAY: Basically in my particular situation, the
20 franchiser had an obligation to buy back the equipment that I
21 had used in my franchise and then he would refund monies due to
22 me and that was kind of when you decide to terminate, when I
23 indicated I wanted to terminate the franchise. Well, as part of
24 this termination process, it was required that, yes, we'll buy
25 back the equipment. The equipment buy-back was already stated

1 in my franchisee agreement. There was no mention of any non-
2 disclosure.

3 At the end when I implemented my termination
4 procedure, it was requested that I would not -- part of this
5 disclosure was really that I would not sue him or anyone in the
6 organization. I feel that there was no restriction in terms of
7 me going to the press or anything like that, but in my
8 particular case it was just that I couldn't pursue any type of
9 legal action, arbitration or anything as part of this
10 termination agreement. Again, that wasn't part of my original
11 franchise agreement. It was something that he wanted me to sign
12 at the end, and again, I refused to do it because I would be
13 waiving my right to legal action.

14 MR. TOPOROFF: Would this provision bar you from
15 speaking in the future to other prospective investors?

16 MR. LAY: Well, no, it wouldn't. It would bar me
17 from -- I guess the way I saw it was if I cannot pursue this,
18 any type of legal action, then it would no longer be disclosed.
19 He would not have to disclose it in his offering circular. That
20 was his concern. That's what he wanted to make sure, even
21 though I didn't sign it and I was able to pursue this in
22 arbitration, he was forced to disclose this in his offering
23 circular, and that was his major concern.

24 In terms of me talking to other franchisees, if they
25 didn't have any knowledge of me, I don't think they would have

1 known, there wouldn't have been any way for them to contact me.
2 But no, I was not prevented from doing that. But the fact is,
3 from a franchiser's standpoint, they're very concerned about if
4 they can skirt around not having to disclose in the offering
5 circular, future franchisees would not know about.

6 MR. TOPOROFF: Thank you. Do you have anything else
7 to add to your statement?

8 MR. LAY: No. I think at this time, that was it. I
9 just wanted to share that experience.

10 MR. TOPOROFF: Okay. I just want to add that the
11 comment period is open until the end of the year. So if at any
12 time you want to supplement what you have said, by all means,
13 you can do that either in writing or through our telephone line
14 or our E-mail address.

15 MR. LAY: I would like to ask a question at this
16 time.

17 MR. TOPOROFF: Sure, with one caveat, and that is
18 the purpose of the meeting today is to get information to help
19 us in our endeavors to review the rule. We cannot talk about
20 any specific case or any specific company or investigation.

21 MR. LAY: Sure.

22 MR. TOPOROFF: With that caveat, sure, you can ask.

23 MR. LAY: I was just curious. What is the mechanism
24 for enforcing the disclosure? For example, in my particular
25 case, which is the Illinois Franchise Disclosure Act, is there a

1 mechanism for the FTC to enforce that, if a franchiser does not
2 comply, what is your role or what can be done?

3 MR. TOPOROFF: Well, the Federal Trade Commission's
4 rule is our Franchise Rule that's set out at 16 CFR Part 436.
5 The UFOC disclosure document is not our rule. It's a state law
6 that's enforced in about 15 various states. What we do is if
7 there are potential violations of our law, then obviously we
8 could enforce it. The position that we take when it comes to
9 violations of a UFOC disclosure document is we will review it
10 and if there are violations that -- well, let me just step back
11 a second.

12 What the Commission has said is a franchiser can use
13 a uniform franchise offering circular document in lieu of the
14 Commission's document but they have to do so completely and
15 accurately. If they don't, then they have failed to meet our
16 standard which is full and accurate disclosure, and in those
17 situations the Commission could basically take action. So we
18 don't enforce Illinois' disclosure law or any of the other
19 states' specific disclosures, but we have to see if there are
20 violations of our law. That's the only authority that the
21 Commission has.

22 MR. LAY: All right.

23 MR. TOPOROFF: Anything else?

24 MR. LAY: If a franchisee wanted to -- if there is a
25 violation of your law, who does someone contact?

1 MR. TOPOROFF: Certainly you could call any of the
2 regional offices that the Commission has, as well as in
3 Washington, D.C., there are two sources. The best source is we
4 have recently established a consumer response center which is
5 the point where the Commission meets the public, where people
6 could call up for information, brochures, to register complaints
7 and those are handled by trained staff. Another option is to
8 send a complaint letter directly to the Division of Marketing
9 Practices in Washington, where that will also get the attention
10 of the Commission staff that deals with franchise and business
11 opportunity or related types of matters.

12 MR. LAY: Okay. Great.

13 MR. TOPOROFF: Okay.

14 MR. LAY: Thank you.

15 MR. TOPOROFF: Thank you. We're going to go off the
16 record.

17 (Whereupon, a recess was taken.)

18 MR. TOPOROFF: We're back on the record. Again,
19 this is the second day of a meeting here in Chicago where the
20 members of the public are invited to offer their statements for
21 the record. Before we continue, I just want to mention that
22 this is being transcribed, and a copy of the transcript will be
23 put on the public record. This is a public meeting. And in
24 addition, a copy of the transcript we hope will be posted on our
25 Internet site. It should be.

1 With that, please.

2 MR. VIDULICH: My name is Spencer Vidulich. That's
3 spelled S-p-e-n-c-e-r, V-i-d-u-l-i-c-h. I'm a doctor of
4 optometry and a franchisee in the Pearle Vision system. I've
5 been a franchisee in that system for six years now.

6 I broke my comments down to two sections, one
7 regarding pre-sale disclosure, which in my understanding is what
8 the FTC has jurisdiction over, and also some issues regarding
9 the relationship afterwards where I think if we're going to do
10 an effective job in overseeing the franchise industry, you need
11 to be involved.

12 Specifically and very recently in my system, Pearle
13 Vision was sold. It used to be owned by Grand Metropolitan and
14 last October, less than a year ago, it was sold to Cole National
15 Corporation. Cole National Corporation operates largely the
16 leased optical departments in Sears stores.

17 I think that points to one area that affected many
18 franchisees that were in the process of buying stores shortly
19 before the system was sold. Had they known they were going to
20 be in competition with their franchiser, many of them may have
21 thought differently about purchasing stores. At the very least,
22 I think that would have been information that may have figured
23 into their equation of buying stores. I think even for the
24 existing franchisees in the system, such as myself, that raised
25 some pretty significant concerns which were addressed by the

1 franchiser merely by saying it's a different market and we're
2 not in competition with you, so basically they said live with
3 it.

4 We also did not know before entering into -- we were
5 offered the new franchise agreement from the new franchiser,
6 which while it addressed some of the problems which had been
7 ongoing in our system, also imposed some new requirements on us
8 that we didn't anticipate, such as being required to carry a
9 product inventory, a fairly significant product inventory that
10 was somewhat restricted, well, I should say completely
11 restricted, because it was specific brands which we can only get
12 through the franchiser which we did not fully know about
13 beforehand.

14 For larger operators like myself, it may not be a
15 big burden, but for some of the smaller operators, it would
16 impose a significant burden. I think that many of these
17 practices were at least unfair and possibly deceptive.

18 One example of a franchisee that I know of, he was
19 told that a location that was under consideration for
20 development before the chain was sold, suddenly after the chain
21 was sold, he was specifically told this store would not be
22 developed, then after the chain was sold, the store was targeted
23 for development and he found out nearly at about the time the
24 papers were signed that the store was going to be developed. It
25 was, according to his ZIP code analysis, 33 percent of his

1 patient base.

2 In my specific instance, I signed a new franchise
3 agreement with the new franchiser, dated May 1st, and
4 approximately July 11th I found out two stores that I feel will
5 significantly affect my business are targeted for development.
6 That was not disclosed to me beforehand.

7 Moving onto earnings claims, initially several years
8 ago, in the process of buying my franchise, I was giving verbal
9 earnings claims. My operations were ongoing businesses so I was
10 presented with a pro forma for the businesses that showed their
11 sales and some of their key percentages of cost. I was told by
12 the sales person that franchisees routinely increase their
13 revenues by 20 percent and then the cost of goods significantly
14 lower. We were given no written statements to that effect.

15 I feel that some form of written earnings
16 information or average operating percentages would be of use to
17 the franchisees. I think, this is just my impression, that
18 franchisers kind of want to have their cake and eat it too in
19 some ways. I think that they want to imply earnings information
20 but not be held to anything. I think the industry may be better
21 served by being more above board in that area.

22 Very often, although some of the franchise
23 agreements have some very onerous provisions, as many of us
24 know, when a franchisee raises objections about that, we're
25 always told, look, we know it's in there, why would we want to

1 do anything like opening a store near you? We wouldn't want to
2 do anything that's going to hurt one of our business, so it just
3 wouldn't make sense, we're not going to do anything like that.
4 And that's usually the way that sort of issue is dealt with.

5 Moving onto the relationship, one area where I
6 question the strength of only requiring pre-sale disclosure, in
7 our situation specifically, I'm on my third franchise agreement
8 in six years, and after you've signed your first one and you're
9 obligated to the note and the rent, you really have very little
10 leverage if there's a change that comes down the road. You sort
11 of have to sign on, because if you're not going to stay in there
12 as a franchisee, then you lose your means by which you could
13 meet your obligations. It seems as though, although in many
14 cases we were given some financial inducement to enter into the
15 new agreements, it's also a continual erosion of your protection
16 and of your rights.

17 In our specific situation, the initial franchise
18 agreement required payments that I believe, it was a new system
19 for Pearle Vision, and after it had been a few years down the
20 road, they realized that economically it wasn't working and many
21 franchisees had significant financial problems, gone out of
22 business and they had to retool it. So as they retooled some of
23 the numbers, they also decreased many of our protections, too.
24 This has been an ongoing issue.

25 You're under a lot of pressure to sign the new

1 agreement, both personally, to appear as a team player and it
2 can put quite a burden on some franchisees and there's very
3 little leverage as a group in terms of trying to get those
4 things changed.

5 Within our system, I feel that we need stronger
6 advertising disclosure. Our new agreement actually attempts to
7 eliminate any obligation of our franchiser to disclose the use
8 of ad funds, in money that they specifically collect as an
9 advertising fund. One of the changes in our new agreement, and
10 this is maybe in one area where we're unique being a health care
11 franchise, because we deal a lot with managed care entities,
12 what our franchiser decided was that revenues collected under a
13 managed care transaction would not be subject to quote, "an
14 advertising contribution," or percentage. It was called a
15 transaction fee. And transaction fees specifically require,
16 under their definition, no disclosure of where it's going.

17 I also feel that post-term covenants not to compete
18 are in many cases to onerous. According to the franchise
19 agreement, they can pretty much put up any store. They can put
20 a corporate store near me without any radius restriction
21 whatsoever, yet post-term in a profession such as mine, to have
22 your ability to earn a living handcuffed like that is unfair.

23 That was all I have to say.

24 MR. TOPOROFF: Okay. Thank you. I do have a few
25 questions.

1 You mentioned about the company opening up competing
2 stores near you. Let me ask, did you get a disclosure document
3 initially before you purchased?

4 MR. VIDULICH: Are you talking about the new
5 franchise agreement that I was just offered?

6 MR. TOPOROFF: No, initially when you first entered
7 into the franchise system.

8 MR. VIDULICH: Yes.

9 MR. TOPOROFF: Was there any mention in the
10 disclosure document whether the company offered exclusive
11 territories or not, do you recall?

12 MR. VIDULICH: I don't specifically recall what the
13 territorial protection was, but my general understanding is that
14 in each successive document, this being the third one, that
15 there was some diminution of what our protected area was or what
16 our rights were.

17 MR. TOPOROFF: So in your first contract, did it
18 specify a particular territory?

19 MR. VIDULICH: Yes, I believe that it did. It may
20 have been a three mile territory and now it's a one mile
21 territory.

22 MR. TOPOROFF: Is your concern that they didn't
23 offer exclusive territories, where they kept changing what the
24 territories would be? I'm not exactly clear on that point.

25 MR. VIDULICH: Well, in this most recent instance,

1 my concern is that there was some knowledge that this site is
2 going to be developed. I'm not answering your question, but I
3 believe that there was at least some knowledge that this site
4 was going to be developed, prior to offering me a new agreement.
5 And I think that would have been something that we should have
6 been able to negotiate about, had I had that information before
7 signing this new agreement.

8 My concern is just that our chain seems to have a
9 pattern of maybe this wasn't the plan but this was just the way
10 things went out, here's a new agreement. There's something
11 wrong in the system and we have to address it so we're going to
12 address it with this new agreement, but it also tightens up many
13 of the legal or relationship issues between the franchiser and
14 the franchisee, so our rights are diminished with each passing
15 agreement.

16 MR. TOPOROFF: Do you know who widespread this
17 problem might be within the entire franchise system or is this
18 unique to the Chicago area?

19 MR. VIDULICH: Are you talking about within the
20 Pearle Vision system?

21 MR. TOPOROFF: Yes.

22 MR. VIDULICH: It's a system-wide issue. Are you
23 talking about the new agreements or development of new stores?

24 MR. TOPOROFF: Development of new stores.

25 MR. VIDULICH: I believe we're seeing the first

1 signs of it here in the Chicago area because this is a fairly
2 strong managed care market for them. But my understanding is
3 that Pearle Vision is aggressively moved in the managed care
4 market and I believe that that's going to drive them to develop
5 more locations. I think it's going to be a bigger problem
6 nationwide.

7 MR. TOPOROFF: I have nothing else. Any questions?

8 MR. VIDULICH: No.

9 MR. TOPOROFF: Okay. Thank you. We're going to go
10 off the record a second.

11 (Whereupon, a recess was taken.)

12 MR. TOPOROFF: We're back on the record. We're
13 continuing with our statements for the public record. Again,
14 this meeting is open to the public. It is being recorded and a
15 transcript will be made available to the public as well as
16 hopefully posted on our Web site. So with that introduction,
17 please.

18 MS. SLIMAK: My name is Caron Slimak, C-a-r-o-n,
19 Slimak, S-l-i-m-a-k. I am the Chicago franchisee for Jacadi, a
20 children's clothing store, and I have been a franchisee for
21 almost three years.

22 It was my first venture into business and I feel
23 very strongly right now that there is a dire need for federal
24 regulations governing conduct of franchisers. When I first
25 came, I was a ground breaking franchisee. There were very few

1 people that I could talk to about their experiences.

2 I know that my franchiser was not qualified or
3 approved to sell a franchise in Illinois; however, we were
4 conducting business. As I go down the road and there are more
5 franchisees, I realize this is his method of operation in order
6 to gain the upper hand once you begin to negotiate your
7 franchise agreement. He lets you go so far down the road that
8 there's no turning back before you're presented with the
9 franchisee agreement to negotiate.

10 Therefore, in my franchise agreement I signed away
11 almost every single one of my rights. I'm tied to one supplier
12 and I have a non-compete for three years with a penalty of
13 \$25,000 should I decide to break with the supplier and try to
14 make a go of it on my own in order to save my investment. I
15 really feel that this should be illegal, that we should not be
16 held to giving up every right that we have.

17 I have also, as I have spoken to other prospective
18 franchisees, one of which called me a few weeks ago from
19 Arizona, where again my master franchiser is not approved to
20 sell franchises, I asked him what kind of UFOC he was given and
21 what kind of information was being circulated, and he told me he
22 was given a UFOC that showed that one Boston store had closed.
23 That UFOC was about seven years old. Currently, of the
24 corporate stores that were existing, there were eight corporate
25 stores, six have closes and six franchises, almost half of the

1 network, have gone out of business. This man was not aware,
2 that he was told that this didn't exist. He took it upon
3 himself to call the other franchisees.

4 I think that there's no federal law governing this
5 conduct. And if my franchiser has to walk away from Arizona, it
6 won't protect anybody else in any other states from falling into
7 this same trap. I was presented with my lease before my
8 franchise offer. My franchise agreement was presented to me by
9 my franchiser. So when it came time to do it and all these
10 things came to my knowledge, it was too late; I had signed a
11 lease, I had signed all sorts of other obligations with other
12 companies.

13 My franchiser is also my main supplier. He's
14 unethical in business, that he will raise prices mid-season
15 without building them into our margins. Last season I told him
16 that I would not agree to the price hikes until he could build
17 them into the margins for next season. The result of that is he
18 withheld this season's merchandise on me until I signed an
19 agreement to his price hikes.

20 I have one supplier and am forbidden from putting
21 anything else into my store front, and I signed the non-compete.
22 Basically this has never been a partnership. It is a strangle
23 hold. Most franchisees that still exist are afraid of
24 retribution and losing their investment which is substantial.
25 The average investment for one of my franchisees is \$289,000,

1 including stock, LCs that are held by the company. People are
2 afraid to come forward, and they control so much that there
3 would be very little I can do to save myself if I made the
4 decision to step out and walk away.

5 Another problem with the franchiser is lack of
6 disclosure. I happen to be with a French company who has set up
7 a pass-through company in New York. The supplier is French.
8 Last year they offered us a prepayment discount and it was the
9 first time they had ever offered the franchises anything that
10 would be to their benefit. After many of the franchisees went
11 out on a limb and stretched themselves financially, they
12 disclosed to us that the company was bankrupt. They do not give
13 us any information on the state of the company. It's on a need
14 to know basis only.

15 The bankruptcy was solved; the company was awarded
16 to a group in France and again, we got a prepayment discount.
17 They were still having cash flow problems. Through my
18 investigation, the company has now been sued by another
19 purchaser and the entire sale of the company has not gone
20 through. So we are still in a bankruptcy situation. They did
21 not feel that it was necessary to tell any of us this, but they
22 still want us to extend ourselves for the company. I think
23 that's highly unethical.

24 There are many other things that I could cite as the
25 way they do business, the way they keep us scattered. There

1 have been threats made to some franchisees about forming a
2 franchise association. There was a fax that went around, the
3 franchiser dissuading people from joining an association. They
4 really do try to intimidate, and since we signed our rights
5 away, there is no federal regulation of this type of thing, we
6 are at their mercy. Basically we are managerial clerks with a
7 \$289,000 investment in the company.

8 MR. TOPOROFF: Okay. Thank you. I really don't
9 have any questions. Myra?

10 MS. HOWARD: No.

11 MS. SLIMAK: I do have one thing to add.

12 MR. TOPOROFF: Sure.

13 MS. SLIMAK: Perhaps there should be a federal award
14 program, if we ever enact a federal legislation to govern the
15 franchisers, for the franchisees who do bring legal activity to
16 the FTC. If there was some sort of award, I'm sure that there
17 would be a whistle blower, one person, and you would stop the
18 unethical business practices of many franchisers.

19 MS. HOWARD: Actually I have a few questions about
20 the process that you went through in signing on. Can you just
21 say a little bit more about that? You mentioned that you signed
22 the lease before you signed the contract.

23 MS. SLIMAK: I contacted the master franchiser. I
24 found him through a sign in his New York store window. He said
25 that there was a \$3,000 fee for each Attorney General's office

1 and therefore, he did not become qualified in the states, in
2 every state, until he thought that there was somebody that was
3 really going to go through with it because it would cost him
4 \$150,000 to qualify himself or to get himself approved in the
5 United States.

6 MR. TOPOROFF: Can I just interrupt? I'm sorry. I
7 just didn't hear what you mentioned about a \$3,000 fee.

8 MS. SLIMAK: He told me that there was a \$3,000
9 application fee with each Attorney General.

10 MS. HOWARD: Filing fee.

11 MS. SLIMAK: Filing fee, and that he didn't really
12 want to pay it until he had a so called "live one." So we
13 started our discussions and I started my business plan. I found
14 my location. At that time I had a partner and I was using her
15 attorney. He said he was going to file. It was four weeks
16 after the date that he told us he would file that he actually
17 did. At this point we had told him we were interested.

18 It was his stalling tactic to gain the upper hand in
19 the negotiations; I really do believe that. And the attorney
20 said, oh, stuff like this happens all the time. Needless to
21 say, I cut that attorney loose and the partner.

22 But I was faced with a business that I wanted to do,
23 that looked good on paper. The only thing I couldn't factor
24 into my business plan was not just poor management, but an
25 opportunistic master franchiser. And I wanted to do it. I was

1 the first one. I had my space which is at Water Tower. They
2 had already told the current tenant that they had found somebody
3 to take over their lease and that they would be allowing them
4 out of their lease and that they would vacate.

5 During this time the franchiser said I don't know
6 what's going on but it's in there; really it's going to come
7 through, it will. And by the time it came through I was forced
8 to sign my lease without the franchise agreement being in place.
9 It was a gamble I took. Looking back, I don't think I would do
10 it again. Sometimes business deals don't fall together the way
11 you think they would.

12 I understand he did the same thing in Nashville.
13 The franchise is now closed. And other locations. Once you
14 start talking to franchisees, you realize that I was not an
15 isolated event.

16 MR. TOPOROFF: I do have a few questions. At any
17 point when you were negotiating the original purchase of the
18 franchise, did you get a disclosure document?

19 MS. HOWARD: Offering circular.

20 MS. SLIMAK: Yes, I did get a UFOC. It was not for
21 the state. It was supposed to be an example, and he said that
22 the UFOC -- yeah, I got a draft. And that the UFOC would come
23 through as soon as it was out of the Attorney General's office.

24 MR. TOPOROFF: Where in the process did you get at
25 least the draft?

1 MS. SLIMAK: I was given a New York UFOC well after
2 my first contacts had been made, and they sent out what they
3 call an advertising package and after halfway into my business
4 plan, when it looked like this could be a profitable business.

5 MR. TOPOROFF: So you already started to negotiate
6 with these people at the time that you got the UFOC?

7 MS. SLIMAK: It wasn't negotiations. We were in
8 deep discussions. I needed information on how the business
9 would run. It should be noted that he very rarely called me,
10 though. However, we were in contact I would say four and five
11 times a week.

12 MR. TOPOROFF: And this was all on the phone?

13 MS. SLIMAK: All on the phone. And then I went to
14 New York to meet with him in April of '93. Our discussions
15 started in February, and I opened my store the following
16 November.

17 MR. TOPOROFF: So you received, granted it was a
18 draft, but you received something but it was --

19 MS. SLIMAK: Not an Illinois UFOC. And it was not
20 current. I don't believe it was current.

21 MR. TOPOROFF: And again, just to make the record
22 clear, about how long had you been speaking with the company
23 before you got even that document?

24 MS. SLIMAK: Two months.

25 MR. TOPOROFF: Do you think it would have made any

1 difference to you if you would have gotten the document right up
2 front?

3 MS. SLIMAK: It would have still been the same stale
4 dated document that didn't really affect very much when my
5 franchise agreement came through. Actually the man should not
6 be permitted to even speak to anybody in a state until he has
7 been approved. It seems to be we have a very charming store;
8 it's an appealing concept. People really walk in and just go
9 nuts for it. And it the same trap that everybody falls into.
10 He really should be forced to be approved in every state.

11 I know he's not approved in Arizona and I do know
12 somebody saw an advertisement to sell franchises in a franchise
13 publication. I assume it was nationwide, so I know he's
14 advertising nationwide. I know that he's not approved in
15 Arizona because he did not give them a current UFOC.

16 When I asked for earnings on the company, I was
17 given earnings for Jacadi USA and Jac-Fran, the franchising
18 selling arm. Basically it's a pass-through company for the
19 company in France. So it was a skeleton of an earnings
20 document. I think that if you're tied to one supplier, and I
21 don't know how there could be any regulation on this, but you're
22 tied to one supplier and they are overseas and I can't go any
23 place else. The parent company overseas should be forced to
24 disclose earnings. It was a privately held company but I would
25 have known that there were having financial trouble in '93

1 instead of having to wait until '96 to find out they were
2 bankrupt.

3 MR. TOPOROFF: Okay. Thank you for appearing here
4 today. Again, as mentioned before, you're more than welcome to
5 supplement your statement either in writing or however you want
6 to do that. The comment period is open until the end of the
7 year.

8 MS. SLIMAK: I have the dates of the other meetings,
9 but I sure there are other franchisees. I know that there's one
10 in Dallas who would like to come and make a statement. And I
11 think there are other franchisees who would probably travel to
12 be able to make a statement. So I need the locations as well as
13 the dates.

14 MR. TOPOROFF: Okay. We can give that to you off
15 the record. Okay. Thank you very much. And we're going to go
16 off the record.

17 (Whereupon, a recess was taken.)

18 MR. TOPOROFF: We're back on the record. Please.

19 MS. SLIMAK: Caron Slimak. I'm making a
20 supplemental statement. I also wanted to bring up one point,
21 that it is not required that the master franchiser disclose on
22 his UFOC how many corporate stores have failed. And it is very
23 important for prospective franchisees to know the failure rate
24 of the corporate stores as well as the failure rate of the
25 franchisees. If the company can't make a go of it, why do they

1 think that the franchisees can? It's important to know.

2 MR. TOPOROFF: Okay. Thank you. I do have one
3 question. Do you think any of the problems that you and other
4 franchisees might be experiencing here is attributable simply to
5 the fact that this is a foreign company that just might not be
6 aware of the various laws in the United States?

7 MS. SLIMAK: No. The master franchiser is an
8 American businessman. He has been in retail in the United
9 States I believe his whole career. He has been franchising now
10 for many years. You cannot attribute this to ignorance. This
11 is deception.

12 MR. TOPOROFF: Okay. Thank you. We're going to
13 take a break.

14 (Whereupon, a recess was taken.)

15 MR. TOPOROFF: We're back on the record. Again, I
16 just wanted to remind everyone that this is a public meeting and
17 a transcript will be made from the tapes and will be put on the
18 public record, as well as our Web page. So with that, please.

19 MR. D'ALESSANDRO: My name is John D'Alessandro, D,
20 apostrophe, capital A-l-e-s-s-a-n-d-r-o. I'm a Quaker State
21 Quick Lube distributor. I'm an ex-Oil Express franchisee. The
22 franchise agreement was terminated by my franchiser. I'm here
23 today to talk to you about franchising and the FTC rule.

24 I feel that it in no way can help me because it's
25 all pre-sale. What happens after the sale is more important

1 than what happened before the sale. I have my MBA from Loyola
2 University in Chicago and I'm able to read financial statements
3 and operations manuals and marketing plans which a lot of
4 franchisers provide to prospective franchisees. However, no way
5 do they describe how they operate and what relationship you will
6 have with them five years, ten years, 15 years down the road.

7 I was a franchisee for approximately ten years. I
8 had some problems. My stores were in the top ten. In fact, one
9 of my stores was number two in sales for the franchise, and I
10 feel that the success of the franchise was because of my
11 efforts, what I had done to bring the franchisees together to
12 form a franchisee association and advertising co-op which was
13 part of the franchisee association. And the franchiser agreed
14 to put most of his stores in there, but he cherry picked and
15 wouldn't put all of his stores in, including the one he owned
16 personally.

17 I'm here today because I'm successful and I'm making
18 money at it. There are many in the system of franchising that
19 lost a lot of money and aren't able to be here today to talk to
20 you. I've traveled to Washington, D.C. to lobby for franchising
21 legislation with the American Franchise Association of which I
22 am a Board member also.

23 To get into the relationship, it started out bad to
24 begin with. The franchiser recommended a contractor and the
25 contractor had no more experience than I had at building

1 facilities. And the contractor happened to be a franchisee
2 also. We had a wall blown out at one of the stores in the
3 construction phase. The basement wall, the foundation had to be
4 completely removed and a new one put in because it cracked after
5 it had been poured. The franchiser would do nothing to help us,
6 couldn't verify we had the right mix of concrete or anything.
7 He said you're on your own. We realized from then we were on
8 our own.

9 During the construction phase, it took nine months
10 to build our store, what normally should take about three
11 months. We owned the land and we owned the building, and the
12 franchiser -- let's put it this way, the contractor walked from
13 our construction site and then turned around and sued us, put a
14 lien on our property for what was owed on the balance of the
15 contract. The franchiser said that's between you and the
16 contractor, not between me. We had to get ahold of the
17 subcontractors and get them back on the job. We had been paying
18 through an escrow account with Chicago Title so we were up to
19 snuff, and the subs were willing to come back in and work for us
20 to get the buildings built.

21 And then after that happened, because of the time
22 and everything, we were short money as far as what we owed the
23 franchiser for our franchise fee, and he allowed us to pay on a
24 graduated basis, a little each month; however, we had to sign a
25 gag order that we wouldn't tell anybody else what happened.

1 Then about two years after I was open, and I opened
2 up three stores. My partner and I opened up three stores in
3 nine months. I was the operating partner of the store and one
4 of the biggest problems we have in our business is employee
5 turnover. It's a constant training job. I had a manager from
6 another store stopping by my store all the time wanting to work
7 for me. And I talked with him and I said, okay, you can come to
8 work for me, and I hired him.

9 Unbeknownst to me, I had a contract; however, in the
10 disclosure there was clauses in the disclosure, but not part of
11 the contract, that said that I could not hire an employee of
12 another Oil Express franchise unless the franchisee agreed to
13 it. But it wasn't in my contract. The franchiser held me to
14 that and said I had signed for the disclosure and threatened to
15 take me to Federal District Court, which he did file papers, and
16 released them after I released the employee. However, six
17 months later, which was the waiting period, this employee still
18 wanted to work for me and I brought him back in.

19 Here again, the franchiser tried not only to control
20 myself and the free enterprise system, but also my employees and
21 other employees. This is indentured servitude. He tried to
22 dictate to everybody. Come on, this is a free country.

23 Things went on and I put that all in the past and
24 said let's go on and let's make this business work. And it took
25 me about three to five years to get on my feet and I started to

1 do well and my stores started to progress. However, in 1994 I
2 peaked and I saw things happening. It didn't look good because
3 of the way our franchiser looked at the business.

4 And that's when I sat down with other franchisees
5 and I said let's form an association and we'll get an
6 advertising co-op and we'll spike the business, what we need.
7 However, we talked to the franchiser and said you do some market
8 research. Let's see what the customers are looking for because
9 our car counts were starting to slide. Our sales were still
10 going up, but when you start to lose customers, you've got to
11 know why. Even though more competition is coming into the
12 market at all times, the franchiser felt that he knew what was
13 best and we were just going to stick to oil changes and nothing
14 else.

15 Well, the competition was going into radiator
16 flushes, air conditioning recharges, light bulbs, all non-
17 technical jobs that a technician could do and do it quickly and
18 still give the customer a convenient, quick service, get them
19 out of the store in ten to 12 minutes. Well, this progressed
20 and even with the advertising co-op we were keeping our sales
21 dollars up, but customers were still not coming in; car counts
22 were going down.

23 So I decided I would talk with an attorney to
24 intercede on my behalf. The attorney wrote a letter to the
25 franchiser listing some 40 items that he thought that we should

1 sit down and discuss and get some resolutions. But I was not
2 the only one that felt that way; there were eight other
3 franchisees representing 25 stores in the market that felt the
4 same way. Obviously they hired the same attorney, proceeded
5 with a demand letter like our contract called for.

6 The franchiser tried to pull a power play and turned
7 around, without any notice, no cure period, nothing and
8 terminated all of us. Our attorney said just be patient; we'll
9 sit down and talk with this man and get it resolved. It was
10 coming, even though, I thought by not paying royalties it would
11 bring him to the table, that money talks but it didn't make any
12 difference to him. We were in breach of our contract and we
13 tried to sit down at a subsequent meeting and he turned the
14 tables on us and charged us with conspiracy. I can tell you, to
15 this day, when we changed our name he hurt our business. That's
16 what he tried to do. He knew it would, yet he still didn't want
17 to sit down and talk, and he didn't want to have anything
18 resolved.

19 I'm in this situation today. I believe in
20 franchising. In fact, because of the way the business has gone,
21 my partner said we should sell our three stores and we have sold
22 our three stores to Quaker State and they're going to put them
23 in their franchise system. My story is just one of many and as
24 I said, I've been successful and I've done very well in the sale
25 of my stores because I've kept the business going, and Quaker

1 State recognizes it and I had a saleable product. Penzoil was
2 also interested in my stores. So I ended up the winner but in
3 the long run, I've ended up the loser because of my relationship
4 with my ex-franchiser.

5 MR. TOPOROFF: Thank you. I have a few questions.
6 One is, you mentioned at some point a gag order that they placed
7 on you. Can you explain how that came about and what exactly
8 did this order prevent you from doing?

9 MR. D'ALESSANDRO: The gag order was he was going to
10 let us pay our franchisee fee -- you pay a fee up front of
11 \$25,000. Well, because of the added cost we had in interest,
12 because of the delay when the building was being built, instead
13 of being built in three months, it was built in nine months and
14 we had to pay additional interest payments.

15 So we had a budget to go into this, and the bank
16 lent us so much money and we didn't have the money to pay the
17 remainder of the franchisee fee up front. So he was going to
18 resolve it and after we resolved the deal with the contractor
19 and got that resolved, he said I will let you pay the remainder
20 of your franchise fee over several months, over a year's time;
21 however, he made us sign a gag order that we would not give this
22 information to anybody.

23 It really wasn't our fault.

24 MR. TOPOROFF: So the gag order would prevent you
25 from what, disclosing the --

1 MR. D'ALESSANDRO: This information to other
2 franchisees.

3 MR. TOPOROFF: That you had negotiated --

4 MR. D'ALESSANDRO: That we had this agreement.
5 Yesterday in the hearings there was a statement made that
6 franchise agreements are negotiated. Let me tell you something,
7 there is no negotiation. It's here's the contract and this is
8 what everybody else signed; take it or leave it. And you know
9 what? As a result of this lawsuit, I've seen the other
10 contracts and they are all the same. So what is negotiated?
11 There's nothing negotiated. You can say, well, you can take it
12 or leave it. You're absolutely right. But if you need a job,
13 which at the time I did. I was commuting to Denver working for
14 my brother and the reason I didn't move there is because that
15 didn't work out, family, Italian families.

16 So in essence, I wanted to be in business for myself
17 and it was the American dream and they tell you about
18 McDonald's, the glitter of McDonald's. But I'll tell you
19 something, after being in the business 11 years, there is no
20 glitter in McDonald's either. The growth isn't there. There's
21 a decline, even though they add additional stores.

22 MR. TOPOROFF: Okay. Were you going to say anything
23 else?

24 MR. D'ALESSANDRO: No.

25 MR. TOPOROFF: Myra, did you have any questions?

1 MS. HOWARD: No.

2 MR. TOPOROFF: Okay. Thank you.

3 MR. D'ALESSANDRO: Thank you very much.

4 MR. TOPOROFF: Thanks.

5 (Whereupon, a recess was taken.)

6 MR. TOPOROFF: We are back on the record. I just
7 want to remind everyone that this is a public meeting. The
8 consumers' statements will be transcribed and put on the public
9 record, and also will be posted hopefully at our Internet site.
10 I just want to make sure that is clear. I just want to make
11 sure that that's clear so that everybody understands what is
12 going to happen here. So with that, please.

13 MS. LUNDQUIST: My name is Marge Lundquist, L-u-n-d-
14 q-u-i-s-t. Was there anything else you needed?

15 MR. TOPOROFF: No, please go ahead.

16 MS. LUNDQUIST: I am at this point not going to
17 state the franchise because I am on my way at 1:00 to sign the
18 final divorce papers, as such, the papers that separate us
19 legally. There's a gag order there. So if you are planning on
20 putting this on the Internet, that could be a problem.

21 This gag order, I have a real problem with the gag
22 order. In the first place, that had not just wanted to have me
23 refrain from giving any information about the agreement that we
24 are about ready to sign, but they also wanted to prohibit me
25 from doing business within a five mile radius of any kind.

1 Well, I happen to be in the business consulting industry as well
2 as insurance and assist businesses to get financing for growth,
3 so that took about nine months to get them to understand that I
4 was not going to sign anything that would jeopardize a
5 livelihood. Five miles in Chicago is a lot of businesses.
6 That's like my livelihood.

7 The gag order I think is a major problem. First of
8 all, that was very unfair. That was incredibly unfair to ask
9 somebody and to hold it up for nine months, refusing to sign the
10 paper because they wanted to prohibit me from doing business in
11 such a large area.

12 The other issue about the gag order, that really
13 prohibits me from being able to answer questions, you know, and
14 give cautionary remarks to other people who might be considering
15 the franchise that I was with.

16 And I've had people call me in the past about this
17 particular franchise and I was able to give them, not
18 necessarily my story and what's happened to me, but more or less
19 some of the issues, if they're in negotiation with the
20 franchise, some of the specific issues that they should be
21 attempting to negotiate, like site selection issues, like
22 disclosure on financial issues, some of the things that assist
23 you in making an educated decision about whether you want to
24 associate yourself with this franchise. So these are very, very
25 important. They were denied me and specifically that happens to

1 be one of the issues that led to making a decision on my part to
2 go with the franchise and having the store actually not make it
3 because of some of those issues.

4 So I'm not quite sure legally now how I can assist
5 other franchisees or potential franchisees in going about making
6 sure that they're not deceived, and that they really get all the
7 fairness of the disclosure, everything that they need to know in
8 order to make this decision. So that's what I'm doing at 1:00.

9 One of the other issues that was particularly
10 crippling to me, I was in business for not quite two years, a
11 little under two years. I owned a store. There was absolutely
12 nothing wrong with the store. They would come out to visit
13 every quarter and look around and examine things and look at the
14 books and things like that. The only thing they ever told me
15 that needed to be altered in order to make that store successful
16 was to make sure that I kept the fan blades clean and one guy
17 had an earring in his ear. Those were the only things they ever
18 told me, ever.

19 They told me that the best stores were stores where
20 the owner was there versus absent; however, they had a number of
21 very successful stores that were being run with absentee owners.
22 So I made sure I was there. There was absolutely nothing in
23 terms of the running of the business that could be called at
24 fault.

25 They would send people in to check people. The

1 brother of the CEO of the company would come in and go through
2 without telling anyone who he was to check it out. I always got
3 calls back saying everything was fine, everything was great.
4 The store was an absolute failure. There was no way that it
5 could thrive, absolutely none.

6 One of the reasons that it could not thrive was
7 because they did the site selection of the store and they did
8 not adhere to their own criteria. When I questioned them about
9 this, their comment was -- and it was totally what they said.
10 It was never in writing, they never showed me proof that this
11 was so. But they said that they had franchise owned stores,
12 company owned stores that were in locations -- they had one or
13 two company owned stores that were in locations that did not
14 meet the criteria and they were doing fine and they were very
15 successful.

16 Well, you know, that was really deceptive. That was
17 majorly deceptive because they never gave me any evidence of it
18 and there's something about going into a business, when you're
19 purchasing a business, you know, you have an eagerness about
20 getting the business going, you know, and you have a belief in
21 the people that you're dealing with. You wouldn't be doing
22 business with them if you didn't care for them. They've
23 demonstrated enough concern and they've given you things that
24 you assumed that that's all there was, that they fully
25 disclosed.

1 But the truth is that things like the site
2 selection, which is so critical, and they actually even did the
3 pre-negotiation with the landlord, you know. So that wasn't
4 even an issue. I mean there are several things around the site
5 selection that I think are really important.

6 One is I think full disclosure of what the site
7 selection criteria would be. I think you really need to know
8 that, and they were very vague and they were not bound to show
9 you what that criteria was. So that's very, very important,
10 that we need to have full disclosure on the site selection
11 criteria.

12 The other thing that is associated with that in
13 terms of full disclosure, to keep the deception down, the verbal
14 deception, I think it would have been very, very advantageous
15 had I been able to look at earnings data. And they did not
16 disclose, they did not disclose any earnings data.

17 Now, I called, in my research prior to signing the
18 agreement and to going with them, I called a bunch of
19 franchisees. Some of them answered and some of them didn't, and
20 you can call so many times and have them no answer and you don't
21 have any access. You need another way of measuring what's going
22 on with the company.

23 So the earnings data is very important, and the
24 earnings data separated, according to company stores, that being
25 piece of data and the other data being the franchisees, because

1 as it turns out, there were like six franchisees that were in
2 sites that had been selected by that company that were not
3 making it. And they weren't returning my calls. I didn't have
4 any access to them, and I had no way of knowing this.

5 So it was very unfair that I didn't have any access
6 to any kind of information that would allow me to discern what
7 the earnings of the franchisees were. Had I had that I would
8 have been able to see that there was something definitely wrong
9 with 13 franchisees, and if you even divide that by 13, it would
10 give you some kind of handle on it. And that was not available
11 to me.

12 All I had was them telling me that the franchisees
13 are doing fine. There was one franchisee that they said wasn't
14 doing -- it was kind of struggling but they thought that that
15 would be fine in another year or so and it was the only other
16 franchisee within the Chicago limits.

17 So there wasn't enough there to make a kind of hard
18 data decision. The hard data wasn't there to deal with and I
19 think that really, really was a disadvantage. I have lost
20 hundreds of thousands of dollars. I probably have lost, when it
21 all finishes, I will have lost probably a half a million dollars
22 on this venture.

23 Now, I might become a ward of the state at my age,
24 having lost a half a million dollars. That's really crippling.
25 You do your best to make decisions to buy a business that will

1 not only support you but will support your family, that will
2 support the people that you hire. And it was really a surprise
3 because I thought I did all of my homework. I really thought I
4 did it. I did everything that I could think of. And some of
5 the things that I was told was deceptive.

6 The site. That was the critical issue right there.
7 The site is what killed it. And had I had a clear understanding
8 of what all the criteria were, had I had the data to look at the
9 other stores and find out whether they really were making it or
10 not and have an opportunity to find out why they weren't making
11 it, I would have learned it was site selection. And that wasn't
12 available to me.

13 And with a gag order, it seems very unfair that I
14 can't alert prospective franchisees to investigate that with the
15 company, should they ask me.

16 I think that's pretty much it. I think that's
17 pretty much it. Those are some really heavy duty things that
18 caused my demise.

19 MR. TOPOROFF: Thank you. We appreciate hearing
20 your comments. I do have a few questions.

21 Do you know of other people in this system that also
22 might be subject to a similar type of gag order? Do you know
23 whether that's common?

24 MS. LUNDQUIST: My understanding is that it's what
25 they do. It's very, very common. Another franchisee that

1 actually -- the company blatantly lied to me. When they said
2 there's only one other store, as it turns out there's another
3 person that actually, like several months after I opened, had to
4 close the store, and it was a site selection issue. By the
5 company, the company had chosen the site, so they had lied about
6 that.

7 And yes, we have talked extensively over the past
8 couple of years. And the gag order is in effect with him. I
9 know that personally. Plus other franchisees that I've met
10 through the American Franchise Association had the similar type
11 of situation. My understanding is that it's very common. My
12 lawyer seemed to think it was very common.

13 MR. TOPOROFF: Could you give us a rough estimate
14 perhaps of the number of prospective franchisees that have
15 contacted you, since the time that you signed the agreement.

16 MS. LUNDQUIST: Signed the franchise agreement?

17 MR. TOPOROFF: I mean the gag order.

18 MS. LUNDQUIST: I sign it at 1:00 today.

19 MR. TOPOROFF: The gag order you sign?

20 MS. LUNDQUIST: Yes, I sign the papers at 1:00 this
21 afternoon that finally dissolves the franchise agreement.

22 MR. TOPOROFF: Are you currently under a gag order?

23 MS. LUNDQUIST: It's one that I'm going to sign.

24 MR. TOPOROFF: Okay. I wasn't clear on that.

25 MS. LUNDQUIST: That's why I'm not stating my

1 franchise, if it's going on the Internet.

2 MR. TOPOROFF: There's no need to identify the
3 franchise system.

4 I thought that you already were under a gag order.

5 MS. LUNDQUIST: Because of the nature of my
6 business, being that I assist small and medium size business to
7 secure financial loans and we also work on some of their
8 organizational efficiency and effectiveness issues, I run into -
9 - and just the places that I travel, I run into a lot of people
10 who are investigating the possibility of going into a franchise.
11 I seem to be in the middle of it all the time.

12 And prior when I had the store open, I would say a
13 half dozen, maybe a little more, had actually called and
14 contacted me that they were investigating that specific
15 franchise.

16 MR. TOPOROFF: Over how long a period of time?

17 MS. LUNDQUIST: I was in business for a year and a
18 half, a little under two years.

19 MR. TOPOROFF: So within a year and a half, two
20 years, you were contacted by approximately a dozen prospective
21 franchisees?

22 MS. LUNDQUIST: Maybe a touch under.

23 MS. HOWARD: Were you given a disclosure document
24 while you were investigating this?

25 MS. LUNDQUIST: I was. I really, really wanted to

1 trust everything they told me and they were so solicitous and
2 they were so tripping over themselves to do things that it
3 looked like they were doing to help me. Well, it turns out
4 those were the things they had to do for me, according to their
5 franchise agreement.

6 The question again? I'm sorry. What did you just
7 ask me?

8 MS. HOWARD: The disclosure statement.

9 MS. LUNDQUIST: They actually gave me a disclosure
10 document and there was like five months between the time they
11 gave me the disclosure document and when I signed the agreement,
12 and there had been another disclosure document in the interim
13 and they had not given that to me.

14 I really did consider, when I closed the store, I
15 spent a lot of money in lawyers trying to figure out whether I
16 should have gone ahead and sued, and we actually drew up a
17 complaint, etcetera. The laws are such, however, there's no
18 precedent set in Illinois for this particular kind of court
19 case. There's nothing that anybody knows. There's only one I
20 think up in Wisconsin or Michigan that they could find any
21 precedent where a disclosure document had been given, not
22 handled appropriately and the franchisee actually won in court.
23 They informed me that I could put out another \$25,000 or more,
24 \$35,000, taking it to court and never having any assurance. A
25 50/50 is just not good enough when you have lost so much money.

1 I backed down on it. But yes, there was a major
2 problem with the disclosure statement.

3 MS. HOWARD: You had mentioned that they had
4 disclosed one other Chicago area company, is that right?

5 MS. LUNDQUIST: The stores are almost all suburban
6 and small town stores. There was only one other store within
7 the Chicago city limits in what's called the real urban area.
8 The others are in the suburbs. So they really didn't have any
9 experience in whether this store would really work there. They
10 didn't know that. They had no experience whatsoever in that.

11 And they also told me interesting things. There was
12 a similar store within about a mile and a half or something and
13 they told me that that store was doing good, that they had
14 inside information that that store was doing really, really
15 good. The truth of it is, is that store was suffering. The guy
16 ended up going bankrupt. So that wasn't true. It was a lie
17 because it wasn't doing good.

18 They also told me, when I asked them about some of
19 the other competition in the area, they informed me that their
20 particular market niche, that they would not be competition for
21 me. Well, you add up all of the other demographic information,
22 they killed me. Of course, it made a difference, when you look
23 at the total picture.

24 MR. TOPOROFF: Okay. Thank you.

25 MS. LUNDQUIST: You're welcome.

1 (Whereupon, a recess was taken.)

2 MR. TOPOROFF: We're back on the public record.
3 Again, I just want to remind everyone that this is a public
4 meeting, that it's being recorded and a transcript will be made
5 available in the public record, and again, hopefully technology
6 permitting, it will be posted on our Internet Web site. So,
7 please.

8 MR. TINGLER: My name is Robert Tingler, T-i-n-g-l-
9 e-r. I'm the Franchise Bureau Chief of the Illinois Attorney
10 General's office, and I'd like to make just a few comments based
11 upon what the discussion was yesterday, and also because I had
12 to leave a little bit before you were finished yesterday.

13 The first thing was that in determining what to do
14 with business opportunity requirements, I think it's important
15 that all the discussions of the FTC, consider what's at stake in
16 business opportunities versus franchises, that my own personal
17 belief is the potential loss of a person buying a franchise can
18 be significantly greater than for a business opportunity or even
19 the purchase of securities. And that in many instances the
20 person who is buying a franchise will be putting up, one way or
21 another, 80, \$100,000, would be common and much more is
22 reasonable, too.

23 Whereas a business opportunity, even by statutory
24 limitations in many states, may not be over \$25,000 and in many
25 cases we're talking \$1,000, which can be very significant to

1 someone who is under-employed and does have a lot of money to
2 spend, that \$1,000 can be extremely significant. But it may not
3 destroy their future, whereas the franchise, it's a larger
4 stake.

5 My only point is there are many, many very good and
6 valuable provisions in the present UFOC guidelines and the
7 franchise rule under the FTC, and when the discussion on
8 business opportunities talks about perhaps reducing some of the
9 requirements, and I certainly am not opposed to doing that, I
10 wouldn't want it to overflow into the franchise situation and
11 perhaps reduce some of the requirements there. Not to say that
12 they can't be fine tuned and improved on, but there are some
13 very good basics that are there now for franchising and business
14 opportunities could justifiably perhaps be reduced in the
15 obligations of the business opportunity seller.

16 One thing that was brought up yesterday was the
17 issue of litigation disclosure. I wanted to add the comment
18 that if a comparatively small business opportunity buyer sues
19 his seller, I think that's a very significant fact because if
20 you're buying a \$500 investment and it turns out to be
21 worthless, and you're willing to spend another 500, 1,000 or
22 more because of what happened to you, I think the next buyer
23 down the line should be aware of this type of litigation. I
24 think that's extremely important to know, if buyers of business
25 opportunities are suing the seller in some numbers, that seems

1 to be impressive.

2 If it's a new business opportunity seller and
3 they've only sold 100 items or sets of services and 50 of those
4 buyers are currently suing them, I don't want to be the 101st
5 buyer. And another area, that perhaps is less important in the
6 business opportunity setting, is where the seller is suing the
7 buyer. I suppose in many of those instances it might be a
8 collection suit. I don't find that very unusual or exciting in
9 and of itself.

10 And we get back to the distinction I mentioned
11 briefly yesterday that I think that it is an important area that
12 business opportunities that have a continuing relationship.
13 Those are the more difficult ones for the buyer where you're not
14 just buying an item or a set of tapes or whatever it may be that
15 are going to lead you to financial success, but you are buying a
16 system which depends upon the seller to service you. And that
17 could be continuing to find accounts for you, helping you find
18 sites, whatever that service may be, you aren't just making a
19 one time purchase. You're dependent upon your future as to what
20 the quality of the services are from the seller. That situation
21 requires I think a lot more disclosure detail to predict what
22 your future is going to be than if you go to a seminar that
23 tells you about how to buy distressed property, and the seminar
24 may have even been free but in the back of the room there are
25 tapes that cost \$750.

1 That is a questionable area I think. Is that a
2 business opportunity or is it the type of situation where you
3 may want to buy the equivalent number of books from a book store
4 to go out and try to do the same thing? But there is a
5 difference in the fact that you are under somewhat of a pressure
6 situation. You've heard the sterling comments of a sales person
7 who speaks glowingly of other people's success and you see 15 or
8 20 percent of the people in the audience getting up to rush to
9 the back of the room to be able to purchase these and take them
10 home with them, rather than have to wait for their delivery
11 because they ran out. It's a little different than making a
12 reasoned decision, but I'm not so sure that that situation is as
13 important as the one where you're dependent upon the services of
14 the seller.

15 So I think there is a distinction on litigation. If
16 you have to have a rule that covers all situations, I think you
17 need to lean toward a broader litigation disclosure, maybe less
18 than franchise, but there should be a lot of consideration for
19 what types of lawsuits should be disclosed. If you're able to
20 distinguish between the long term relationship versus the one
21 time sale, then I'm not so sure you need much litigation
22 disclosure if any for that one time sale.

23 Then on total purchasers or number of outlets, I
24 think it's very significant to know some type of figure as to
25 the sales activity of the company that you're dealing with. If

1 for no other reason, I think you would like to know if they're
2 new at this game. If they only have a handful of sales, there
3 may not be anything wrong with that at all, but you may base
4 your decision more on their explanation of how their system
5 works than being taken in by the idea that we've sold 50,000
6 packages of whatever it is that's for sale, as if that's an
7 indication that they are successful. So I think the number of
8 sales could be important.

9 The list of buyers of whatever you're selling is a
10 little more problematic in that we get back to this distinction
11 I think of whether you're servicing the buyer or whether it's a
12 one time sale. For the most part, I can't envision why it's
13 very important to know a list of addresses, phone numbers, so
14 forth of other buyers of a one time purchase, but I think there
15 could be some description that would be reasonable where you
16 could perhaps say that you have to provide a list of the 100
17 most recent purchasers of your system as of 30 days of holding
18 your seminar or 30 days of your disclosure, some kind of a
19 system where you would have a small number of people that are
20 available.

21 I guess the opposite of that is I'd like to see a
22 number that's high enough that it's more difficult for the
23 seller to pick key people for you to contact so that they know
24 they're pre-programmed and some of them may not even be buyers.
25 So it's a real struggle I think to figure out the right

1 definition, but I would look at the long term relationship sale
2 of a business opportunity, to be in that case to be more like
3 franchise, where you need to know a significant number of
4 purchasers so that you can contact them and ask realistic
5 questions and get good answers that you're not going to get from
6 the seller, the typical being the vending machine sales
7 operation where theoretically you're going to keep buying more
8 machines and they're going to be trying to find more sites for
9 you. You better know how they've treated the prior buyers of
10 that system.

11 I like the idea of the first substantive discussion
12 as being an alternative to the first personal meeting for
13 business opportunities as a trigger for disclosure. I'm not wed
14 to those words, but something along that line that will be a
15 little broader than what's the franchise situation and be a
16 little better trigger than trying to just have a cooling off
17 period. I think we need to have something other than a date or
18 number of days or number of weeks. It should be an actual
19 physical type of trigger that requires the disclosure,
20 regardless of whether that disclosure in fact turns out to be
21 six months before the sale is consummated or two weeks before
22 it's consummated.

23 And again in contrasting franchise and business
24 opportunities, in most cases your business opportunity documents
25 are going to be a lot smaller in quantity and complexity than

1 the franchise situation. So I have never been overly happy with
2 the ten day rule, but it's workable. I certainly think that ten
3 day rule would be adequate or 14 calendar days, however you want
4 to work it, that period certainly would be adequate for most
5 business opportunities. You ought to be able to make up your
6 mind once you've got in that period of time before you hand over
7 your money. It's a little more of a problem with franchising.

8 On the issue of bankruptcy, I go back the dichotomy
9 I was speaking of between the ongoing relationship where I think
10 bankruptcy is important, to know what the bankruptcy is, of who
11 you're dealing with, the company or people, principals. If it's
12 a one time sale, I don't think it makes much difference because
13 if you're walking away with the product and you're not expecting
14 to have further contact with the company that sold it to you,
15 what do you care if they were bankrupt years ago or one of their
16 officers has gone through bankruptcy or has run a half a dozen
17 companies into the ground? If you think this product is good
18 for you, I don't think bankruptcy is that important for a one
19 shot sale.

20 But again, if you can't make that distinction in
21 ultimate rules you come out with, I think bankruptcy becomes
22 somewhat important across the board. The rule should be broad,
23 that you want some type of bankruptcy history.

24 Earnings claims I think are extremely important.
25 I'm not in the position to recommend for or against mandatory

1 earnings claims in the franchise or in the business opportunity
2 area. But I think that the business opportunity situation is
3 more likely than an I can think of where they will make earnings
4 claims, some of them very boldly in their advertising. I think
5 that there should be a very stiff rule for earnings claims
6 across the board on franchise as well as business opportunities,
7 that if you make an earnings claim, you have to be able to back
8 it up.

9 But I would go further even with business
10 opportunities, that they should actually show some evidence of
11 what backs up that earnings claim, as part of the documentation
12 that they give you. They should disclose that X, Y and Z have
13 in fact earned \$100,000 apiece and you can contact their CPA's
14 if necessary. I mean that may be going too far, but I'm just
15 trying to make the point that there should be something that
16 demands more than the bold claim with a rule that you must back
17 it up if you're challenged. I think that the back up to some
18 degree should be right there in front of the buyer as to how
19 they can make that claim. And if they say most of our people
20 have earned \$100,000 a year, I think they should have to say we
21 have 200 people, and 100 of them have made over \$100,000 a year,
22 or in a year, whatever the claim is. There should be more to it
23 than just the claim itself.

24 I think that maybe some comments that should be
25 made, as you talk to more and more people, about the financial

1 threshold. I think it's important that a threshold exclude the
2 smaller sales. I think that's a valid goal and one I agree with
3 in franchise and business opportunities, that there has to be a
4 point at which the buyer has to be totally responsible for what
5 he does. If he buys something for \$10, we can't go to war over
6 it. So a \$500 figure may be a very good threshold. I'm not
7 saying it's too high, too low, just that a threshold is good.
8 However, I think it should be clear that you can't avoid that
9 threshold very easily and that there should be some mention of
10 cumulative payments where the initial payment is \$499 but you
11 are required or it's obvious that you will have to buy something
12 else from the seller in order to make this opportunity work.
13 But they're telling you that your business opportunity cost 499.
14 Of course, you'd be stupid not to buy this package and that
15 package, this item and this product, which happen to come to
16 \$1,500. Or our initial package is 499 but in year two, in order
17 to make this succeed, you're going to have to put out another
18 \$1,000 or another 500 or whatever it is. Or pay off your fee in
19 installment payments.

20 Either of those situations, the installment payment
21 or the ability to escape the threshold by making requirements
22 that will obviously cost you more than \$499, I think should
23 still trigger disclosure. You may want to put a limit on it,
24 that this accumulation can only take place over a 12 month
25 period perhaps. You don't want to destroy business from being

1 sold either and there is a -- I wish I had the citation -- but
2 there are two or three federal cases where the plaintiff is To-
3 Am, T-o, dash, A-m and one of them deals with a forklift company
4 which is To-Am, they got caught up in being named a franchise in
5 litigation and it stuck. They never intended it to be a
6 franchise.

7 They were a dealer, and over the course of a year or
8 two, they purchased additional parts manuals and service manuals
9 at cost from the seller and those payments, finally after a few
10 years, accumulated to some \$1,500 or so and they made that
11 retroactive to reach the franchise threshold of \$500. Initially
12 they weren't required to buy any manuals. They were all
13 provided with one copy of every manual they would need, but
14 eventually they needed more and then they had to buy more. And
15 the company didn't say you couldn't photocopy them either. But
16 nevertheless, they were found to be a franchise that met the
17 threshold. That's why it triggered that in my mind, that you
18 don't want to go too far in cumulative idea to come up with
19 strange situation.

20 But I do think some mention of a cumulative
21 provision might be helpful in making sure that the trigger for
22 \$500, or whatever the threshold may be, is still viable. I
23 think that's all my comments.

24 MR. TOPOROFF: Thank you. We appreciate it. We're
25 going to go off the record for a second.

1 (Whereupon, a recess was taken.)

2 MR. TOPOROFF: We're back on the record. I just
3 want to make sure it's clear that this is a public meeting.
4 This is being taped and a copy of the transcript will be made
5 available on the public record and hopefully on our Internet Web
6 site.

7 With that, Susan.

8 MS. KEZIOS: My name is Susan Kezios, K-e-z-i-o-s.
9 I'm president of the American Franchisee Association.

10 This morning we've heard a couple of people talk
11 about the investments that they've lost. As you're familiar
12 with, I've always been an advocate of legislating some standards
13 of conduct between franchisers and franchisees. But the more
14 that I talk to franchisees, especially after they've lost their
15 investment, I'm coming to the conclusion that franchising
16 perhaps needs to be regulated like the sale of a security. I've
17 come to that conclusion for a number of reasons, but primarily I
18 know of no other industry where investors routinely lose
19 millions of dollars. And I'm going to give you a formula that I
20 just played with the other day.

21 It's coming up to millions of dollars a day, if
22 these facts are all correct. And there seems to be no one,
23 nobody is really paying attention to this incredible loss of
24 human beings' personal resources, their capital. Two studies
25 that have come out, which you may or may not be familiar with,

1 which I base some of what I'm going to say to you on, one was
2 done by Dr. Timothy Bates, talking about survival patterns among
3 franchised and non-franchised firms.

4 He used census data over a period of, I forget how
5 many years off the top of my head. What he found was that 38
6 percent of these franchises that were started from scratch,
7 failed, as opposed to 32 percent of the independent businesses
8 in similar industries that failed. So that's one set of numbers
9 that's in my head.

10 The other set is something that Dr. Scott Shane came
11 up with. He did a report entitled the Difference Between
12 Successful and Unsuccessful Franchisers. And he studied from
13 1983 to 1993, 138 franchisers that started out in 1983, and by
14 1993, 75 percent of them weren't around anymore. Did they go
15 out of business? Did they just quit franchising? Regardless
16 what the answer is, my question is what happened to those
17 franchisees, those people who invested money, who paid at least
18 an initial up front fee, and apparently ongoing fees over a
19 period of time.

20 Then you look at popular industry data. I'm looking
21 at a sheet here from June of '95 which may be a little out of
22 date, which claims that a new franchise opens every eight
23 minutes of each business day. And one day I actually sat down
24 and figured this out. My question was always, how many of them
25 close. In every business day, how many of them close? I never

1 see those numbers.

2 If you figure that every eight minutes of every
3 business day, that would be in a 24 hour time period, 180
4 franchises that open in a 24 hour times period. You figure that
5 on average an investor maybe will invest \$100,000. We heard
6 this morning \$289,000 from the one woman. Let's just figure on
7 the low side to be conservative, \$100,000. That's \$18 million a
8 day that's being invested in new franchises.

9 If you use Dr. Bates' survival rate of the
10 franchised firms, his number of 38 percent of those franchises
11 that start up and failed, that's, what, seven million down the
12 tubes every day from people who invested in a franchise. I
13 don't know of any other industry where American consumers can
14 lose \$7 million a day. It doesn't happen in securities.
15 There's no question under the securities laws, are we
16 regulating. Yeah, we are. We're making sure that the companies
17 are reliable, that the companies are strong, that the people who
18 make the offers and sell the securities have some liability and
19 have some culpability.

20 But it doesn't seem to be the case in franchising.
21 Also in securities, what I've started to learn is that if
22 there's a false statement in the sale of a security, someone is
23 witnessing it and that person is liable. That person is liable,
24 besides the corporation. And I think you heard this morning,
25 franchisees at least, the public telling you that things were

1 said to them. Nobody is held responsible for these things. The
2 Federal Trade Commission, from some of our members' viewpoints
3 and certainly from some people who spoke this morning, seems to
4 allow sales people or the franchisers to make claims and then
5 requires them to sign all sorts of things. We didn't ask this
6 morning about integration clauses, who these promises were made
7 or verbal statements were made to, a variety of people this
8 morning. But did they have to sign an integration clause which
9 basically means I can lie to you up to the point where you sign
10 the contract, and then you're going to say that we're bound by
11 the four corners of the contract.

12 And the other point, I thought it was very
13 interesting when Chuck Lay asked what do you do to enforce the
14 rule, I was wondering if anybody would ask him the question, do
15 you remember seeing on the front cover page of your offering
16 circular; we haven't read it, we don't check it. You need to
17 let us know about it. You've got the franchisers and the
18 franchisees that fail up front. And for those that don't fail
19 up front, then there is a whole laundry list of issues that come
20 under what we would consider unfair or deceptive acts or
21 practices, which the Commission keeps not taking action, like
22 some of the encroachment issues that were mentioned this morning
23 with Dr. Spencer Vidulich, whereby he signs a contract and
24 learns shortly thereafter that they're coming in with other
25 units which in effect will devalue his investment, yet that's

1 not our purview.

2 Transfer, the assignability of the current contract.
3 When a small business person wants to sell his or her business,
4 they do that. When a franchisee wants to sell his or her
5 business, the franchiser often requires that that new franchisee
6 sign the then current franchise agreement, which often contains
7 materially different financial and operational terms. The
8 franchisee, the current franchisee is stripped of their
9 ownership of that business. What happened to all that effort?
10 What happened to that investment? This is a serious public
11 policy issue.

12 They mentioned it a couple of times this morning.
13 Non-compete clauses. The franchise relationship almost always
14 includes a post-termination covenant not to compete which does
15 not allow for that franchisee to work. They were trying to make
16 Marge sign something. But this is a contractual device. It's
17 pervasive. It is used to ace the franchisee out of public
18 policy ownership of that business and the intangible good will
19 associated with that business.

20 These are pervasive tactics. They certainly should
21 come under the purview of unfair and deceptive acts or
22 practices. And also another one, the radically different
23 franchise agreements upon renewal. I think in my written
24 remarks I talked about, at the bare minimum, the word renewal is
25 a misnomer. You are not renewing what you entered into business

1 today and understood. Most franchisees find, when it's time to
2 renew, they are entering into a whole new franchise agreement
3 and they're presented it on a take it or leave it basis.

4 There was some mention this morning of coercion,
5 pressure for them to sign at certain points. And it's an
6 enormous pressure to sign upon renewal. This is truly a gun to
7 the head situation for these men and women. And this is routine
8 and it's systemic, from what we hear from our members.

9 It goes back also to no private of action under the
10 FTC rule for franchisees. Even they find that their franchiser
11 has violated the FTC rule, they have no private right of action.
12 The current state and federal regulatory scheme is wholly
13 inadequate for these men and women to safeguard their
14 investments.

15 If you go back to where opening up franchise
16 businesses to the tune, conservatively speaking, of \$18 million
17 a day and maybe 40 percent of that is going by the wayside, who
18 is watching these companies and the people who are making these
19 investments? I don't believe it happens in the securities
20 industry, although some of these people, I'm surprised some of
21 them are still standing. I visualize them mentally as slowly
22 bleeding to death. This is not a big train wreck. You don't
23 have the press in here taking photos of all this, but how does
24 Marge Lundquist sit here and calmly tell you she may be out a
25 half a million dollars? Does she have enough time left on this

1 earth to earn that money back? So who is watching out for that
2 investment by that person?

3 Earnings claims, I think I wrote in my written
4 comments, that the North American Administrators Association is
5 taking a look at historical financial performance information.
6 I serve on their franchise advisory board so I've been privy to
7 some of those discussions. You heard this morning also from a
8 couple of them, that having some kind of historical financial
9 performance information would probably have saved them from
10 perhaps not investing money to buy their particular franchise.
11 I think it also speaks to the fact that if the Commission would
12 mandate that franchisers must come up with some kind of earnings
13 information, financial performance information, the incidents of
14 unprofitable businesses that are being franchised would go way
15 down. Because right now they're able to hide behind the fact
16 that it's a voluntary disclosure.

17 We know that the majority of them volunteer not to
18 disclose it and they've been volunteering not to disclose it
19 since the rule was promulgated in 1979. So the market isn't
20 going to make them disclose historical financial performance
21 information. Some kind of a standard, a rule will make them do
22 that.

23 Franchisees who suffered significant economic harm
24 because of not having that information, to me it still escapes
25 me why that is not considered necessarily unfair or deceptive by

1 the Commission. In a general sense, if you're talking about
2 pre-sale and disclosure, perhaps the Commission can take a look
3 at how the franchises are sold. And somebody said something up
4 here this morning about where their franchiser claimed they were
5 going to be the McDonald's of the industry or they used that
6 phrase. That should be a phrase that perhaps the Commission can
7 banish from the use of any franchise sales person's lexicon,
8 because they neither have the resources that you would suppose
9 McDonald's to have and they certainly don't have the financial
10 capability or strength that a McDonald's would have. And that
11 phrase, by itself, often brings people in to make an investment
12 that perhaps they would not otherwise have made.

13 I think one of the first frauds that is perpetrated
14 upon many people when they buy franchises is this metaphor of
15 buying a franchise is like owning your own home, you're building
16 equity in yourself, which is totally untrue. It is more like,
17 when you look at what happens upon renewal, it's more like
18 renting an apartment. At the end of your lease, the landlord is
19 going to put a new contract down in front of you. Yet that's
20 not how the franchises are sold. And there's nothing in any
21 state law or federal rule that says you can't use this metaphor.
22 It doesn't matter what they sign, what they read later, what
23 they have signed and agreed to in writing later, it doesn't
24 matter, the damage has already been done.

25 Resources, since 1991 I've heard the Commission

1 state publicly, at least four times, and I'll probably quote it
2 here, that they lack enough resources to act on all meritorious
3 claims brought to it in a franchise realm. I'd like to know,
4 maybe I can find this, and I don't know where it is, but I'd
5 like to know what does the Commission request from Congress in
6 terms of money in the franchise area? What do you request from
7 ONB? I want to see what do you request specifically in
8 franchising because I know Congress isn't just going to give you
9 more money to address some of the issues in franchising without
10 you requesting it. That to me would be an interesting number to
11 take a look at.

12 Those are all the comments I have today.

13 MR. TOPOROFF: Okay. I have a number of questions.
14 First off, the analogy to securities -- do you want to take a
15 break?

16 MS. KEZIOS: No, I just want to get some water.

17 MR. TOPOROFF: The analogy to securities, in part
18 securities are regulated because Congress passed various
19 statutes that address the sale of securities, setting up the
20 Securities and Exchange Commission and any number of statutes,
21 and I would not at all profess to be an expert in the sale of
22 securities.

23 Isn't much of what you're proposing really a
24 question of getting federal legislation as opposed to what the
25 Federal Trade Commission could actually do under the statutory

1 authority that it already has?

2 MS. KEZIOS: I think it has a broad statutory
3 mandate under Section 5 to stamp out unfair, deceptive acts or
4 practices. And it seems that in certain areas, with Joe Camel,
5 tobacco, we're starting to define what's unfair, but we just
6 don't see it happening in the franchise industry.

7 On the one hand I'm saying I think you've got some
8 room to maneuver under Section 5. On the other hand, yeah,
9 Congress hasn't set up a Securities and Exchange Commission. So
10 on the one hand I'm saying I'm here to try and seek an
11 administrative solution to some of these problems, but on the
12 other hand, I also stated, as you know, we're very much
13 advocating legislative solutions to franchisee problems.

14 MR. TOPOROFF: I appreciate that. Getting to
15 Section 5, there's often misconceptions of what Section 5 really
16 states. Just for background purposes, what is your
17 understanding of what Section 5 is all about?

18 MS. KEZIOS: Basically that you can in fact look, I
19 guess within an industry, for lack of a better word, to see what
20 may be systemic as far as unfair or deceptive acts or practices.
21 I do know also that Congress limited, I forget when, 80's maybe,
22 what the FTC could do, severely limited from what I understood,
23 in defining what was unfair in commerce and trade.

24 MR. TOPOROFF: That's right.

25 MS. KEZIOS: So I understand that. I'm not sure if

1 I know exactly how that came about, but I'm also aware of that.

2 MR. TOPOROFF: Just so that the record is clear, I
3 would like to state exactly what the definition of unfairness
4 is, so that we have that on the table. I can get you a copy of
5 this.

6 This is in the Re-authorization Act of the Federal
7 Trade Commission which I believe was in 1994. Basically it says
8 for Section 5, it says, the definition of unfair acts and
9 practices, and then it continues, "The Commission shall have no
10 authority under this Section," meaning unfair practices, "to
11 declare unlawful an act or practice on the grounds that such act or
12 practice is unfair, unless the act or practice causes or is
13 likely to cause substantial injury to consumers which is not
14 reasonably avoidable by consumers themselves, and not outweighed
15 by countervailing benefits to consumers or to competition."

16 So basically what the Act says is it's not a
17 question when the Commission should act or even a definition of
18 unfair. It specifically says that the Commission has no
19 authority at all to look at unfair practices unless the
20 following three criteria are met. Again, just to summarize,
21 substantial injury; a showing that it's not outweighed by other
22 benefits to competition or to consumers; and again, that it's
23 not reasonably avoidable.

24 So given that restraint on the Commission, how do
25 you see the Commission taking a greater role in the area of,

1 let's just say for example, encroachment of territories?

2 MS. KEZIOS: First of all, I think the Commission
3 has -- \$7 million a day my rough estimate. I think that's
4 substantial injury and substantial economic harm to somebody or
5 to a class of people. So I think right away the first criteria
6 is covered.

7 What was the second criteria? Reasonable avoidance.
8 I got the third.

9 MR. TOPOROFF: That is not outweighed by count
10 availing benefits to consumers or to competition.

11 MS. KEZIOS: I'm not sure I know what that means,
12 but if that means we provide disclosure --

13 MR. TOPOROFF: Let me give you an example. This
14 comes up all the time in encroachment.

15 A franchisee may come and tell us that they're
16 suffering from encroachment, meaning that the franchiser has
17 opened up systems --

18 MS. KEZIOS: I think I understand, but it's
19 beneficial for the consumers to have so many locations.

20 MR. TOPOROFF: Or benefits to competition. I could
21 tell you only one instance in the ten years that I've been
22 working at the Commission, only one instance in a franchise
23 case, a complaint that came to our attention, that even
24 purported to give any kind of economic analysis that a
25 particular problem did not provide any benefits to other

1 consumers or to competition.

2 We hear a lot of problems but there is almost never
3 any attempt to show that the difficulty that the franchisee is
4 suffering is not outweighed by again benefits to competition or
5 to other consumers.

6 MS. KEZIOS: There are recent articles, reports,
7 that are showing within industries outside of franchising that
8 over-saturation of a market has its economic limitations, when
9 you're bringing up the encroachment issue. But what you're
10 saying is that it's beneficial to consumers to have all these X,
11 Y, Z franchises around. So that's how it goes?

12 What happens to these people's investments, as their
13 investments are devalued? Who pays attention to that?

14 MR. TOPOROFF: That's not what I'm saying.

15 MS. KEZIOS; My question is still not answered.

16 MR. TOPOROFF: It could be that there's just a gap
17 in the law that's not being addressed. What I'm saying is, and
18 again I'm using encroachment as an example, but I don't mean to
19 dwell on it, that for the Commission to have authority under our
20 statute to determine whether that's a deceptive act, there has
21 to be a showing that it's not outweighed by benefits to
22 consumers. If we don't have that and if we were to go into
23 Federal Court, for example, the Judge would look at our statute
24 and if there was absolutely no analysis at all of the issue, the
25 case would be dismissed because we have failed to show that the

1 Commission has authority in this area.

2 So I just want to make it clear that when it comes
3 to unfair practices --

4 MS. KEZIOS: Your hands are tied at this point, is
5 that what you're saying?

6 MR. TOPOROFF: That there's a statutory showing that
7 we must make. And again, we certainly appreciate hearing from
8 franchisees and learning from their experiences, but part of
9 this is that there should be realistic understanding of exactly
10 what the Commission would have to show in order to get into
11 Federal Court. Again, I just wanted to emphasize that except
12 for one instance that I'm aware of, that resolved itself in
13 other ways, I've never seen any complaint or information that
14 was submitted to the Commission that even approached or
15 purported to approach this question of the balancing, of
16 weighing the particular harm to franchisees or alleged harm to
17 franchisees in a particular system versus benefits to consumers
18 or to competition.

19 MS. KEZIOS: I understand your point. I understand
20 your point. I have a clear understanding now. You've given me
21 the document. However, my question is still not answered and
22 neither are these people's. What about my investment? Who is
23 looking out for me? I've invested hundreds of thousands of
24 dollars here.

25 I'm assuming you have stocks somewhere, and if you

1 invested a lot of money and lost it, I bet you'd be screaming or
2 at least coming somewhere and saying to somebody who is going to
3 do something about this.

4 MR. TOPOROFF: So basically what I'm suggesting,
5 after we boil this all down, is --

6 MS. KEZIOS: I'm in the wrong place?

7 MR. TOPOROFF: Possibly. And that ultimately
8 doesn't this require a legislative fix as opposed to looking
9 toward the Commission to solve problems under a very, very
10 limited definition of unfairness in our statute.

11 MS. KEZIOS: I've already stated, we're continuing
12 to pursue a legislative solution. If we can fix any of these
13 problems administratively, if I can have one less thing to argue
14 about before a Congressional hearing, I'd like to. So we're
15 here to offer that.

16 MR. TOPOROFF: Okay. The next issue. You've
17 mentioned private right of action, same kind of issue. What
18 authority would the Commission have to enable any franchisee to
19 have a private right of action?

20 MS. KEZIOS: You need that from Congress.

21 MR. TOPOROFF: That's right.

22 MS. KEZIOS: I already know that. But I have to put
23 it on the record.

24 MR. TOPOROFF: That's fine. That's fine. One other
25 point I wanted to mention is you talked about resources at the

1 Commission as far as franchising goes. I'm not going to offer
2 any comment on that one because as an attorney I deal in case
3 work and not the budget, so I'm not in a position to offer any
4 advice or comment on that.

5 But one thing that I would want to mention is you
6 and others have noted the number of cases that the Commission
7 could bring at any one time versus the number of complaints that
8 it might receive. An argument could be made that given limited
9 resources that the Commission has and may continue to have, that
10 alternatives to law enforcement should be pursued. And that's
11 one of the proposals that the Commission has put forth in the
12 ANPR, some kind of voluntary compliance mechanism, if you will,
13 that would enable franchisees who do have disclosure issues to
14 be heard in some kind of forum.

15 Would you have any advice for us -- and I know that
16 we're going to address this later on in September, and if you
17 prefer to delay the discussion until then, but would you have
18 any advice for us as we consider those types of proposals? And
19 again, if you feel more comfortable discussing it in September,
20 that's fine.

21 MS. KEZIOS: We were preparing to do that in
22 September because we've got some reservations about the proposed
23 -- I forget what it's called -- the mediation program, the so
24 called mediation program which is one of our concerns with it,
25 because I don't think it really is mediation. I think it's kind

1 of a misnomer, as well.

2 But I will address that in September when we're at
3 the round table there.

4 MR. TOPOROFF: All right. Thank you.

5 MS. KEZIOS: Thank you.

6 MR. TOPOROFF: We're off the record.

7 (Whereupon, the meeting was concluded
8 at 12:52 p.m.)

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

C E R T I F I C A T I O N O F R E P O R T E R

DOCKET/FILE NUMBER: R-511003

CASE TITLE: In re: FRANCHISE RULE

HEARING DATE: AUGUST 22, 1997

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED:

MARY C. FRITZ

C E R T I F I C A T I O N O F P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

SARA J. VANCE