January 31, 2000

Mr. Donald S. Clark, Secretary
Federal Trade Commission
600 Pennsylvania Avenue N.W., Room 159
Washington, D.C. 20580

Re: 16 CFR Part 436
Rebuttal Comments

Dear Mr. Clark:

The following comments were prompted by one or more of the 27 comment letters previously filed with your office to suggest modifications to the proposed FTC Franchise Rule amendments.

PREEMPTION

States should not be foreclosed from having their own requirements, especially if they are not provided for in the FTC trade regulation. One of the most important areas is jurisdiction/venue /choice of law.

When franchisors designate their headquarters state as governing jurisdiction and choice of law in contradiction of another state's law, the door is open for any state or federal judge to decide that the signed contract should be given more weight than the expressed or implied intention of the state legislature.

If the FTC decides to deal with jurisdiction and choice of law issues, it should state that no franchisor can designate in its contract a state foreign to a franchisee as the venue or choice of law for legal disputes if the franchisee's state laws would be in conflict. For purposes of uniformity the franchisor could state in the contract where jurisdiction would be and what state law applies for each state within which sales activity is taking place. The other choices for the franchisor would be to say nothing about jurisdiction or choice of law, or to state that the law to be applied and jurisdiction for legal disputes shall be the state where the franchisee is located.

Dual federalism has served the public well. The states have been the laboratories for new ideas and in many areas the federal government has appropriately refused to preempt this relationship. The present merger of UFOC Guidelines and the FTC Franchise Trade Regulation is a good example.

If the FTC established a preemptive rule as to amendment requirements it should make it very clear that delivery of such material changes to prospective franchisees must be done immediately.

The FTC should also make a clear declaration that regardless of any specific preemptive rules, the states are free to establish or continue franchise registration and review systems.

DEFINITIONS

Brokers

A definition of Franchise Broker is necessary and different commentators have made good suggestions. The most common misunderstanding is with people who think of themselves not as brokers, but merely as persons making a referral and earning a referral fee. Any definition should make clear that, except for the franchisee making a referral within the same franchise system, anyone sending a prospect to the franchisor with the expectation of a fee should be considered a broker. Illinois has established new rules for brokers that take into account the isolated transaction, which excuses registration and franchisor disclosure. A copy of the Illinois statute [815 ILCS 705 §§3(21) 5(3); 13]; and Rules [14 Ill. Admin. Code §200.116; 202b] are enclosed as to broker's responsibilities.

Franchises

Several commentators want to increase the $500 threshold by hundreds or thousands of dollars regarding the definition of a franchise. The best solution is to leave this almost universal element of the franchise definition as-is. The reality is that a $500, up-front investment, is only the tip of the iceberg in virtually every franchise system. Royalties, equipment purchases, leases, inventory and myriad other payments and contractual obligations put most franchisees at great financial risk while having little or no direct experience to make life-changing decisions. To exempt franchises that do not have an initial fee, or ones that have what appears to be a modest fee of $1,000 or $2,500, would put too many "small" investors at risk. Franchisee exposure is typically much greater than the typical stock or bond purchaser, but regulation of corporations and stockbrokers is more comprehensive as to market investments than the regulation of franchises. Please do not eliminate substantial segments of franchising from regulation if to do so would have unsophisticated buyers at great risk.

Another commentator raised the issue of the franchise definition in §436.1 (g) including business relationships called a franchise by the parties, but which otherwise would fail the traditional definition. Case law verifies that a relationship will be a franchise if it fits the definition, even if the parties specify that it is not a franchise. However, there is no reason to thrust franchise responsibilities on persons who have in fact not created a franchise, although the "franchisee" might have a separate cause of action for misrepresentation.

Exclusive Territories

Some of the comments filed raise important issues regarding territories. There should be a definition of "exclusive territory" and a warning legend in Item 23 that at least covers the various forms of franchisor controlled competition.

The new franchisee may not realize that an unclear territory definition in the contract would allow direct competition by the franchisor at non-traditional sites or through unanticipated means. For example: catalogs, web-sites, adding a product line in unrelated retail stores and competing brands owned by the franchisor can each diminish the sales in a franchisee's market area.

CONFIDENTIALITY CLAUSES

Comments regarding the "gag clause" disclosure proposal ranged from total opposition to outlawing confidentiality clauses, with some taking a middle ground, that justifiable trade secrets should be confidential, but the day-to-day relationship of franchisors and franchisees should never be silenced when a prospect asks for information. Please reconsider §436.1 (k) and the related provision in Item 20 to instead forbid confidentiality clauses that prevent franchisees from disclosing relationship issues to prospective franchisees.

The proposed rules could also list the subjects of confidentiality clauses that could properly be required of franchisees.

It would be reasonable to allow confidentiality as to prior agreements of a company that were not involved in franchising when the agreements were entered into.

CONTRACT INTEGRATION CLAUSES

One of the most difficult situations facing a franchisee and their counsel is the franchisee hearing a material representation that is relied upon, but only after meeting with a lawyer does the franchisee realize that the representation was meaningless because of the integration clause and contract law. Unlike the problem of oral statements, a franchisor should be held to the written representations in its UFOC unless a specific, negotiated change, would contradict something in the UFOC.

Comprehensive disclosure that gets the prospect through the door, should not be cast aside in the contract with an integration clause, the impact of which will be unknown to the franchise prospect when the contract is signed.

ITEM 20 LIST OF OUTLETS

The general consensus of commentators seems to be that Item 20 charts needed improvement, the proposed rule is an improvement, but some additional information is needed to

make this disclosure more meaningful.

The problem that still needs to be solved is to identify high turnover at particular sites that may be unprofitable no matter who manages them, but the franchisor keeps selling the site or territory to new franchisees. Identifying the first or last event for the year at each site is totally inadequate.

One commentator made an excellent suggestion, which was to tie the list of former franchisees to the events indicated on the charts. This would be very helpful to prospective franchisees.

Separate charts to deal with what happened at various sites versus what happened to particular franchisees may resolve many of the problems with Item 20 data.

FINANCIAL STATEMENTS

Inclusion of the parent company's financial statements should not be required unless that parent is a guarantor of the franchise system's financial obligations. If the FTC decides to require such financial statements from parent companies not acting as a guarantor, the rule should require a bold statement as to whether or not a parent is a guarantor for its subsidiary franchise system.

FRANCHISEE ASSOCIATIONS

Identifying franchisee associations for prospective franchisees is an excellent idea. Several commentators want to diminish the degree of this disclosure, but in the process of trying to eliminate persons or groups representing few franchisees, the benefits of this disclosure may be totally lost.

While trying to design a workable association rule, please consider the mindset of most franchisees, which is an extreme fear of retaliation for belonging to an association not sponsored by the franchisor. Even in systems where this fear is unjustified, franchisees are still afraid to be identified with people or groups that may from time to time oppose policies of the franchisor. Setting a minimum percentage of franchisees to be a qualified association is virtually unworkable, but if this approach is used the threshold should be set very low. Five percent of a system's franchisees who are willing to be known as members of a franchisee association may be accompanied by 25% of the franchisees that are of like mind, but afraid to reveal their membership.

FINANCIAL PERFORMANCE REPRESENTATIONS

If a franchisor disseminates a previously published media statement containing information or quotes that could constitute earnings claims, the franchisor should be required to back up the claims upon request by a prospective franchisee or a regulatory agency. However, if the representations are accurate and supportable, the franchisor should be given the option of

making a disclosure in Item 19. If the prospective franchisee could reasonably believe that a newspaper article provided by the franchisor presents reliable data, the franchisor should be responsible for material errors that influence a buyer's decision to be a franchisee.

GAAP REPORTING

There is no apparent need to require compliance with Generally Accepted Accounting Practices (GAAP) in Item 19 earnings claims. Disclosure in Item 19 should be encouraged, but GAAP requirements would further discourage disclosure.

However, with regard to GAAP requirements for Item 21 Financial Statements, foreign franchisors should continue to comply with GAAP. These franchisors could be allowed to use reconciliations and footnotes to restate or explain data that is absent under their accounting standards or that is in conflict with GAAP, but the basic requirement should remain. Reconciliation is most frequently necesssary when reporting goodwill, deferred taxes, pension costs, asset revaluation, net income and shareholders' equity.

Individuals, the S.E.C. and accountancy organizations throughout the world have compared the respective GAAP requirements of various countries and the general conclusion is that they wish complying with United States GAAP requirements could be made easier, but there is no need to rush into an international set of standards. Expecting franchisees, or even their accountants, to understand the nuances of multi-national accounting standards is not reasonable under the circumstances.

The January, 2000 edition of Business Finance includes the article "Worldwide Accounting Standards" The Ball Is In the SEC's Court (see copy attached). The article points out that although the Financial Accounting Standards Board (FASB) is making U.S. GAAP a little more like foreign standards, the standards developed by the International Accounting Standards Commission (IASC) are not likely to be accepted by the Securities and Exchange Commission (SEC), because they are not detailed enough and do not have the degree of credibility provided by U.S. GAAP.

This is not the time to attempt a dual set of accounting standards based upon the unproven concept that accepting foreign accounting standards will increase the number of foreign franchisors desiring to sell in the United States.

Sincerely,

Robert Tingler
Franchise Bureau Chief

RT/gcc

FRANCHISE DISCLOSURE ACT OF 1987

815 ILCS 705/1-44 (1999)

705/3 **DEFINITIONS**

§3. As used in this Act:

(21) **"Franchise broker"** means any person engaged in the business of representing a franchisor in offering for sale or selling a franchise and is not a franchisor or an officer, director or employee of a franchisor with respect to such franchise. A franchisee shall not be a franchise broker merely because it receives a payment from the franchisor in consideration of the referral of a prospective franchisee to the franchisor, if the franchisee does not otherwise participate in the sale of a franchise to the prospective franchisee. A franchisee shall not be deemed to participate in a sale merely because he responds to an inquiry from a prospective franchisee.

705/13 **REGISTRATION OF FRANCHISE BROKERS**

§13. A franchise broker shall not offer or sell a franchise which is required to be registered under this Act unless the franchise broker first registers under this Act by filing an application in a form prescribed by the Administrator and a consent to service of process, if required, and shall file with the Administrator, for each salesperson who represents the franchise broker in the offer or sale of franchises which are required to be registered under this Act such information as the Administrator may by rule require. The Administrator may prescribe rules governing the sale of a franchise by a franchise broker including qualifications, conduct, suspension, termination, prohibition or denial of the registration of a franchise broker. The registration of a franchise broker shall be effective for a period of one year from the registration date, and may be renewed for periods of one year, unless the Administrator by rule or order prescribes a different period. **[Note: also see Rules 900-901 and Appendix B]**

RULES UNDER THE FRANCHISE DISCLOSURE ACT

14 Ill. Admin Code §200

§200. 116 Franchise Broker

A person shall be deemed to be a franchise broker engaged in the business of representing a franchisor in offering for sale or selling a franchise within the meaning of Section 3 (21) of the Act, unless otherwise exempt, if such person provides a prospective franchisee with information about specific franchises other than the franchisor's name, address and phone number. The expectation or acceptance of a fee contingent upon a franchise sale shall be considered as evidence of franchise broker status unless such fee results from an isolated transaction as defined in Section 200. 202.

§200.202 Exemptions by Rule

b) **Isolated Transaction**

1) If a referral source provides the name of a prospective franchisee to a franchisor and receives a referral or broker fee, but the person making the referral has no involvement in presenting the advantages of that particular franchise system, handles no franchisee payments owed to the franchisor, and has made no referral to that franchisor during the preceding 12 months, then such an isolated transaction does not require registration as a franchise broker and does not require the franchisor to provide disclosures concerning the person making the referral in the franchisor's UFOC.

2) If a franchisor obtains a prospective franchisee from an unregistered broker, the franchisor must verify the representations made to the prospect by the broker and that all required disclosure has been provided. No referral fee or commission shall be paid to the broker until such broker is properly registered with the Administrator or is found to be exempt from registration.

c) An **officer, director or employee of an affiliate or related company of the franchisor** is exempt from the Broker Application and Registration requirements of Section 13 of the Act, provided that the franchisor files a Sales Agent Disclosure Form with the Administrator for any such person. See Appendix A, Illustration C.

THE GLOBETROTTER

Worldwide Accounting Standards: The Ball Is in the SEC's Court

Will the global business community ever have a single set of global accounting standards? If so, which set of accounting standards will be used — U.S. GAAP, the standards developed by the International Accounting Standards Commission (IASC) or some other country's GAAP?

So far, these are important but unanswered questions for U.S. companies. One thing is certain, however. Regardless of what standards are chosen, the U.S. Securities and Exchange Commission (SEC) will have tremendous influence over that decision. The SEC has two choices: (1) It can, essentially, give its stamp of approval to the international accounting standards developed by the London-based IASC (International Accounting Standards Commission) by allowing foreign companies trading in U.S. markets to use IASC standards in their financial statements; or (2) It can reject IASC standards outright and go on requiring that all companies trading in U.S. markets continue the current practice of using either U.S. GAAP in their financial statements or some other accounting method but providing footnotes in financial statements indicating results using U.S. GAAP.

"In either case, the SEC has an enormous amount of influence," says William E. Decker, partner in charge of the global capital markets group at PricewaterhouseCoopers LLP in New York. "If it closes the door to IASC standards, it will encourage the use of U.S. GAAP. If it embraces IASC standards, it will gain influence because it will be the only enforcer of those standards."

Despite this, the SEC has shown no indication of when — or if — it will take action. "The ball is in the SEC's court, and it is sitting on it," according to Dennis Beresford, executive professor of accounting at the University of Georgia's Terry College of Business in Athens, Ga. Beresford is also a former director of the Financial Accounting Standards Board (FASB). However, he notes that the general thinking is that the SEC will not issue a blanket "yes" on the use of IASC standards. "There is a general feeling that IASC standards are significantly less disciplined than U.S. standards and produce less good information on financial statements," he says.

Why Do Anything?

The lack of global accounting standards has not deterred foreign companies from entering the U.S. securities markets. Whether looking for capital or the right opportunity for a stock-based acquisition, foreign companies are establishing a presence in U.S. markets at a rapid pace and many more are preparing to enter, says Decker. Clearly, these companies are not waiting for IASC standards to be recognized as the global accounting standards. Instead they are ready to use U.S. GAAP in their financial statements as do U.S. organizations. Or, they are preparing their financials using another standard, such as UK GAAP or German GAAP, and providing a footnote describing the difference between that method and U.S. GAAP, and showing the impact the method has on shareholder equity and the difference between the two, says Decker.

From the U.S. perspective, this status quo is working well. "The general feeling in the U.S. is, why do anything," says Beresford. "We have the best capital markets in the world largely because of our credible financial reporting, so people are very happy with the status quo." Beresford calls significant acceptance of IASC standard in the U.S. a "long shot because there is a feeling that IASC standards are vague, don't provide

enough details, and [are] not enforced with discipline," he says. "Consequently, those standards don't have the same degree of credibility as U.S. GAAP."

The Impact on U.S. Companies

For their part, U.S. companies see the debate over global accounting standards as a non-issue. "That is a mistake," says Decker. If the SEC allows foreign companies to use different accounting standards in U.S. markets, "U.S. companies may soon find they are competing for capital against companies that use a different, and possibly more lax, set of accounting standards," he says. "Companies will begin asking, 'Why can't we do these things?' "

The bottom line is that financial executives want to follow only one set of accounting standards to ensure a level playing field in the capital markets. "Companies don't want to compete for capital against other companies that can get away with providing less or different financial information," says Beresford.

No matter what the final outcome of the global accounting standards question, the overall question is part of a broader trend toward the internationalization of accounting. "FASB is already making changes to make U.S. GAAP more like the accounting standards used globally," says Beresford.

—JS

Take my Accounting Department, Please

BP Amoco PLC, the London-based petrochemical company, has once again sealed a "largest-yet" deal. This time, the superlative describing the company's $1.1 billion, 10-year deal with PricewaterhouseCoopers (PwC) might read: "Largest Accounting Outsourcing Agreement."

When the outsourcing deal was announced in November, its size caught the attention of headline writers and finance professionals. PricewaterhouseCoopers reported that 1,200 out of 1,276 employees who work in BP Amoco's U.S. accounting department (including financial reporting and accounts payable) and back-office operations had accepted offers to transfer to PwC. Despite the scope of this particular business process outsourcing (BPO) agreement, the seeds of the PwC outsourcing deal were sown in August 1998 when British Petroleum Co. PLC and Amoco Corp. first announced their intent to merge. At that time, BP CEO Sir John Browne, who is now the CEO of BP Amoco, said the new company expected to save $2 billion through staff reductions, more focused oil exploration and streamlined business processes. Before the merger, British Petroleum Co. pursued an outsourcing strategy, and Amoco relied upon shared services, which essentially is an internal form of outsourcing. The outsourcing agreement with PricewaterhouseCoopers is a product of blending the two organizations.

PricewaterhouseCoopers had assumed many accounting and back-office functions for BP Amoco in Europe and South America before the U.S. deal was announced, and a similar agreement for the company's Canadian operations is expected to be announced this month.

Finance executives will be watching closely to see how much savings BP Amoco realizes from this arrangement. Clearly, the company considers outsourcing accounting functions an effective outsourcing strategy, and the CEO's buy-in was key to the deal. More important, the deal may make similar business processing outsourcing agreements seem less imposing to finance executives at other companies.

—EK