



June 8, 2023

By electronic submission: <http://www.regulations.gov>

Federal Trade Commission
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex C)
Washington, DC 20580

Re: Franchise Agreements and the Franchisor / Franchisee Relationship

To whom it may concern:

On behalf of the Restaurant Law Center (the “Law Center”) and the National Restaurant Association (the “Association”), we submit the following comments in response to the Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices (the “Solicitation”), issued by the Federal Trade Commission (“FTC” or the “Commission”) on March 9, 2023.

I. Interest of the Commenters

The Restaurant Law Center (“Law Center”) is the only independent public policy organization created specifically to represent the interests of the restaurant and foodservice industry (the “Industry”) in the courts and before regulatory agencies. Its expressed purpose is to promote laws and regulations that allow restaurants to continue growing, creating jobs, and contributing to a robust American economy. The Law Center’s goal is to protect and advance the Industry and to ensure that the views of America’s restaurants are taken into consideration by giving its members a stronger voice, particularly in the courtroom, but also before legislative and administrative bodies. Thus, the Law Center files comments and pursues cases of interest to the Industry.

Founded in 1919, the Association is the largest foodservice trade association in the world. The Industry is very labor-intensive comprised of over one million food

service establishments employing approximately 15.5 million people across the Nation – approximately 10 percent of the U.S. workforce. Restaurants and other foodservice providers are the Nation’s second largest private-sector employers. The restaurant industry is also the most diverse industry in the nation, with 47% of the industry’s employees being minorities, compared to 36% across the rest of the economy. Further, 41% of restaurant businesses are primarily owned by minorities, compared to 29% of business across the rest of the United States economy. Supporting these businesses is the Association’s primary purpose.

While the Industry is generally considered the second-largest private sector employer, the Industry is primarily made up of small businesses. Even well-known brands are often made up of smaller franchised businesses, individually owned and operated by families and small private companies.

We are concerned about the Commission’s process here, where it may interpret anonymous, unreliable, anecdotal accounts as justification for engaging in a formal rulemaking process to restrict the franchise relationship. This type of restriction would detrimentally affect family business growth, disrupt safe food supply chains, damage financial investments in brands, and adversely affect decades of court precedent that articulates when a franchisor exerts too much control and exposes itself to the liabilities of a franchisee.

II. Factual and Legal Information

1. History and Reasons for Franchise Relationship.

To consider the Commission’s request for comments, it is important to look at the history of franchising. The franchise model has evolved over time, with roots in earlier forms of delegation of authority. The modern franchise system was greatly assisted in its development by the legislative grant of franchise rights to utilities. Rapid growth in the United States expanded the use of the franchise system in many areas as a means of reliably providing goods and services to a broad and diverse population.

The franchise model experienced rapid growth following World War II. Franchising became a popular way for businesses to expand their reach. Franchises are regulated by state and federal law, with various protections for both franchisors and franchisees. For example, in *Westfield Centre Serv. v. Cities Serv. Oil Co.*, 158 N.J. Super 455 (1978), the court discussed the Franchise Practices Act and the rights and responsibilities of franchisors and franchisees.

Indeed, the Commission has its own regulations already in place. There, the FTC’s definition of a “franchise” is found in 16 C.F.R. § 436.1(h):

(h) Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;

(2) The franchisor *will exert or has authority to exert a significant degree of control over the franchisee's method of operation*, or provide significant assistance in the franchisee's method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.¹

The *definition* of a franchise under the Commission's Franchise Rule contemplates some degree of control be exercised by the franchisor to ensure the system and methods of the brand are implemented by the separately owned franchisee's business.

Controls such as these provide protections to both the franchisee and the franchisor. For the franchisee, the controls protect the equity built or building in their business and guard against fluctuations that may result from others offering sub-standard products to customers under the same brand. In much the same way, franchisors are protected by these controls in that their capital investment in branding, marketing, and system integration are maintained over time.

Generally, the controls the Commission's definition currently contemplates also benefit the consumer. Here, the controls allow Restaurant franchisors to exercise control of suppliers to ensure consistent and safe products for consumption.

2. Need for Control for the Purpose of Food Safety and to Ensure Brand Standards Are Met.

Franchisors need to control food safety for franchisees in order to protect the public as well as the franchisor's trademarks, and to maintain brand integrity. This concept is supported by several court cases, emphasizing the importance of a franchisor's need to control the quality of goods and services provided by franchisees in

¹ 16 C.F.R. § 436.1(h) (emphasis added).

order to protect the public and its brand. For example, in *IHOP Rests. LLC v. Moeini Corp.*, the court notes that a franchisor has “good cause” to terminate a franchisee who repeatedly fails to comply with food safety standards, in order to protect its brand. *IHOP Rests. LLC v. Moeini Corp.*, 2018 WL 762343 (S.D. Ala. Feb. 7, 2018). Similarly, in *Greil v. Travelodge International*, the court discusses the need for a franchisor to guarantee that third parties dealing with the franchisee will receive goods or services of the quality they associate with the trademark. *Greil v. Travelodge International*, 541 N.E.2d (Ill. App. Ct. 1989).

Other cases emphasize the importance of a franchisor's ability to enforce health, safety, and sanitation standards. For example, in *Dunkin' Donuts, Inc. v. Albireh Donuts*, 96 F. Supp. 2d 146 (N.D.N.Y. 2000) the court discusses the franchisor's need to ensure that franchisees adhere to these standards in order to protect the public and maintain brand integrity.

In addition to ensuring food safety, an optimized supply chain network that leverages the scale of the franchise system allows franchisors to negotiate with a manufacturer and know that the product will arrive at the restaurant with a reasonable distribution cost markup and the most dependable, lowest freight rates. The bargaining power that the franchisor has due to scale, benefits the franchisee over the long term, avoiding spot pricing that fluctuates in both cost and quality.

3. Need for Some Control to Ensure Worker Safety and Brand Standards Regarding Customer Experience Are Met.

Franchisors will generally look to limit control over worker safety in order to avoid liability for the actions of their franchisees. Franchisors may be held liable if they exhibit the traditionally understood characteristics of an “employer” or “principal” by retaining or assuming a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees.

Legal cases have assisted franchisors and franchisees to understand where the line is between control for the sake of protecting brand standards and control that subjects the franchisor to the liabilities of the franchisee. For example, in *Salazar v. McDonald's Corp.*, the court held that the franchisor was not an “employer” for purposes of wage and hour claims because it did not control aspects of the franchisee's operations such as hiring, firing, and other personnel matters. Similarly, in *Karnauskas v. Columbia Sussex Corp.*, the court held that the franchisor was not liable for injuries occurring on the licensee's premises because the franchisor did not have “considerable day-to-day control over the specific instrumentality that is alleged to have caused the harm.”

However, franchisors do need to enforce health and safety requirements on franchisees in order to protect their brand and reputation, as seen in *Dunkin' Donuts, Inc. v. Albireh Donuts*. In that case, the franchisor was able to require the franchisee to maintain the interior and exterior of the store and all fixtures, furnishings, signs, and equipment in a clean and orderly manner. As stated supra., these types of protections administered through the system protect the franchisee's investment and equity in their business, while maintaining the value of the brand for the franchisor.

4. Small Businesses in the Industry Will Be Adversely Impacted if the Traditional Model of the Franchise Relationship Is Not Maintained.

Many businesses in the restaurant industry are small family-run businesses with one or two restaurants, or small local franchisees. Many of these businesses are operated by first-time business owners of diverse backgrounds. These businesses will be particularly affected by changes to the franchise model. The increased costs that a change to the franchise rule will impose upon small businesses will be significant. In addition, a change to the franchise rule will create inequities between the small family business and their large competitors.

III. The FTC Does Not Have the Legal Authority to Broadly Regulate the Franchise Model.

The Commission's RFI invites unreliable anonymous ad hoc comments to be used as steppingstones to undermine the foundation of decades of court decisions and regulations regarding the franchise model. Weakening the foundation would work to the detriment of consumers and employees alike through unreliable and unsafe food supply chains and facilities.

Presumably, the Commission will attempt to rely on Section 5 of the FTC Act as its purported legal basis to promulgate any wide sweeping change to the franchise rule. However, Section 5 is impermissibly vague and ambiguous, permitting the Commission to "prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."

Ultimately, Section 5's vague and ambiguous description of authority is precisely the type of purported authority that was struck down by the United States Supreme Court in *West Virginia v. EPA*. There, Chief Justice Roberts wrote for the majority that, pursuant to the Major Questions Doctrine,

"in certain extraordinary circumstances, both separation of powers principles and a practical understanding of legislative intent make us 'reluctant to read into ambiguous statutory text' the delegation claimed to be lurking there. To

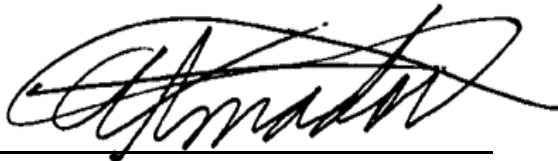
convince us otherwise, something more than a merely plausible textual basis for the agency action is necessary. The agency instead must point to ‘clear congressional authorization’ for the power it claims.”

Undoubtedly, the size of the franchise business community makes any fundamental change to the Franchise Rule a Major Question. Section 5’s vagueness and ambiguity will fail to withstand judicial scrutiny.

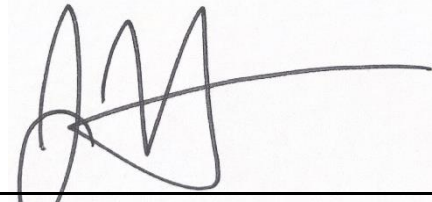
IV. Conclusion

For the reasons set forth herein, the Law Center and the Association cannot envision broad FTC regulations of the business relations between the separate businesses of franchisors and franchisees. To do so would endanger the business value of many small family businesses, as well as endangering the safe and reliable delivery of food products throughout the nation. We request the FTC proceed no further with broad sweeping regulations of the franchise model, instead focusing on protecting potential buyers of franchises through education and due diligence requirements. We thank you for the opportunity to submit these comments and look forward to working with the FTC moving forward on such an important issue to the restaurant industry.

Sincerely,



Angelo I. Amador
Senior Vice President & Regulatory Counsel
National Restaurant Association
Executive Director – Restaurant Law Center
2055 L Street, NW
Seventh Floor
Washington, DC 20036
P: 202-331-5913
aamador@restaurant.org



Jordan Heiliczer
Director
Labor & Workforce Policy
National Restaurant Association
2055 L Street, NW
Seventh Floor
Washington, DC 20036
P: 610-731-6500
jheiliczer@restaurant.org

** We thank outside counsel for the assistance in drafting these comments:*



Alden J. Parker
Regional Managing Partner
Co-Chair Hospitality Industry Group
[Fisher & Phillips LLP](#)