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FAIRNESS IN FRANCHISING ACT

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HEARINGS

BEFORE THE

COMMITTEE ON COMMERCE
UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

S. 2335

TO REGULATE COMMERCE BY PROVIDING FRANCHISORS AND FRANCHISEES WITH CERTAIN REMEDIES TO ASSURE FAIRNESS AND TO PROTECT AGAINST OVERREACHING, UNJUST ENRICHMENT, AND UNJUSTIFIABLE TERMINATION, AND FOR OTHER PURPOSES

APRIL 7 AND 8, 1976

Serial No. 94-74

Printed for the use of the Committee on Commerce

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U.S. GOVERNMENT PRINTING OFFICE

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FAIRNESS IN FRANCHISING ACT

WEDNESDAY, APRIL 7, 1976

U.S. SENATE,
COMMITTEE ON COMMERCE,
Washington, D.C.

The committee met at 10:10 a.m. in room 4200, Dirksen Senate Office Building, Hon. Frank E. Moss, presiding.

OPENING STATEMENT BY SENATOR TUNNEY

Senator TUNNEY (presiding). The hearing will come to order.

The chairman of the hearing today, Senator Moss, is not here. I think that we ought to get the hearing going because we have a new rule in the Senate that at 1 p.m. we have to stop all hearings.

So I would like to take this opportunity to make a few remarks myself with respect to the legislation that is the subject of the hearing today.

I would like to go on record in support of S. 2335, clarifying the relationship between a franchisor and franchisee. As everyone knows, the franchise relationship is a relatively new form of contract which holds great potential for upgrading commerce by providing for uniform distribution of goods and services. A fair and equitable franchise agreement is in the best interests of the consumer.

A franchise relationship provides the means for providing centralized planning with local initiative and capital formation. Because the franchise system is new as a type of business contract, the law applicable to franchising needs careful scrutiny and some modification. We must eliminate the loopholes that allow unjust termination in the franchise agreements.

I am happy the committee has scheduled these hearings on S. 2335. This legislation seeks to remedy defects in the existing law relating to franchising. I hope the testimony to be presented at this hearing, will enable the committee to report a just and effective bill.

It is my understanding that Senator Moss intended to call Mr. Waldie as the first witness.

Does Senator Ford have anything to say?

Senator FORD. I want to follow your leadership, Senator.

Senator TUNNEY. I was planning to follow yours. That puts us in a terrible bind.

Staff member assigned to these hearings: Edward E. Merlis.

[The bill and agency comments follow:]

94TH CONGRESS
1ST SESSION

S. 2335

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 11, 1975

Mr. Moss (for himself, Mr. ABOUREZK, Mr. PHILIP A. HART, Mr. MAGNUSON, Mr. MCGEE, Mr. MCGOVERN, and Mr. STEVENSON) introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To regulate commerce by providing franchisors and franchisees with certain remedies to assure fairness and to protect against overreaching, unjust enrichment, and unjustifiable termination, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Fairness in Franchising Act".

DECLARATION OF POLICY

SEC. 2. (a) FINDINGS.—The Congress finds that—

(1) A substantial amount of useful business activity in and affecting interstate commerce is today carried on

and conducted pursuant to franchise agreements or relationship between franchisors and franchisees.

(2) Such agreements and relationships are beneficial to the economy, the enhancement of commerce, and the promotion of competition because they provide a means for combining centralized planning, direction, and standard-setting (franchisor) with local decisionmaking, initiative, and capital formation (franchisee), in a way that appears to be as effective or more effective than commercial arrangements based on principal and agent relationships.

(3) Because the franchise relationship in its present form is a relatively new one, however, the law applicable thereto has not evolved sufficiently to protect adequately the parties thereto and to insure against overreaching, unjust enrichment, and unjustifiable termination. The law applicable to franchise agreements and relationships should not be traditional agency and contract law doctrines to the extent that such doctrines permit inequities to occur and fail to provide sufficient remedies for conduct that should, in this context, be characterized as wrongdoing.

(b) PURPOSES.—It is therefore declared to be the intent of Congress in this Act to provide certain remedies to franchisors and franchisees to assure fair dealing, to protect

franchisees from inequitable practices, and to guarantee to consumers the greater benefits that would flow from more equitable franchise agreements and relationships.

DEFINITIONS

SEC. 3. As used in this Act, the term—

(1) 'antitrust laws' means the Act of July 2, 1890 (15 U.S.C. 1 et seq.), as amended; the Act of October 15, 1914 (15 U.S.C. 12 et seq.), as amended; the Federal Trade Commission Act (15 U.S.C. 41 et seq.) as amended; sections 73 and 74 of the Act of August 27, 1894 (15 U.S.C. 8 and 9), as amended; and the Act of June 19, 1936, ch. 592 (15 U.S.C. 13, 13a, and 212), as amended;

(2) "Commission" means the Federal Trade Commission;

(3) "franchise" means a relationship in or affecting interstate commerce—

(A) that is established and maintained by contract, agreement, lease, or any other written or oral, express or implied, arrangement or understanding between the parties thereto;

(B) pursuant to which one party (the franchisor) grants, and a second party (the franchisee) receives, the right to, or permission, to sell, to offer to sell, to provide, or to distribute in commerce

certain goods or services in return for the performance of certain obligations and on certain terms and conditions;

(C) that is characterized by such franchisee substantially associating its business with that of such franchisor through the use of the latter's trademarks, service marks, trade names, commercial symbols, standards, and/or advertising; or that involves a representation by such franchisor that it will extend more than nominal assistance to the franchisee with respect to such franchisee's business organization, management, promotional activities, marketing, operational plans and methods, and/or the resolution of other business problems; and

(D) in which annual gross volume is equal to or more than $25,000.

The term includes any such relationship pursuant to which the franchisee is granted the right, or permission, to sell or to negotiate, on behalf of or in the name of the franchisor, the sale of additional such franchises. The term does not include any relationship that would otherwise be included, if the second party thereto has been engaged in the same type of business for a period of two or more years prior to entering upon such relationship with such a first party so long as such

parties do not contemplate or anticipate that such second party will be involved, predominantly or primarily, in the sale or distribution of goods or services covered by such relationship;

(4) "good cause", with respect to the termination or attempted termination of a franchise by a franchisor, means—

(A) a failure by the franchisee involved to comply substantially, without reasonable excuse or justification, with an essential and reasonable requirement imposed by such franchise; or

(B) bad-faith conduct or unjustified and unreasonable failure to act, by the franchisee involved with respect to the carrying out of the terms of such franchise;

(5) "legitimate business reason" means a commercial determination that is fair and reasonable in light of all the circumstances;

(6) "market area" means the geographic zone or area within which a franchisee is granted exclusive or special rights to sell or distribute any goods or services covered by the applicable franchise;

(7) "marketing area withdrawal" means a cancellation, failure to renew, or other termination of a franchise by a franchisor for the purpose of enabling such

franchisor to withdraw entirely from the business of granting, organizing, supplying, or directing franchises within a multi-State region, a State or a standard metropolitan statistical area. There is legitimate business reason for such withdrawal and good cause for such a termination if—

(A) it is not in violation of any of the antitrust laws;

(B) there is no subsequent commercial reentry by such franchisor into such region, State, or area within five years thereafter; and

(C) such franchisor pays such franchisee a reasonable compensation for the value of the latter's business (including, but not limited to, goodwill) or provides such franchisee, with the latter's consent, with a new and equivalent franchise for a different market area; and

(8) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and any territory or possession of the United States.

REVIEW OF LAWS

SEC. 4. The Commission shall, in accordance with this section, conduct a continuing review and study, in consultation with the Department of Justice, the National Confer-

ence of Commissioners on Uniform State Laws, the American Law Institute, and other knowledgeable groups and individuals interested in improving the fairness, functionality, and uniformity of the substantive and procedural law applicable to franchises and franchising. Such study shall include, but need not be limited to, (1) a restatement of the law applicable to franchises and franchising in each of the States; (2) an evaluation of the appropriateness and adequacy of such provisions in assuring fair dealing between present and potential franchisors and franchisees, in protecting franchisees from practices that are unfair or inequitable, in insuring against overreaching, unjust enrichment, and unjustifiable termination, and in guaranteeing consumers the full benefit potential of the franchise form of business; (3) a "model code" of franchise law, including minimum standards and mandatory provisions to be incorporated into each franchise agreement and relationship by operation of law; and (4) recommendations for legislative and administrative action by the Congress and the executive branch of the Federal Government and by the several State governments. A preliminary report of such study shall be submitted to the Congress and the President, and shall be published by the Commission, not later than two years after the date of enactment of this Act. A final such report shall be prepared on the basis of public hearings and comments on the preliminary

report, and such final report shall be so submitted and published not later than three years after the date of enactment of this Act. Nothing in this section or Act shall be construed to annul, suspend, or in any way limit the authority of the Commission under section 18 of the Federal Trade Commission Act (15 U.S.C. 57a), with respect to franchises and franchising. There are authorized to be appropriated to the Commission such sums as are necessary for the conduct of such study, not to exceed $1,000,000, such sums to remain available until expended.

REQUIREMENT OF NOTICE

SEC. 5. (a) Except as otherwise provided in subsection (b) of this section, no franchisor who is doing business in or affecting interstate commerce, shall cancel, fail to renew, or otherwise terminate a franchise unless he furnished prior notice thereof to each franchisee affected thereby, pursuant to this subsection. Such notification shall be in writing and shall be sent to each such franchisee by certified mail not less than ninety days prior to the date on which such franchise will be so terminated. Such notice shall contain a statement of intent, together with the reasons thereof; the date on which such action shall take effect; and a statement of the remedy or remedies available to such franchisee under this Act, including a summary of the applicable provisions of this Act.

(b) Notwithstanding the provisions of subsection (a) of this section, a franchisor may cancel, fail to renew, or otherwise terminate a franchise upon forty-eight hours notice thereof to the applicable franchisee—

(1) in order to protect against an imminent danger to public health or safety; or

(2) in the event of insolvency, bankruptcy, or receivership proceedings involving such franchisee.

TERMINATION

SEC. 6. (a) A franchisor who is doing business in or affecting interstate commerce shall not cancel or terminate a franchise unless—

(1) such franchisor has good cause for such cancellation or termination; or

(2) such franchisor is effecting a marketing area withdrawal

The provisions of this subsection are not applicable to a termination by failure to renew a franchise, in accordance with the terms thereof.

(b) (1) A franchisor who is doing business in or affecting interstate commerce shall not terminate a franchise by failure to renew unless—

(A) such franchisor has good cause for such failure to renew;

(B) such franchisor has legitimate business reason

for such failure to renew if the term of the agreement which is not being renewed was five years or more; or

(C) such franchisor is effecting a marketing area withdrawal upon the expiration of the terms of the franchises outstanding in the area involved.

(2) A franchisor who fails to renew for a legitimate business reason shall pay to the franchisee involved a reasonable compensation for the value to the latter's business, including, but not limited to, goodwill.

JUDICIAL REMEDIES AND BURDEN OF PROOF

SEC. 7. (a) If a franchisor engages in conduct prohibited under this Act, a franchisee may maintain a civil action against such franchisor.

(b) The court shall grant such equitable relief as is necessary to remedy the effects of conduct which it finds to exist and which is prohibited under this Act, including declaratory judgment, mandatory or prohibitive injunctive relief, and interim equitable relief. The court may, unless required by this Act, award damages, including the value of goodwill. The court shall, if such suit is successful, direct that costs, including reasonable attorney and expert witness fees, be paid by the franchisor. The court shall, if it finds that the franchisor has acted in bad faith in invoking the termination provisions of section 5(b) of this Act, award actual and punitive damages, as well as costs, as provided in this subsection.

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(c) A civil action under this section may be brought, without regard to the amount in controversy, in the district court of the United States for any judicial district in which the franchisor against whom such suit is maintained resides, is found, or is doing business. No such action shall be maintained unless commenced within two years after the cancellation, failure to renew, or other termination of the franchise, unless the franchisor has allegedly re-entered the marketing area after having effected a marketing area withdrawal, in which case no such suit shall be maintained unless commenced within two years of such alleged re-entry.

(d) In any civil action brought pursuant to section 5 (b) or 6 of this Act, the burden of proof shall be upon the franchisor.

PROHIBITION ON WAIVER OF RIGHTS AND ARBITRATION

SEC. 8. (a) Except as provided in subsection (b) of this section, any condition, stipulation, provision, or term of any franchise agreement waiving any rights granted under this Act or relieving any person from liability imposed by this Act shall be void and unenforceable.

(b) Nothing contained in this Act shall limit the right of a franchisor and franchisee to agree to binding arbitration of disputes, if—

(1) the standards applied in such arbitration are no less than the requirements specified in this Act; and

(2) any arbitrator employed in such arbitration is chosen from a list of impartial arbitrators supplied by the American Arbitration Association or other impartial third parties designated after the occurrence of the dispute.

ANTITRUST LAWS

SEC. 9. No provision of this Act shall repeal, modify, or supersede, directly or indirectly, any provision of the antitrust laws. This Act is and shall be deemed to be supplementary to, but not a part of, the antitrust laws.

DEPARTMENT OF JUSTICE,
Washington, D.C., March 30, 1976.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Department of Justice on S. 2335, a Bill "To regulate commerce by providing franchisors and franchisees with certain remedies to assure fairness and to protect against overreaching, unjust enrichment, and unjustifiable termination, and for other purposes."

This Bill would substantially limit the power of franchisors to cancel, terminate or fail to renew their franchise agreements, and it would require that franchisees be given prior notice of such actions by the franchisor. The Bill would also authorize and direct the Federal Trade Commission to review state and federal laws applicable to franchising and to consider a "model code" of franchise law as well as to recommend other appropriate legislative or administrative action in this area. The Bill's operative provisions affecting franchising practices are contained in Section 5–8.

Section 5 of the Bill provides, with two narrow exceptions, that a franchisor may not cancel, fail to renew, or otherwise terminate a franchise agreement, as defined in Section 3, except on 90 days notice.

Subsection (a) of Section 6 provides that cancellation or termination of a franchise may be made only for "good cause" or when the franchisor is effecting a "marketing area withtdrawal." "Good cause" is defined in Section 3 as:

(A) A failure by the franchise involved to comply substantially, without reasonable excuse or justification, with an essential and reasonable requirement imposed by such franchise or

(B) Bad-faith conduct or unjustified and unreasonable failure to act, by the franchisee involved with respect to the carrying out of the terms of such franchise.

As thus defined, the term "good cause" is extremely vague and would place a substantial burden on the courts to determine, without clear standards, those requirements in a franchise agreement that are to be deemed unessential and unreasonable. Thus, the Bill would undoubtedly foster extensive litigation and undermine the certainty necessary for contractual bargaining between franchisors and franchisees.

The term "marketing area withdrawal" is defined in order to permit a franchisor to terminate a franchise if he desires to cease franchising in a particular area, but such withdrawals: (a) may not involve antitrust violations, (b) proscribe any form of reentry for five years, and (c) require the franchisor to compensate the franchisee or replace his franchise.

Subsection (b) of Section 6 places restrictions on a franchisor who decides not to renew a franchise. It provides that a franchisor shall not fail to renew any franchise unless:

(A) Such franchisor has good cause for such failure to renew;

(B) Such franchisor has legitimate business reason for such failure to renew if the term of the agreement which is not being renewed was five years or more; or

(C) Such franchisor is effecting a marketing area withdrawal upon the expiration of the terms of the franchises outstanding in the area involved.

By utilizing the concept of "good cause," this subsection suffers from the same vagueness problems previously discussed with regard to the cancellation or termination provision. The meaning of "legitimate business reason" is also difficult to discern. This vagueness invites litigation and may make it very difficult for a franchisor not to renew a franchise for valid reasons. Further, subsection (b) also provides that the franchisor must compensate the franchise for failure to renew if the reason for this failure is a "legitimate business reason." Since the line between failure to renew for "good cause" and failure to renew for a "legitimate business reason" is difficult to define, it can be expected that the courts will have a difficult time in determining when compensation is to be awarded.

Section 7 of the Bill establishes civil remedies in U.S. District Courts for violation of this Act, and provides that the burden of proof shall be upon the franchisor in any suit brought by the franchisee alleging violation of the Act.

Under its provisions, punitive damages are possible, as well as reasonable attorneys fees if the suit is successful. Section 8 of the Bill provides that with the exception of certain agreements to seek binding arbitration, a franchisee may not waive his rights under this Act. Section 9 makes clear that this Act does not affect or supersede the antitrust laws as they apply to these matters.

While the Department of Justice is in sympathy with the primary objective of this Bill—to prevent losses to franchisees which may result from arbitrary and unreasonable cancellations of franchise arrangements—we believe that the Bill would raise significant competitive problems. Moreover, we have some doubts as to the likely effectiveness of the Bill in redressing problems of unequal bargaining power between franchisors and franchisees. These problems are exacerbated by the vague standards employed by the legislation, which would encourage litigation whenever a franchisee is terminated or not renewed.

There are substantial costs to the economy associated with a measure which makes it difficult to terminate contractual arrangements. The Bill prevents a franchisor from cancelling or terminating a franchise unless he has "good cause" or is effecting a "marketing area withdrawal." The former requirement would, as previously discussed, involve the courts in a complex and difficult determination of what provisions in a private contract are "essential and reasonable." The Bill gives some additional flexibility to a franchisor who can cite a "legitimate business reason" for failure to renew a franchise, but requires compensation to the franchisee. However, because of the vagueness also associated with this concept, and the very strong civil remedies afforded to franchisees, the flexibility may be more apparent than real. It may thus make it difficult for a franchisor to terminate an inefficient franchisee.

The Bill may even have the effect of operating against the interests of franchisees in general by reducing a franchisor's willingness to appoint franchisees. A franchisor who is aware of the costs and difficulties of terminating franchises under this legislation might be reluctant to make future arrangements. Where feasible, a manufacturer, for example, might elect to integrate forward to perform functions which franchisees might otherwise efficiently perform. In other cases, a franchisor might try to minimize the problems of termination by appointing only a larger established distributor as franchisee.

To the extent that the Bill may, for the above reasons, lead to the retention of incompetent or inefficient dealers, it can interfere with the efficiency of distribution and lead to higher costs for consumers.

In certain industries, franchises have adequate bargaining power to negotiate for fair treatment, and this Bill will unnecessarily impose burdens on the corresponding franchisors. On the other hand, this Bill may be ineffective in preventing coercive demands by a powerful franchisor who has many opportunities, short of termination of a franchise or a threat to terminate, to put pressure on a franchisee who is economically dependent. For example, a powerful manufacturer whose dealerships are in great demand may simply create a new franchise to serve the customers of the old, causing the existing franchisee a significant loss of business. We are, therefore, inclined to believe that where bargaining power is equal the Bill may be unnecessarily burdensome, and where substantial inequality of bargaining power exists other methods, unaffected by the Bill, can probably be used to induce a franchisor to abandon his franchise.

Because it appears that under certain market conditions these sections of the Bill would unnecessarily burden the efficient allocation of resources and the development of competitive systems of distribution, while in other situations they might not be effective in redressing the inequality of bargaining power that may be used by a franchisor to unjustifiably harm his franchisees, the Department of Justice does not support enactment of them.

Section 4 of the Bill calls for a study by the Federal Trade Commission, in consultation with the Department of Justice and other groups, which shall include: a restatement of the laws applicable to franchising in each of the states, the adequacy of such laws in protecting franchisees and consumers, a "model code" of franchise law, and recommendations for legislative and administrative action by the Congress, the Executive Branch, and the states. In view of the present, somewhat unsettled law of franchising, the Department of Justice would have no objection to enactment of this Section.

The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

MICHAEL M. UHLMANN,
Assistant Attorney General.

Senator TUNNEY. Our first witness is Mr. Jerry Waldie. I would like to say, for the benefit of those in attendance, that Mr. Waldie is a very close friend of mine and a highly esteemed Californian, Congressman for 6 years, candidate for Governor, a person of integrity, intelligence, and I think really one of the most outstanding citizens of our State.

It is a pleasure to have you here, being the leadoff witness.

Senator FORD. Senator, I can hardly wait to hear him.

Senator TUNNEY. He will dazzle you.

STATEMENT OF JEROME R. WALDIE, ATTORNEY, AMERICAN ASSOCIATION OF INDEPENDENT NEWS DISTRIBUTORS

Mr. WALDIE. Those startling attributes were little perceived by the California electorate.

Senator, I ask permission of the Chair that my statement be included in the record in its entirety.

Senator TUNNEY. Without objection.

Mr. WALDIE. In this capacity I am not only representing the American Association of Independent News Distributors, but also the National Franchisee Association Coalition, which a group of franchisee organizations that are organized for a limited and single purpose. That purpose is to seek legislative relief from the abuses with which the franchising distribution system is fraught.

In that coalition—I have listed on the first page of my statement, the constituent members of that coalition. There is an error that I would like to have corrected for the record.

I have listed in that group of franchise associations, the Ford Dealers' Alliance. The Ford Dealers' Alliance for this particular purpose and this particular bill, should not have been listed and I ask for that correction in the record. Similarly, I neglected to include the Wine & Spirits Wholesalers of America, Inc., as one of the constituent members of the NFAC and I request their inclusion.

In the interest of time, so that I can formulate for you as best I can the procedure that the National Franchise Association Coalition will follow in presenting their evidence, it will be my role simply to lay the groundwork for the type of case we hope to be able to persuade you exists in terms of abuses in the system and our support for this bill as a remedy to those abuses.

My testimony will be general. I will be followed by specific witnesses, who will be, hopefully, able to fill in and flesh out the general comments that I make.

Mr. Chairman, the franchise distribution system is really fraught with abuse. The abuses begin in the inception of the franchise relationship wherein the franchisee, the prospective franchisee and the franchisor sit down and they contract. The franchise contract is presented to the franchisee and is executed.

The abuses in that portion of the franchisee-franchisor relationship at the inception are well documented and even conceded by our opponents to this legislation, spokespersons for the franchisors, the IFA. They concede in the inception of the relationship, the abuses are demonstrable and not worthy of even arguing as to their existence and they have accepted a proposal advanced essentially by the FTC, but also by congressional experts as a remedy for the abuses, that the remedy should be disclosure.

We concur that the abuses in the inception of the relationship would at least be improved if full disclosure were demanded. I want to suggest to you that there is an inconsistency in the position of the International Franchise Association as to their support of a remedy of disclosure, which they insist should be Federal legislation and their rejection of any remedy for abuses in the remaining portions of the franchise contract, that is the performance and termination of the contract where they maintain that the remedy there, if at all extended, should be enacted by the individual States.

They believe that disclosure should be a national remedy for those abuses at the inception of the contract, but all other remedies for abuses that occur during the continuation of the franchise agreement, should be relegated to State control, if anywhere.

Mr. Chairman, our position is that abuses exist and permeate the entire franchise system, though a great deal of contention will be made that these abuses are really rare and few in number and that they do not directly relate in some instances to abuses in termination or failure to renew.

Our position is that documentation exists that the abuses in the franchise distribution system are not unique, are not minimal, but are pervasive and those abuses are most devastating not at the inception of the franchise agreement where disclosure is the remedy, but during the performance of the franchise agreement.

The abuses have been amply documented not only in the hundreds of thousands of pages in the lawbooks of this country, where franchisees who have been abused have sought relief through the judicial system generally to no avail, but they have been equally documented without any peradventure of a doubt in numerous volumes of records of the FTC and the SBA and then finally as this committee well knows, the documentation before congressional committees is extensive, persuasive, and convincing.

So, the argument that there have been no indication of abuses of a widespread nature, and therefore no remedy is necessary, flies in the face of facts that just simply are beyond refutation.

We maintain, Mr. Chairman, that all of these abuses during the performance of the contract, result from the staggering imbalance of power exists between the franchisee and the franchisor.

The worst factor in that imbalance of power stems from the terminal powers possessed in every instance by the franchisor of termination or failure to renew. It is the leverage of the unrestrained and uncertain exercise of those powers by the franchisor that brings about the abuses that have been documented.

Therefore the remedy suggests itself with little difficulty. The remedy is to circumscribe the exercise of those terminal powers of termination and failure to renew.

The effort of the bill before this committee to do exactly that is reasonable, specific, and we think will go a very, very long way in improving the system of distribution of goods and services through the franchise method of distribution. Because with these circumscribed terminal powers, the ability of the franchisee to perform literally as an independent businessman will be vastly enhanced over his or her present condition.

You will be told, Mr. Chairman, by opponents to the bill, that No. 1 there are no real abuses in the system during performance of termination of the franchise contract. But if there are, they will say, the recourse to remedy ought to be to the courts or to the States.

I suggest to you that that is unrealistic, that directing a franchisee to the courts for relief from the abuses that are in existence in the distribution system is no relief at all.

The franchisees have been going to the courts, over all of the years of the franchise distribution system, and for the most part their efforts at finding a remedy through the court system have been futile, because the legal background that would provide such a remedy is so narrowly drawn under existing law that it does not enable redress for most of the abuses that occur.

No. 2, the cost of such remedy, if it were attainable, is prohibited to the usual franchisee because of the enormous imbalance of economic power between the franchisor and franchisee.

The court system, then, Senators, does not provide an adequate or reasonable remedy to find relief from abuses.

The contention that the remedy, if at all to be extended in this instance, should be sought at the state level equally, I think, is unrealistic. This is a national problem.

The source of the power that has resulted in the abuse of the franchisee by the franchisor is national power; trademark, registration, copyright, and patent law.

It would seem to follow, as night should follow day, if you are seeking to circumscribe a power that has as its source national legislation, you should seek the circumscribing of that power in an equal way, Federal legislation.

In addition, as our evidence will demonstrate, the franchise distribution system is clearly national in character. Clearly the remedies then for abuses within that system should simply have as their source, national authority.

Mr. Chairman, I will conclude by just simply emphasizing to the extent that I can, that we believe the case for documentation of abuses has been made so substantial in the sources to which I have referred, that judicial or congressional notice can be taken of those cases though we intend to present some individuals who have suffered from the abuses in the system.

And if you accept that the system is fraught with the abuses that the record discloses to be the case, then a remedy should be provided.

If you further accept that the major source of those abuses is the uncircumscribed exercise of the powers of the franchisor in the terminal relationship of termination or failing to renew, the remedy suggests itself with equal validity that there should be

Federal legislation circumscribing reasonably the exercise of the powers of the franchisor in these terminal matters.

Mr. Chairman, with that general presentation as to what we believe are the problems of this distribution system and why we believe so strongly that the proposal before this committee is a reasonable attempt to effect a remedy to this problem, I would like to introduce to you the witness we hope will be able to next testify on behalf of the National Franchise Association Coalition, Mr. Timothy Fine.

I stand ready to answer any questions you may wish to ask.

Senator Moss [presiding]. Thank you very much. I apologize for being late. I am victim of a disease that is not uncommon here, of being in two places at one time. I apologize to you and the others who have been kept waiting.

We look forward to hearing from Mr. Timothy Fine, who will be the next witness.

I have two or three questions perhaps that you could help us on, and my colleague may have some, too.

You talk of the Sword of Damocles inherent in the right of termination or failure to renew.

Is there any leverage that a franchisee has if the supplier does not adhere to the franchise requirements to which the franchisor subscribes?

Mr. WALDIE. If the supplier does not adhere?

Senator Moss. Does the franchisee have any leverage against the franchisor if the latter doesn't live up to his agreement?

Mr. WALDIE. The only leverage would be a contractual cause of action, perhaps that the franchise agreement in terms of its contractual provisions was not adhered to.

The difficulty with any remedy that exists, whether it be contractual or otherwise, is that the franchisee lives hourly with the knowledge that if he rocks the boat, the terminal powers can or will be exercised, so what you generally find, except for the most courageous of franchisees, is an acceding to practices such as you have described, and remedies are not sought for those abuses.

If he was not fearful of termination or failure to renew, it is conceivable that he would then seek remedies to that sort of abuse through the court system.

So I would only have to say realistically, although there might be in the lawbooks, a remedy described for them, access to the remedy for all intents and purposes is not available because of his fear.

Senator Moss. Is this unique in the franchise area of distribution, or doesn't this exist to some extent between wholesalers and retailers all across our economic system?

Mr. WALDIE. I suppose it does exist to a degree, but I am inclined to believe in the franchise distribution system, the parameters of the problem are more easily defined and more susceptible to a legislative solution.

Senator Moss. You, in your statement, rebut assertions which I assume will be made by opponents of the legislation. You suggest that the opponents would have the terminal power of the franchisor

circumscribed by individual case-by-case approach in the court. You reject that assertion of the opponent.

Won't S. 2335 also see its true force in effect through individual case-by-case litigation and suffer the same defect you have ascribed to the opponents' reasoning or the same benefit which the opponents see in the case-by-case approach?

Mr. WALDIE. I think not, Mr. Chairman.

The reason I think not is because if there is legislation that compels the franchisor to exercise these powers reasonably and pursuant to law, it is less likely that the franchisor will abuse those powers as is the present case.

To the extent the franchisor does abuse the powers, access on a case-by-case instance to relief, is much more readily attainable under this law because the power of failure to renew is subject to restriction under this law, and relief in the courts would give the franchisee an opportunity better to present his case for relief.

Senator Moss. Do you think that this bill is too broad?

Isn't that one of its shortcomings in trying to be all things to all kinds of franchisees?

For example, problems of the fast food franchisee, newspaper dealer, and appliance franchisee, aren't they different? The fast food man is out of business immediately if he is terminated. The newspaper dealer may be harmed severely, but probably has other items to distribute on his route. And the appliance dealer probably is not injured very much because he undoubtedly carries several lines.

Mr. WALDIE. I am not ready, Senator, to accept the argument of the opponents of this bill that the disparities in franchisee-franchisor relationship are so great that legislation of general application would not be in the best interests of the public.

I am only suggesting to you, and I think the evidence that will be presented to the committee and has been presented in the past to congressional committees, should persuade that in terms of the exercise of these terminal powers, and that is all this bill deals with, no matter what the distribution system is, the consequences are the same and the major consequence is the lack of independence on the part of the franchisee and that is contrary to public interest.

Now the degree of harm that may accrue to an individual franchisee by an abuse of these terminal powers may vary from system to system. Take it as a stated fact Senator, that I think the evidence will show that though the degree of harm may vary, there will always be harm when these powers are abused.

Senator Moss. I thank you for your responses. I want to get that on the record because I have recognize that will be presented by those who are in opposition to the bill.

I just wanted your defense for it, for the bill.

I certainly appreciate your appearance and good work.

Does the Senator from Kentucky have any questions?

Senator FORD. Mr. Waldie, I am trying to put this all together a bit.

I notice from your statement, and you refer to it, that those associations you represent today—and I notice you took out the Ford dealers alliance, so automobiles have probably come out—it

indicates to me that you are representing, or the associations or the group, coalition, are primarily fast food or food distributors. That is the overwhelming group of people you represent today.

Mr. WALDIE. It is in the majority certainly, Senator.

Senator FORD. It is in the majority.

Are you in favor of disclosure by the franchisor?

Mr. WALDIE. Strongly.

Senator FORD. Are they opposed to that?

Mr. WALDIE. The franchisors?

Senator FORD. Yes.

Mr. WALDIE. Their present position has been an evolving position. They suggest that disclosure is desirable to attack abuses at the inception of the franchisee-franchisor relationship. They insist that disclosure be national rather than State by State. They do not believe, however, that any remedy is needed or required to deal with abuses subsequent to the inception of the relationship, the abuses during performance of the contract, the abuses at the end of the contract, which are far more destructive and far more contrary to the public interst than the abuses at the inception of the relationship.

Their position, as I understand it, is that the only abuses that are destructive of public interests occur at the inception of the franchisee-franchisor relationship, and the only remedy required is full disclosure.

Senator FORD. It seems to me—and disclosure is a good word for me because I like it in all facets—it seems to me that if a full disclosure prior to the contract would give the franchisee the opportunity to deal with what is expected of him and what is expected of the franchisor prior to the contract being signed, it seems to me this would be a very desirable position for the franchisee to be in.

Would you agree with that?

Mr. WALDIE. Absolutely, we are thoroughly in support of disclosure.

However, we add a caveat that we believe disclosure only addresses one portion of the relationship between the franchisee and the franchisor. That is the inception of the relationship. The abuses that are most destructive occur subsequent to that point in time.

As to those abuses, no remedy except this in this bill, has been suggested.

Senator FORD. It seems to me as a businessman, that the franchisor would want his franchise to stand out, to be acceptable to the public and therefore they would do what was necessary to continue a good business operation based on a good franchise, that the food was delivered properly or the papers were there on time, the magazines were on the shelf when they were supposed to be in order to have good business practice.

It seems the burden would be on the franchisor rather than the franchisee, and they would want to do this in order to have a good franchise and make money.

Mr. WALDIE. You would think so, Senator.

As you present it, it seems logical.

Senator FORD. I try to be logical.

Mr. WALDIE. I like to believe in fact your position as to what you believe they should do is a description of what, in fact, they do. The reputable franchisor as I have stated in my formal statement in fact circumscribes already his power of termination and failure to renew. Thus this bill would have no impact upon his operations. The successful, responsible franchisor would perform much as you have described.

The fact of the matter is that the successful, responsible franchisor is still in the minority in the totality of franchise distribution system. I am puzzled, frankly, by International Franchise Association's position upholding the franchisor that overreaches, that abuses the franchisee. The franchisor that operates as you have suggested in no way would be impacted by this legislation. Only the franchisor that does not subscribe to the principles you enunciated would, in fact, be impacted by this legislation.

Senator FORD. It is my understanding that some of the franchise operations actually have a committee of franchisees that come periodically and discuss the problems they have in representative group.

Is that true?

Mr. WALDIE. Perhaps you should address that to some of the franchisees and listen carefully to their response, and then look to the franchisors.

It is true that there are franchisee organizations. Some of them are quite independent as those that are listed in this statement that I have given you, and that are here before you today.

Many of them are not independent at all. Many of them are designed by the franchisor, and properly, as a public relations vehicle by the franchisor to seek to address problems within the distribution system before they become problems of confrontation. That is a healthy trend and one we do not denigrate.

That is no answer to terminal power or failure to renew, because the committees in their performance are constantly aware of the imbalance of power between them and the franchisor.

Senator FORD. What is the average term of a contract?

Mr. WALDIE. I don't think there is such a thing as average term in the industry.

Senator FORD. What is the range?

Mr. WALDIE. It ranges from at will to 20 years. That is probably the longest of which I am aware.

McDonald's operators have a 20-year franchise, whereas the newspaper distributors and many others in similar unhappy circumstances have no specified term.

Senator FORD. I notice that you represent the National Congress of Petroleum Retailers.

Mr. WALDIE. I do not.

They are a member of the National Franchise Association coalition for purposes of seeking legislative relief in terms of the exercise of powers of termination and failure to renew. That is the extent of my participtaion in representing them.

Senator FORD. I thought we had taken care of this group of people in their dealers' day in court legislation. At least we had hearings on it and worked in that direction.

Mr. WALDIE. The general wisdom in the industry is that the dealers' day in court bill, though the only effort thus far to address problems in that industry, has not been a satisfactory way to deal with many of their problems.

Senator FORD. You might be interested in that there will be hearings, I understand. It has passed the Senate and there will be hearings in the House related to that legislation next week. I am sure we will get into the area of individuals and their so-called abuses later on.

I think this is an important item.

I think, Mr. Chairman, I have asked all of the questions of Mr. Waldie I need to at this time.

I am beginning to get into what you are trying to get over to us here today.

I thank you.

Mr. WALDIE. May I add one more comment, because of Senator Ford's interest in the fact that we will be presenting witnesses that deal with abuses.

I caution you, we will produce three witnesses from our coalition on the subject of abuses that they have experienced.

The contention is often made by the opponents you have only presented three, and there are 500,000 franchisees, and we only present cases of 3 abuses. That is a misleading and odious position.

I want to put an exclamation point that the record is replete in the SBA files and the FTC files, congressional hearings and court hearings, of the abuses. We will only give you a representative sampling of that.

Senator FORD. Do you believe that this legislation is too broad?

Mr. WALDIE. I do not, Senator.

Mr. Fine will address that question in more detail. Certainly his position is that when you are dealing with a problem of this magnitude, you should address it in terms of legislation with language of the all-encompassing nature as the antitrust laws for example, because it is a constantly evolving distribution system, evolving, in our view, and as the testimony will reflect, contrary to the best interests of the public.

It is a constantly evolving distribution system and therefore the legislation that addresses its problems should be able to interpret the evolution of the system.

Senator FORD. Aren't we getting into the antitrust arena in this legislation.

Mr. WALDIE. No.

Senator FORD. You don't think we are infringing on the antitrust laws at all?

Mr. WALDIE. No.

Senator TUNNEY. I have one observation, Mr. Chairman. I think Mr. Waldie has given to us conceptually an excellent understanding of what the problems are in the franchising business.

In theory he has explained where the frictions lie between the franchisors and the franchisees. I think that he has done it in a cogent and clear manner.

I think that it is important that the record of this hearing contain as many examples as is possible of representative abuses of

franchising agreements above and beyond just the statements of the witnesses before the committee. The witnesses alluded to the reports the SEC, courts, FTC being replete with examples.

It would be helpful if some of that documentation could be supplied for the record so that when this bill is taken to the full Commerce Committee, or is brought out on to the floor of the Senate, that we will be able to answer any such challenges that were suggested by the witness, that the witnesses who testified are just malcontents and are not describing a pattern of behavior that is extant in the franchising business.

Mr. WALDIE. Mr. Fine will make reference to citations and records for that purpose.

Senator TUNNEY. Thank you very much. You are a fine witness.

Senator Moss. Thank you very much.

[The statement follows:]

STATEMENT OF JEROME R. WALDIE, ATTORNEY FOR AMERICAN ASSOCIATION OF INDEPENDENT NEWS DISTRIBUTORS, WASHINGTON, D.C.

Mr. Chairman and Members of the Committee. My name is Jerome R. Waldie. I am the legislative advocate for the American Association of Independent News Distributors. I am also coordinating the efforts of a coalition of franchisee associations who have loosely formed under the name of the National Franchisee Association Coalition for the sole and single purpose of seeking legislative relief from Congress in the matter of unjust and unfair franchisor practices.

It is in this regard that we appear today in support of the Fairness in Franchising Act by Senator Moss, S. 2335.

The National Franchise Association Coalition at present consists of the following associations of franchisees: McDonald's Operators' Association, Kentucky Fried Chicken National Association, American Association of Independent Newspaper Distributors, International Federation of Store Owner's Association, Inc. (Dairy Queen), National A&W Franchisees Association, Arby's Franchise Association, International House of Pancakes Association, International Franchised Dealers Association (Shakey's), Ford Dealers' Alliance, National B/R Storeowners Association (Baskin-Robbins), National Beer Wholesalers Association, Consolidated Franchise Association (Dunkin Donuts) and National Congress of Petroleum Retailers.

In the interest of time, Mr. Chairman, representatives from only several of those associations will testify. We do request, however, the opportunity to file a written statement on behalf of each of these associations prior to the hearing record being closed and we do further request that those statements be made a part of the record of these hearings.

Mr. Chairman, practicaliy every complaint that is known as to abuses received by franchises during the performance of their franchise, stems from the clear and overwhelming imbalance of power that is inherent in the franchisee-franchisor relationship.

The clear source of that imbalance of power is the right to terminate and the accompanying and equally pervasive, right to fail to renew that are both possessed by the franchisor.

It serves little purpose to argue that the accumulation of power that is vested in the franchisor by the possession of these two important rights varies in its potency from franchise agreement to franchise agreement. That can be quickly and easily conceded—the power to terminate and the power to fail to renew varies from reasonably circumscribed powers to totally arbitrary powers from one industry to the other.

But the critical point to always remember is that no matter how much the variation might be in the total power vested by these rights in the franchisor, the net and inevitable result in every franchisee-franchisor relationship is that the franchisee must always be submissive to the franchisor or risk the exercise of these terminal powers by the franchisor.

Thus, the SBA described the relationship of a Coors franchisee in its Brief filed in the Coors case, December 5, 1972, Docket 8845:

"Consequently, Coor's franchisees must work with a constant fear of termination of their franchise and a loss of their investments. With such a threat over a franchisee's head, he is inhibited from acting freely and is also forced to follow every demand placed upon him by Coors whether it be reasonable and legal or unreasonable and illegal" (p. 16 supra).

It is then, the knowledge of this sword of Damocles poised over the franchisee's head, that brings about so many abuses of his alleged status of an independent businessman.

The SBA Brief further stated:

"The ever present threats diminish the quality of a franchisee's operations, in addition to inhibiting his managerial and economic development" (p. 17 supra).

Though we intend to present to this Committee concrete examples of abuses in termination and in failure to renew, let me caution that you not restrict your inquiry into this problem to only termination or failure to renew abuses. The whole panorama of abuses that afflict the franchise distribution system have been testified to before many Congressional Committees over the past decade or so, have, additionally occupied hundreds of thousands of pages of law cases; have equally filled volumes of FTC and SBA and other administrative agency files. Their existence is simply not to be denied nor discounted because at this one Hearing only a sampling of such abuses will be covered. What is important to note, is that every single abuse during the existence and continuation of the franchise relationship is possible only because of the inherent difference in power between the franchisor and franchisee. And that difference in power can clearly be traced to the terminal power of termination or failure to renew possessed by the franchisor.

Therefore, Mr. Chairman and Members of the Committee, as you view and listen to the testimony that will follow, I urge you to keep in mind this one question.

If the power to terminate and the power to fail to renew were reasonably circumscribed, would the relationship between the franchisor and franchisee have been as abusive as is being described?

In most cases with which I am familiar, be they court, administrative agency, or Congressional testimony, the answer would be "no".

The next question, Mr. Chairman, that I hope you will consider as you listen to this evidence is, is it possible to circumscribe this terminal power of the franchisor by individual case by case approach in the Courts, as the opponents to this Bill propose? The answer again, is clearly "no." The reasons will become apparent. They involve the limited access to the Court under the Anti-Trust Act and because of the relative economic powerlessness of the franchisee.

A further question will be presented you by the opponents of this Bill. Why, they will contend, if, in fact, abuses have occurred, do not the franchisees resort to the States for relief? One answer, among many you will hear, is that the source of this and all powers of the Franchisor is the Federal Trademark Act. If the source of their power is Federal legislation, is it not eminently reasonable that the source of any curb on that power should and must be of equal gravamen, namely, federal legislation?

Reasonable curbs on the enormous power vested in the franchisor to eliminate or fail to renew will in no way hinder the operations of the reputable franchisor. That franchisor, in all likelihood, already has agreed to circumscribe his exercise of thes awesome powers. The reputable franchisor, and we assume he is in the majority of those who belong to this Bill's most prominent opponent, the IFA, should welcome legislation that is designed to strike at the disreputable and over-reaching franchisor whose activities provide the sad history of abuse that has plagued the franchise distribution system.

Though I can understand the strategy in opposing legislation of this nature by arguing, where are the specific cases of abuse and when those are produced, thereafter arguing, these are only a few cases and not representative of a pattern, I cannot understand the failure of those who so argue to recognize that which the SBA stated in its Brief in the Coors case in reference to termination powers:

"They are weapons that prevent small Coors wholesalers from acting as independent businessmen for they realize that if they do not follow Coor's "suggestions" they run the risk of being terminated with no right to realize the true value of their investment by sale or transfer" (p. 18 supra).

Finally, it will be argued that these parties entered into a contract fully understanding all of its provisions including the terminal powers. Therefore, when abuses occur during the execution of the contract, a franchisee who complains or seeks legislative relief, is, in the words of Congressman Scheuer of New York, a "crybaby".

Those who so argue impart to the franchise relationship, certainties and truths that do not exist.

Again, the SBA in its Coor's Brief, p. 14, state the true condition of the contracting parties in the Franchise Contract:

"With the development of large scale business and its resultant mass production and distribution techniques, the standardized mass contract has grown more and more prevalent. Under this type of contractual arrangement, the individuality of the parties and the expression that they once gave their contracts through bargaining has disappeared.

"Standardized contracts are used by industries which enjoy a strong bargaining position. They present these contracts to their weaker counterparts on a take-it-or-leave-it basis. No significant concessions are made. In effect the stronger party legislates by contract whatever provisions it desires. For these reasons, standardized contracts are frequently contracts of adhesion.

"This is precisely the situation that exists in franchisor-franchisee relationship where there is a very great imbalance of power between the franchisor and the economically weaker franchisee. This difference in power is very apparent during the initial contract negotiation, as well as over the term of the relationship.—Because of this imbalance and disparity of bargaining power in the initial stages of the relationship, the imbalance between the franchisor and franchisee extends to the franchise agreement itself.—*That is such a distributor has absolutely no choice, he must accept those terms that are offered him as regards termination* * * *" (Emphasis added).

It will also be argued by franchisors in opposition to this Bill, that the only area of abuse is found in the inception of the franchise relationship, not in its performance. Therefore, they will argue, full disclosure is the remedy for these admitted abuses. (Interestingly, they will also argue that full disclosure should be Federally legislated; not by the individual States. Though they refer franchises who are abused during performance of the franchise to the 50 States for relief, they insist on uniform Federal legislation for the remedy in terms of abuses at the inception of the contract).

We contend that abuses exist at all points of the franchise relationship, its inception, its performance and its termination.

Full disclosure deals with inception abuses of the franchisor and is needed. S. 2335 deals with the more prevalent and more destructive abuses of the franchisor during the performance and termination of the franchise contract. It is needed even more.

Chairman of the Federal Trade Commission, Paul Rand Dixon, when he testified on March 11 of this year on Franchise Protection and Finance, calling on the extensive experience the FTC has had in dealing with franchisor abuses of franchisees, answered the argument of opponents to the Bill that only disclosure was required as a remedy to such abuses by stating:

"However, the problem is not simply one of full disclosure. A franchisor normally occupies such an overwhelming strong bargaining position that he is able to dictate the terms of a franchise agreement in such a way as to maximize his power to control the franchisor throughout the relationship. Even assuming full disclosure, an inferior bargaining position may leave a prospective franchisee with no meaninglul choice other than to accept the terms as dictated or to forego the business investment. *One result of this imbalance of power is the inclusion of provisions in the franchise contract which permit the franchisor to terminate the relationship or which limit the duration of the agreement to a short term, thus enabling the franchisor arbitrarily to fail to renew.*" (Emphasis added).

Chairman Dixon strongly addressed the key point of this effort to legislatively circumscribe these two terminal powers of the franchisor, namely, the relationship of these extreme powers to the ability of the franchisor to abuse the franchisee in the conduct of the franchise:

"The threat of termination or failure to renew, either of which could result in substantial loss to the franchisee, may become an effective device by which the franchisor can force a franchisee to relinquish a substantial degree of control over his business." (Emphasis added).

In conclusion, Mr. Chairman, I believe the evidence is overwhelming and conclusive as to the existence of the ever increasing abuses by the franchisor of the independence of the franchisee. That evidence fills literally volumes of testimony presented over the years to numerous Congressional Committee; that evidence further is present in even greater volume in the records and files of the SBA and the FTC, and, clearly, that record of specific abuses fills law book after law book as franchises, for the most part, futiley sought relief from these abuses under the Anti-Trust Laws.

Similarly, Mr. Chairman, we are confident that the source of these increasing abuses will be amply demonstrated by testimony adduced at this Hearing as well as by testimony from those most familiar with the magnitude of the problem already on record, the official spokespersons for the SBA and the FTC. That source of abuse is simply undeniable. It is the enormous imbalance of power given the franchisor by reason of his terminal powers of termination and failure to renew.

To correct those abuses, you must circumscribe the exercise of the source of the abuses, the terminal powers of the franchisor.

Mr. Chairman, we believe S. 2335 is designed carefully and selectively to reasonably accomplish that very result.

Senator Moss. We will have Timothy Fine of the National Franchise Association Coalition to testify.

We have your excellent and voluminous statement, Mr. Fine. We are anxious to hear from you.

To any extent you can summarize or condense in any way, we appreciate that.

STATEMENT OF TIMOTHY H. FINE, GENERAL COUNSEL, NATIONAL FRANCHISE ASSOCIATION COALITION, SAN FRANCISCO, CALIF.

Mr. FINE. Thank you, Mr. Chairman and distinguished members of this committee.

I will not repeat my entire statement. You have it and I ask that it be printed in the record in its entirety.

Senator Moss. It will be put in the record in full together with the attachments you have appended to it.

Mr. FINE. This is a consumer subcommittee. Senator Tunney is one of the great advocates of our antitrust laws as you are, Mr. Chairman, and Senator Ford, and I want to emphasize as an attorney in the antitrust field representing small business on a day-to-day basis that this franchise legislation—S. 2335—is pro competitive and pro consumer. I would like to explain why.

As you know, under the antitrust laws the burden is upon the franchisee to prove that the franchisor overtly used termination or the threat of termination to coerce the franchisee into engaging in an antitrust violation.

That is, in order to establish an antitrust violation the franchisee must show that he was actually threatened with termination if he did not go along with the franchisor's suggested prices, if he didn't go along with buying the franchisor's sponsored products or if he didn't stay within his franchisor assigned territory.

I want to point out from my experience over many years that such overt threats of termination by the franchisor are not necessary to obtain franchisee compliance with suggested prices, with suggested products to handle or staying within one's assigned territory.

If you have a franchisor who is in a dominant economic position and he has the power under his franchise agreement to terminate

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the agreement without cause or not renew the agreement at will, he has in effect the inherent power to coerce the franchisee into going along with suggested prices, suggested products, et cetera without actually threatening the franchisee.

This was so indicated by the Supreme Court in the case of *FTC* v. *Texaco*—393 U.S. 223, 226—where there were no facts that showed that Texaco had actually used coercive practices to force its gasoline station dealers to buy the sponsored brand of TBA—tires, batteries, and accessories.

The Supreme Court held that the sales commission system of marketing in light of the disparity in the relationship of the parties was inherently coercive and was an unfair method of competition in violation of section 5 of the FTC Act.

I want to point out that by requiring good cause before the franchisor can terminate the franchise agreement or legitimate business reason in order not to renew the franchise agreement, the effect of S. 2335 would be to eliminate the inherent coercion upon the franchisee to follow the franchisor's so-called suggestions.

In other words, this legislation will protect the economic freedom of franchisees to exercise their independent business judgment and initiative in the operation of their businesses without fear of retribution.

Therefore, in actuality, S. 2335 will be in aid of the competitive processes in giving the franchisee the courage to make decisions on what price he will charge, what products he desires to sell, what customers he wants to sell to and in what areas he wants to sell.

In addition, I want to point out how inadequate the antitrust laws really are in providing a meaningful remedy.

The FTC, as you know, brought an action against the Adolph Coors Co. for almost every per se violation of the antitrust laws.

It was proven and upheld by the reviewing appellate courts that Coors engaged in vertical price fixing, territorial restrictions, customer restrictions, and refusing to permit its distributors to handle other competing products.

The Commission felt that because Coors had used the threat of termination and the termination clause of its distributor contract to obtain compliance with its suggestions on price, territory, customers, and what products to handle, it ordered Coors not to terminate its distributor contracts without 180 days' advance notice and without good cause.

Coors appealed to the U.S. Court of Appeals for the Tenth Circuit. The Tenth circuit upheld the findings of the Commission that Coors had used the threats of termination and termination to effectuate the charged violations of the antitrust laws. But the court struck down the remedy of the Commission to require 180 days' advance notice and good cause before Coors could terminate its distributor contracts.

The Tenth Circuit said that this is a matter of private contract and the Commission did not have the authority in spite of all the evidence documenting abuses by Coors to impose upon Coors a prophylactic rule that it could no longer terminate its distributor agreements at will. See *Adolph Coors Co.* v. *FTC*, 497 F.2d 1178 (10th Cir. 1974).

This demonstrates how inadequate the antitrust laws are—even for the Federal Trade Commission—to effectively stop proven termination abuses by franchisors.

Next I want to point out that this Congress has had 12 years of hearings on both franchising and distribution.

I have set forth in my prepared statement all of the hearings that have been on this subject and the volumes of reported testimony.

Many times in these hearings the argument was made that franchising was an infant, it should be allowed to develop and that it should be allowed to grow up without interference. The opponents of franchise legislation argued: "Let's see what happens," and "Let's not circumscribe it in its growth."

Well, franchising has now grown up. It is a mature adult.

As indicated in my prepared statement, many of the larger, most diversified corporations in America have bought the franchising systems of other companies.

It reads like a "Who's Who" of conglomerates.

Pillsbury owns Burger King. Union Tank Car owns the Lindsay Chain. Consolidated Food purchased Chicken Delight. Ralston Purina purchased Jack In the Box.

Today the argument can no longer be made that franchising is an infant and should be treated as such.

Today, many franchise systems are owned by some of the largest corporations in America. It has come of age. It must be treated accordingly by this Congress.

Next, a question was asked by the committee about the contractual remedy. Isn't that remedy possible where a franchisor has failed to live up to his contractual commitment? To answer this question, I want to read you just a short quote from a book that was written on the history of the relationship between the automobile manufacturers and the automobile dealers. The book is titled, "The Law and The Balance Of Power" and it is authored by Stewart Macaulay. He speaks of an effort at the use of contract law by the automobile dealers over a period of three decades to obtain relief from abuses and here is what actually happened:

> In the 1920's, the 1930's and in the early 1950's, dealers were unhappy about being forced to take unwanted and unordered cars from the factories and about sales quotas enforced by terminations of the franchises of those who failed to meet them.
>
> Attempts to stop these practices through the common law of contracts were largely unsuccessful.
>
> To a great extent, the common law has facilitated the operation of large corporations by not looking to the "inequality" of bargaining power or skill in transactions between manufacturers and dealers and by allowing the manufacturers to deal on the basis of legally unenforceable agreements "treaties" that are supported by the manufacturers collection of other-than-legal sanctions.
>
> Thus, typically, the manufacturers have been able to act as they pleased because their lawyers drafted the provisions of the dealer-manufacturer selling agreements, and dealers accept these standard forms without modifications."
>
> Until fairly recently, when major changes were made in the franchises, they were legally unenforceable as contracts because they lacked mutuality of obligation. While the manufacturer demanded that the dealer sell enough cars and invest enough capital in the dealership to satisfy the manufacturer, it reserved the right to cancel the agreement at will and was careful not to promise to do anything. Thus the document gave the dealers no rights.

Contract law is not a viable remedy because almost all franchise agreements are drafted by the franchisor's lawyers and they are offered on a take it or leave it basis.

I have yet to hear, with one exception, of a franchisee being able to substantially modify a written agreement proposed by the franchisor.

One of the questions asked by the committee was in regard to the need for this legislation by a franchisee although not needed by a department store.

The reason why a franchise law is necessary for franchisees is because most franchsees are dependent upon a single trademark or single source of supply.

A department store, on the other hand, has many departments, many goods; the loss of one does not seriously affect the overall operation. But in franchising, the franchisee is totally dependent on the franchisor.

This is true in newspapers. Rarely do publishers permit their distributors to handle other products.

There are Washington Post dealers and they handle only the Washington Post.

There are San Francisco Chronicle dealers and they only handle the Chronicle.

They are not permitted and it is generally not the case except in outlying areas for the distributor to handle more than a single product.

When your total livelihood is dependent on one supplier you are in a vastly different economic situation than if you are a large department store and have many, many suppliers.

The question of abuses have been documented by the Congress in the aforementioned hearings. In preparation for this hearing, I obtained statements, which are attached to my prepared statement, from 22 different franchisees. They have set forth the facts pertaining to their terminations which we believe well document the continuing abuses that are taking place in the franchise industry today.

Another question raised was, shouldn't we seek narrow legislation? Aren't we trying to deal too broadly with this very diverse franchise industry?

Our position is that we want broad legislation. We admit that there are many different relationships. We admit that those relationships vary from industry to industry and from one end of the country to the other. But we look upon S. 2335 as a charter of independence, which has the broad language that will survive the passage of time, that will effectively cure the abuses, much like the language of the antitrust laws.

If you are going to deal with many different franchise relationships you must use language that in the words of Mr. Justice Holmes is of constitutional breadth.

We want a bill that will survive the technological, marketing changes that will occur over a period of time.

Naturally the courts will have to deal with such language so as to effectuate the bill's purposes in light of changing conditions.

We do not believe this problem should be handled on an industry-by-industry approach. Such narrow legislation has proven to be ineffective.

I want to quote the Washington representative of the International Franchise Association, who will be testifying no doubt tomorrow, Mr. Phillip Zeidman, one-time General Counsel to the Small Business Administration.

As General Counsel of the SBA he admitted in respect to the Automobile Dealers' Day In Court Act, "There are many who believe that the Automobile Dealers' Day In Court Act has not been effective and not achieved its goal. Perhaps they are right."

The Automobile Dealers Day In Court Act has had an unhappy experience since its enactment several years ago and has proven ineffective for the protection of the automobile dealers.

Such legislation indicates that an industry-by-industry approach is not practical.

We want legislation that would give a remedy that would survive the passage of time.

A question was raised by the committee about disclosure laws as a remedy. All disclosure laws do is require a franchisor, who may be a very dominant and powerful corporation, to disclose the nature of the one-sided relationship, to wit: that your franchise investment can be confiscated and you can be out of your store on a 30-day termination notice, with or without cause.

As long as the franchisor makes that disclosure he has compiled with the disclosure law. The disclosure law does not correct the abuse that results thereafter if that termination clause is exercised and the franchisee is terminated without cause and forfeits his business back to the franchisor. To cure such abuses substantive legislation is needed.

Next, I would like to ask that a recent decision of the United States Court of Appeals for the Ninth Circuit be placed in the record. This decision demonstrates the real need for this legislation. It is entitled *Noble* v. *McClachy Newspapers*, and I ask that it be inserted in the record.

Senator Moss. Without objection, it will be inserted.

[The information follows:]

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WILLARD M. NOBLE and ETTA M. NOBLE, *Plaintiffs-Appellees,* vs. McCLATCHY NEWSPAPERS, a corporation, et al., *Defendants-Appellants.*	No. 72-2021
WILLARD M. NOBLE and ETTA M. NOBLE, *Plaintiffs-Appellants,* vs. McCLATCHY NEWSPAPERS, a corporation, et al., *Defendants-Appellees.*	No. 72-2042

OPINION

[November 14, 1975]

Appeal from the United States District Court
for the Northern District of California

Before: BROWNING and TRASK, Circuit Judges,
and GRAY,* District Judge

BROWNING, Circuit Judge:

Willard Noble and his wife, Etta, were distributors of the Sacramento Bee newspaper. Their distributorship was cancelled They brought this private antitrust action against McClatchy Newspapers, publisher of the Bee, and seven individuals.[1]

*Honorable William P. Gray, United States District Judge, Central District of California, sitting by designation.

[1]The individual defendants are three officers of the corporation, two circulation department employees, and two persons who acquired plaintiffs' route following termination of plaintiffs' distributorship.

Three claims are at issue on these appeals: First, that defendants violated section 1 of the Sherman Act to plaintiffs' injury by terminating plaintiffs' distributorship; second, assuming the lawfulness of the termination of plaintiffs' distributorship, that defendants violated section 1 of the Sherman Act to plaintiffs' injury by preventing plaintiffs from selling their distributorship after termination; and third, that defendants violated section 2 of the Sherman Act to plaintiffs' injury by monopolizing the publication of daily newspapers of general circulation in the relevant market.

The case was tried to a jury. The jury returned a verdict for defendants on claim one (the termination claim) and three (the monopolization claim), and for plaintiffs on claim two (the sale-of-business claim). Judgment was entered in favor of plaintiffs on the sale-of-business claim in the amount of $63,333.04—$15,000 in damages, trebled, costs and attorneys' fees of $18,333.04.

Defendants appeal the denial of their motion for judgment n.o.v. or a new trial on the sale-of-business claim. Plaintiffs appeal the denial of injunctive relief with respect to this claim. They also urge that errors in jury instructions and rulings on evidence infect the judgment as to the termination and monopolization claims, and seek a new trial on these claims if defendants succeed in their appeal of the judgment as to the sale-of-business claim.

BACKGROUND FACTS

Willard Noble was an independent city newsstand distributor for the Sacramento Bee from October 1, 1960, to July 1, 1969, under three contracts with McClatchy Newspapers. Etta Noble was a party to the third of these contracts, entered on April 18, 1969.

Under the distributorship contracts, plaintiffs were responsible for sale and distribution of the Bee in an area referred to as "Newsstand #5," encompassing a portion of the City of Sacramento and its suburbs. Plaintiffs purchased daily and Sunday copies of the Bee from McClatchy Newspapers at wholesale and resold them from newspaper vending racks and to retail outlets. Unsold papers could be returned at cost, but plaintiffs assumed full responsibility for copies lost through theft or other causes.

Paragraph nine of the distributorship contracts provided that if plaintiffs decided to transfer their route they would give McClatchy Newspapers sixty days' notice, that McClatchy had "the right to determine the qualifications of the proposed new distributor," and that McClatchy's consent to transfer "shall be required, and will not be unreasonably withheld."[2] Paragraph eleven provided that the contract "may be cancelled by either party at any time upon thirty days prior written notice to the other party."

By letter dated May 27, 1969, McClatchy Newspapers cancelled plaintiffs' distributorship effective July 1, 1969. The reason for this action was disputed. Plaintiffs contended their refusal to agree to split their distributorship territory "was a substantial factor in causing [McClatchy] to terminate them." Defendants contended that the distributorship was terminated because of Willard Noble's "continued stream of complaints" regarding such matters as late delivery of papers and McClatchy's refusal to compensate distributors for theft losses."[3]

According to defendants, the difficulties with Noble came to a head during a telephone conversation between Noble and defendant Carlo Bua, assistant circulation manager. Bua testified that the conversation "started as a griping session" during which Noble complained "about the thefts of his papers, the late papers, he couldn't get qualified help, and so forth and so on." Noble ques-

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[2]Paragraph nine was added to the city newstand distributors' contracts in the spring of 1969, at the request of the distributors. Defendant Byron Conklin, circulation manager of the Bee, testified there never had been any "prohibition against selling a distributorship." Wentworth Kilgen, associate house counsel for McClatchy, testified that he approved the addition of paragraph nine to the contract because it was the "natural consequence" of the law "that a person can sell any asset that he has unless there is some restriction preventing him from doing so." He also stated "there was nothing to prevent the transfer of the distributorship under the previous contract, because there was no restriction against it."

[3]Defendants did not question Noble's competency as a distributor. Defendant Conklin testified that Noble was "very circulation conscious," that he "worked very hard to service his dealership," and that he "did a hell of a job" for the Bee. Defendant Carlo Bua, assistant circulation manager, testified that Noble was a "knowledgeable, experienced newspaper distributor." During Noble's nine years of service circulation of the Bee in Newsstand 5 increased approximately fourfold.

tioned whether the Bee was properly accounting for theft losses in reporting its circulation to the Audit Bureau of Circulation, an independent organization whose audits of publishers' circulation statements are heavily relied upon by advertisers. Noble also said he believed the distributorship contract was illegal insofar as it forbade bulk sales of unsold copies of editions that contained advertising discount coupons.[4] Bua "mentioned" that the solution to Noble's problems would be to split his distributorship. Noble replied that "under no circumstances would he want to split his distributorship."[5] Bua reported the substance of the conversation to defendant Byron Conklin, the circulation manager.

Conklin testified that Noble's complaints were "the straw that broke the camel's back"; his "patience was exhausted." He consulted his supervisor, O. J. Brightwell, business manager of the Bee, explaining that "his department was no longer able to get along with Mr. Noble," and recommending that he be terminated. Brightwell agreed. The cancellation letter was sent the following day.

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[4]The bulk sale problem concerned McClatchy because of complaints by advertisers that unusually high percentages of coupons were being returned for redemption, including many they believed had not been used to purchase the advertised products. Noble admitted that in late 1967 or early 1968, he made bulk sales of about 5,000 copies of the Bee containing discount coupons, but claimed these sales were made with Conklin's knowledge and approval to reduce theft losses. Conklin denied this. Noble testified that in May 1968 Bua admonished him to stop selling in bulk, and he complied. Conklin subsequently informed the city newsstand distributors that bulk sales of editions with coupons would be cause for termination. Still later, in April 1969, distributor contracts were revised to provide that "sale of editions containing advertising coupons will not exceed the normal demand for single copy sales of such editions and that [the distributors] will not sell in bulk for purposes of abnormal use of said coupons."

[5]Bua and Conklin admitted they had "suggested" to Noble on a number of prior occasions that he split his territory. They testified these suggestions were merely "constructive advice" as to how Noble might eliminate the problems he complained of.

Robert Gilliland, plaintiffs' expert on newspaper circulation practices, testified it was "in the best interests of management to keep [dealership] areas down to limited size," and if a dealer refused to split, management would "have to . . . take legal action to split the area or, quite frankly, cancel the man who won't split it."

A few days later Conklin told Bua, "now is the best time to split Newsstand 5." He instructed Bua "to find a satisfactory boundary line." Noble asked for reinstatement. Conklin refused. Noble asked if he could sell his distributorship. Conklin said "he had nothing to sell," and in any event McClatchy had plans to split the distributorship. Noble asked that he be allowed to "retain a portion of [his] dealership if it was split." Conklin refused.

Bua decided on a two-part division of Newsstand 5. Conklin initiated discussions with defendant Gary Downing, an employee of the Bee's circulation department, about becoming a distributor in a portion of Newsstand 5. Defendant James Gallagher, the Bee distributor for Newsstand 2, requested that he be considered for the remaining portion. Downing and Gallagher entered into distributorship contracts for the divided portions of Newsstand 5, effective July 1, 1969. With the permission of McClatchy, Gallagher sold his business in Newsstand 2 for $6,000.

DEFENDANTS' APPEAL

The sole issue on defendants' appeal is whether the district court erred in denying their motion for judgment n.o.v. or new trial on plaintiffs' sale-of-business claim.[6] We agree with defendants that the motion should have been granted.

Instructions given by the district court on the sale-of-business claim are reproduced in the margin.[7] According to these instruc-

[6]Plaintiffs argue that defendants waived their right to raise this issue by failing to raise it below. However, defendants challenged the sufficiency of the evidence on the sale-of-business claim in their trial brief, in their proposed instructions, in their motion for directed verdict on the sale-of-business claim, and in their brief in support of the motion for judgment n.o.v. or new trial on this claim.

[7]The relevant instructions, requested by plaintiffs, read:

> The [second] claim in this case is that the plaintiffs . . . contend that they were injured by reason of defendants' alleged violation of Section 1 of the Sherman Act, in that defendants refused to permit plaintiffs to sell and transfer their newspaper distribution business known as Newsstand No. 5, as plaintiffs contend that they were entitled to do so pursuant to their ownership of said business.
>
> I will refer to this claim as the sale of business claim.
>
> This sale of business claim is a different claim from the territorial claim which I have just instructed you on. This sale of business claim is made by both plaintiffs and is irrespective of whether or not the termination of the contract was lawful; that is, plaintiffs

tions the claim rested entirely upon the unlawfulness of defendants' refusal to authorize plaintiffs to sell Newsstand 5. For the purpose of this claim, lawfulness of the termination was to be treated as irrelevant. The jury was instructed to consider the sale-of-business claim separate and apart from the termination, and "irrespective of whether or not the termination of the contract was lawful."[8] It follows that plaintiffs' recovery under the sale-of-business claim may be sustained only if there was evidence from which the jury could conclude that *after* termination plaintiffs owned a valuable asset. Such proof was lacking.[9]

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are saying that regardless of whether or not the termination of the contract violated Section 1 of the Sherman Act, as they assert in support of their territorial restriction claim, there was another and different violation of Section 1 of the Sherman Act which caused them injury.

This other and different violation of Section 1 claimed by the plaintiffs is that after the contract was terminated there was a contract, combination or conspiracy to prevent them from selling their business, that this contract, combination or conspiracy in fact prevented them from selling their business and that this contract, combination or conspiracy restrained interstate commerce unreasonably.

In order for plaintiffs to recover for this alleged violation of Section 1, plaintiffs must show that after the contract was terminated there was a contract, combination or conspiracy to prevent them from selling their business, if any, as a going concern, and that this contract, combination or conspiracy in fact prevented them from selling their business, if any, and that this contract, combination or conspiracy was in unreasonable restraint of interstate trade and commerce.

[8]This portion of the instructions was necessary to enable plaintiffs to state a separate claim on the basis of McClatchy's refusal of permission to sell Newsstand No. 5 since the damage alleged under this claim and the termination claim was the same, *i.e.,* the going concern value of the distributorship.

[9]We thus do not reach the following issues raised on defendants' appeal: (1) whether there was sufficient evidence that plaintiffs were prevented from selling their distributorship by a contract, combination or conspiracy that unreasonably restrained interstate commerce; and (2) whether there was sufficient evidence that defendants Eleanor and C. K. McClatchy and Walter Jones personally participated in or approved the allegedly unlawful conduct forming the basis of sale-of-business claim.

"It is well settled that a manufacturer may discontinue dealing with a particular distributor 'for business reasons that are sufficient to the

Upon receipt of the letter of termination, as defendants accurately put it, "plaintiffs owned nothing but a contractual right to distribute the Bee for thirty-odd days." The witnesses who testified regarding the value of this right agreed that it was worthless.[10] Nothing in the distributorship contract purported to give plaintiff a right to sell, after termination, as if termination had not occurred.[11]. There was no evidence of a trade practice to this effect.[12] The only reasonable conclusion the jury could draw from the record was that no damage had been shown under the sale-of-business claim. *See Chisholm Bros. Farm Equip. Co. v. Interna-*

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manufacturer and adverse effect on the business of the distributor is immaterial in the absence of any arrangement restraining trade.'" *Bushie v. Stenocord Corp.*, 460 F.2d 116, 119 (9th Cir. 1972), *quoting Richetti v. Meister Brau, Inc.*, 431 F.2d 1211, 1214 (9th Cir. 1970). Allowing plaintiffs in the present case to recover antitrust damages on the sale-of-business claim after losing the termination claim would in effect reverse the well settled law on the antitrust implications of distributorship terminations. Allowing plaintiffs to recover on the sale-of-business claim after winning on the termination claim would be to permit duplicative recovery.

[10]This was the opinion of defendants and other representatives of McClatchy. It was shared, however, by one of plaintiffs' experts, Robert Gilliland, and by two distributors who testified on behalf of plaintiffs. It also appears to have been the view of plaintiffs' counsel as reflected in the following exchange with defendant Gallagher:

> Q. And you do know that under this paragraph 11 of the contract the Bee could terminate you and you would have nothing to sell?
>
> A. That's true.

[11]The distributorship contract involved in *Albrecht v. Herald Co.*, 390 U.S. 145, 148 (1968), provided that if the contract were terminated the distributor would have 60 days to provide a satisfactory purchaser for his route, as the Court of Appeals pointed out, 367 F.2d 517, 519 8th Cir. 1966).

[12]It was established that terminated distributors of another newspaper, the Sacramento Union, were paid $1.00 per subscriber. But this payment was expressly provided for in the Sacramento Union's distributorship contracts. There is no similar provision in plaintiffs' contracts with McClatchy. Even under the Sacramento Union's contracts no sale of a distributorship has been made "after [a] dealer was terminated and the termination was unrescinded." The circulation manager of the Sacramento Union testified that he had twice rescinded terminations, but that the rescissions were not granted for the purpose of giving the distributors an opportunity to sell their routes.

tional Harvester Co., 498 F.2d 1137, 1139-40 & n.5 (9th Cir. 1974). The insufficiency could not be cured by retrial; accordingly, the district court erred in refusing to grant the defendants' motion for judgment n.o.v.[13]

PLAINTIFFS' CROSS-APPEAL

Because plaintiffs' judgment on the sale-of-business claim must be reversed, we consider plaintiffs' contention that they are entitled to a new trial on the termination and monopolization claims because of alleged errors in the jury instructions and in the admission and exclusion of evidence. We conclude that a new trial is required on the termination claim.

Plaintiffs alleged that their distributorship was terminated in substantial part because they refused to accede to defendants' request that they give up a part of the territory covered by the distributorship. The district court instructed the jury as follows:

> If you should find from the evidence that defendants or some of them wished plaintiffs to agree to confine their sales of the Sacramento Bee to a particular part of Newsstand No. 5, that the plaintiffs refused to agree to this, and that their alleged refusal was a substantial factor in the termination of the contract, you must then determine whether, if plaintiffs had agreed to the arrangements, an unreasonable restraint of interstate commerce would have resulted, as a result of being a part of an alleged arrangement between the Sacramento Bee, its distributors and carriers.

Plaintiffs contend that the district court should have instructed the jury that an agreement to restrict the territory in which newspapers purchased from McClatchy could be sold would have been a per se violation of section 1 of the Sherman Act, and it was therefore unnecessary for plaintiffs to prove an unreasonable restraint of interstate commerce would have resulted from such an agreement. Plaintiffs correctly state the law.

In *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967), the Supreme Court held:

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[13]For the same reasons, plaintiffs were not entitled to injunctive relief on the sale-of-business claim under § 16 of the Clayton Act, 15 U.S.C. § 26, providing such relief "against threatened loss or damage by a violation of the antitrust laws."

> Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it . . . . Such restraints are so obviously destructive of competition that their mere existence is enough. If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale.

The rule of *Schwinn* is unequivocal:

> Once the manufacturer has parted with title and risk, he has parted with dominion over the products, and his effort thereafter to restrict territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a *per se* violation of § 1 of the Sherman Act.

388 U.S. at 382.[14]

Although the wisdom of per se rules with respect to territorial restraints has been the subject of substantial commentary,[15] the Supreme Court has adhered to *Schwinn* and, indeed, has expanded its prohibition. In *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972), the Court held that horizontal as well as vertical ter-

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[14]The opinion in this case deals only with the precise type of territorial restriction involved in *Schwinn*. We intimate no view whatever as to the rule to be applied to other dealer restrictions such as the location clauses involved in *GTE Sylvania, Inc. v. Continental T.V., Inc.*, No. 71-1705, now under submission to the court in banc.

[15]*See, e.g.*, Averill, *Sealy, Schwinn and Sherman One: An Analysis and Prognosis*, 15 N.Y.L.F. 39 (1969); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 Yale L.J. 373 (1966); Chadwell & Rhodes, *Antitrust Aspects of Dealer Licensing and Franchising*, 62 Nw. U.L. Rev. 1 (1967); Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 Harv. Law Rev., 1419 (1968); McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Retail Prices and Refusals to Deal*, 37 Antitrust L.J. 137 (1967); Zimmerman, *Distribution Restrictions After Sealy and Schwinn*, 12 Antitrust Bull. 1181 (1967); Editorial Note, *Territorial and Customer Restrictions: A Trend Toward a Broader Rule of Reason?*, 40 Geo. Wash. L. Rev. 123 (1971); Note, *Territorial Restrictions and Per Se Rules—A Reevaluation of the Schwinn and Sealy Doctrines*, 70 Mich. L. Rev. 616 (1972);

ritorial restraints were unlawful per se, rejecting the trial court's conclusion that the anticompetitive effect of a territorial restraint on intrabrand competition was outweighed by the increased ability of dealers in Topco-brand products to compete in the inter-brand market. In justifying the per se approach in this area, the Supreme Court said (405 U.S. at 609-10):

> The fact is that courts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against preservation of competition in another sector is one important reason we have formulated *per se* rules.

The Court noted (405 U.S. 609-10 n.10):

> Without the *per se* rules, businessmen would be left with little to aid them in predicting in any particular case what courts will find legal and illegal under the Sherman Act. Should Congress ultimately determine that predictability is unimportant in this area of the law, it can, of course, make *per se* rules inapplicable in some or all cases, and leave courts free to ramble through the wilds of economic theory in order to maintain a flexible approach.

As the Fifth Circuit recently observed: "[W]e must accept the fact that the Court has set its face against both horizontal and vertical territorial restrictions with the possible exception of vertically imposed restrictions by 'new entrants' and 'failing companies' briefly mentioned in *Schwinn*." *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934, 943 (5th Cir. 1975).[16]

Defendants contend that application of *Schwinn* to the distribution of newspapers will be destructive of an orderly system essen-

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Note, *United States v. Arnold, Schwinn & Co.— Vertical Customer and Territorial Restrictions and the Sherman Act,* 63 Nw. U.L. Rev. 262 (1968); Comment, *The Impact of the Schwinn Case on Territorial Restrictions,* 46 Texas L. Rev. 497 (1968); Case Comment, *Horizontal Territorial Restraints and the Per Se Rule,* 28 Wash. & Lee L. Rev. 457 (1971).

[16]Policy arguments against the *Schwinn* per se rule are examined and rejected by Judge Wisdom in an extensive footnote. 506 F.2d at 941-43 n.5.

tial to timely delivery of perishable news and advertising. There is nothing to indicate that independent distributors, their livelihood at stake, would fail to make timely delivery unless competition among them were eliminated by territorial restrictions. Lawful means less restrictive of intraband competition are available if required to assure effective distribution.[17] Defendants' argument of necessity is particularly surprising in view of their equally vigorous insistence that they did not impose territorial restrictions on their distributors.

In any event the argument that need for speedy delivery of perishable products justifies an exception to the *Schwinn* per se rule has been rejected whenever raised. *Adolph Coors Co. v. FTC,* 497 F.2d 1178, 1187 (10th Cir. 1974); *Fairfield County Beverage Distributors, Inc. v. Narragansett Brewing Co.,* 378 F. Supp. 376, 378 (D. Conn. 1974); *cf. Copper Liquor, Inc. v. Adolph Coors Co., supra,* 506 F.2d at 947. In *Albrecht v. Herald Co.,* 390 U.S. 145, 153-54 (1968), a price-fixing case involving an independent newspaper distributor, the Supreme Court indicated that the *Schwinn* per se rule would be held applicable to just such a case as this.[18]

In *Adolph Coors Co. v. FTC, supra,* the Court of Appeals for the Tenth Circuit reluctantly applied *Schwinn* to the distribution of a perishable product, expressing the hope that "the Supreme Court may see the wisdom of grafting an exception to the *per se*

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[17]The decree on remand in *United States v. Topco Associates, Inc., supra,* allowed creation of territories of primary responsibility, so long as the device was not used directly or indirectly to achieve or maintain territorial exclusivity. *United States v. Topco Associates, Inc.,* 1973 Trade Cas. ¶¶ 74,391, 74,485 (N.D. Ill.), *aff'd mem.,* 414 U.S. 801 (1973). *See also White Motor Co. v. United States,* 372 U.S. 253, 271-72 & n.12 (1963) (Brennan, J., concurring).

[18]The Court stated:

> Certainly on the record before us the Court of Appeals was not entitled to assume, as its reasoning necessarily did, that the exclusive [territorial] rights granted by [the newspaper] were valid under §1 of the Sherman Act, *either alone or* in conjunction with a price-fixing scheme. *See United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 373, 379 (1967). The assertion that illegal price-fixing is justified because it blunts the pernicious consequences of another distribution practice is unpersuasive. If, as the Court of Appeals said, the economic impact of territorial exclusivity was such that the public could be protected only by otherwise illegal price-fixing itself injurious to the public, the entire scheme must fall under §1 of the Sherman Act. (Emphasis added).

rule when a product is unique and where the manufacturer can justify its territorial restraints under the rule of reason." But an exception to *Schwinn* based upon asserted uniqueness of product would be difficult to administer, and would introduce an element of uncertainty the per se rule was intended to eliminate. *United States v. Topco Associates, Inc., supra,* 405 U.S. at 609 n.10. As we read the *Schwinn* opinion, manufacturers may avoid the per se rule only by vertical integration or adoption of agency or consignment methods of distribution.[19] Manufacturers who wish to enjoy the advantages of distribution through independent entrepreneurs must be prepared to accept the burdens of *Schwinn*.

Maufacturers have a significant incentive to distribute their products through independent contractors rather than through employees, agents or consignees. Use of independent distributors avoids the substantial investment, expense, and risk incident to alternate methods of distribution.

The record in this case reflects other benefits. Paul Rothman, former circulation director of the Sacramento Union, testified, "the cost factor to have salaried employees in place of dealers would represent two and a half or more times outlay for the publisher." The difference, Rothman explained, is that "a dealer works seven days a week," usually with the help of other family mem-

[19] *Schwinn* approved a "rule of reason" approach to territorial and customer restraints imposed on agents or consignees of the manufacturers. The Court said, 388 U.S. at 380:

> Where the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer, it is only if the impact of the confinement is 'unreasonably' restrictive of competition that a violation of §1 results from such confinement, unencumbered by culpable price fixing.

We reject defendants' suggestion that plaintiffs' distributorship was analogous to the agency and consignment situations referred to in *Schwinn*. The distributorship contract expressly provided that the distributor was to be "an independent wholesale distributor and not . . . an employee." Conklin testified that plaintiffs were "dealt with as independent contractors," and the record establishes that plaintiffs in fact operated on this basis. They purchased their own trucks and equipment and hired their own employees. They agreed "to purchase" the Bee. Defendants concede that plaintiffs acquired title to the copies purchased. Plaintiffs could return unsold copies at cost, but assumed the full and substantial risk of loss from theft and other causes.

bers, and "takes care of his own transportation and equipment."[20] Robert Gilliland, plaintiffs' expert on newspaper circulation practices, testified that in addition to these obvious economic benefits, independent distributors are "normally a harder working group of people and . . . have a more serious concern about the operation than a salaried employee."

Because of such advantages to manufacturers, independent distributors continue to survive, and bring to the public the benefits of added competition in the distribution of goods and services. These benefits would be lost if manufacturers could obtain the private economic benefits of a system of distribution through independent businessmen, and at the same time restrict the freedom of such independent businessmen to compete. It was to prevent the wholesale destruction of this opportunity for competition that *Schwinn* forbade manufacturers to control the disposition of products after sale. "To permit this would sanction franchising and confinement of distribution as the ordinary instead of the unusual method which may be permissible in an appropriate and impelling competitive setting, since most merchandise is distributed by means of purchase and sale." 388 U.S. at 379.

Defendants contend there was no factual basis for a *Schwinn* instruction, because plaintiffs failed to establish that a split of their territory would have resulted in the imposition of a territorial restraint. Plaintiffs' distributorship contract did not define the boundaries of Newsstand 5, and did not expressly forbid plaintiffs from selling the Bee in areas other than Newsstand 5. Bua described the geographical boundaries of the city newsstand dis-

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[20]Rothman testified:

A. Well, a dealer works seven days a week, because it's his business. His wife usually takes care of his books. If he has a couple of boys they carry a paper route. If it was an employee setup, they would be working five days a week, forty hours a week, and you would have to have one and a third man for each dealership plus the fact that you would have to have a relief man for it, plus the fact that anytime that they worked beyond that forty hours, and this dealership is practically a twenty-four hour affair, in case of an emergency, why, you would have to pay all that overtime, plus the fact that you would have to supply trucks, vehicles of all kinds, where the dealership, the dealer takes care of his own transportation, plus the fact that you would have to buy or print all your various forms which the dealer either pays for now or buys it himself."

tributorship as areas of "primary responsibility," and on cross-examination Willard Noble answered in the affirmative when asked, "Now, as you understand it, this contract gave you an area of primary responsibility; did it not?" From this defendants argue that as a matter of law, no territorial restrictions existed.

The absence of an express territorial restriction is not fatal to plaintiffs' claim. There is no magic in the label "area of primary responsibility." It is enough if the restriction existed in fact, whether the product of an express or tacit understanding. *See United States v. Arnold, Schwinn & Co., supra,* 388 U.S. at 382; *Hobart Brothers Co. v. Malcolm T. Gilliland, Inc.,* 471 F.2d 894, 900 (5th Cir. 1973); *Beverage Distributors, Inc. v. Olympia Brewing Co.,* 440 F.2d 21, 28 (9th Cir. 1971); Zimmerman, *Distribution Restrictions After Sealy and Schwinn,* 12 Antitrust Bull. 1181, 1187-88 (1967). *But see Colorado Pump & Supply Co. v. Febco, Inc.,* 472 F.2d 637, 639 (10th Cir. 1973).

The jury could have inferred the existence of a tacit understanding from the evidence of numerous "suggestions" to plaintiffs that they split their territory, and from the testimony of Gallagher and two other city newsstand distributors that they always stayed within their assigned territories. *See Beverage Distributors, Inc. v. Olympia Brewing Co., supra,* 440 F.2d at 30. Willard Noble testified that there were "some fuzzy areas" at the boundaries of Newsstand 5, and admitted that he had unsuccessfully sought to have his "boundary lines spelled out." Nevertheless, the boundaries were sufficiently definite that at trial Bua was able to outline all city newsstands on a street map of the Sacramento area. When plaintiffs' distributorship was split following termination, Bua marked out the boundaries of the two new distributorships on a map in his office. Bua exhibited this map to defendants Gallagher and Downing, plaintiffs' replacements. Gallagher testified that he knew the area he was going to take over "in terms of its definition by street boundaries."

The jury could have found, therefore, that the proposed division of plaintiffs' distributorship would have involved the imposition of a territorial restraint. There was also sufficient evidence that plaintiffs' refusal to agree to divide their distributorship was a substantial factor in their termination. Thus, the jury may have based the verdict for defendants upon a finding that the territorial restraint was not an unreasonable burden on commerce.

Since under *Schwinn* the jury should have been instructed that such territorial restrictions are per se unreasonable, the judgment for defendants on the termination claim must be reversed and remanded for a new trial.

We do not agree with plaintiffs that a new trial is also required on the monopolization claim. Plaintiffs complain because the court instructed the jury that plaintiffs must prove that defendants "willfully acquired or willfully maintained monopoly power" *and* "had the intent and purpose to exercise the monopoly power." Plaintiffs correctly point out that while a general intent is required for actual monopolization it may be shown by proof of the willful acquisition or maintenance of monopoly power,[21] and it was improper for the court to state that both were required, as if they were independent. Although plaintiffs are technically correct, we think the redundancy was harmless.[22]

Two rulings of the trial court should be considered in view of the remand for a new trial. It was not error to exclude evidence that McClatchy deleted allegedly anticompetitive provisions in the distributorship contracts after plaintiffs' termination. Plaintiffs argue that "an inference of guilt or wrongdoing may be drawn," from such evidence; but it is well settled that evidence of subsequent remedial measures is not admissible to prove culpability of prior conduct. *See Boeing Airplane Company v. Brown*, 291 F.2d 310, 315 (9th Cir. 1961); Federal Rules of Evidence, Rule 407.[23]

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[21]*United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); *United States v. Griffith*, 334 U.S. 100, 105-07 (1948).

[22]It was harmless error, if error at all, to admit the published circulation reports of the Woodland Daily Democrat, the Grass Valley Union and the Colusa Sun Herald, without testimony from representatives of the newspapers that the reports were prepared in the regular course of business. The impact of the evidence was de minimis.

[23]Plaintiffs contend that the contract changes were admissible to explain "the loss of market position by the Sacramento Bee after the filing of the lawsuit." We do not consider the merits of this argument. The evidence of the contract changes was not initially offered on this theory. Later defendants introduced an exhibit showing the Bee's circulation had declined from 1963 to 1971. Plaintiffs' counsel objected to the post-1969 figures, stating "if they are entitled to show what was happening in circulation since '69, I think we should be entitled to show that certain things were done that may have affected that circulation." Plaintiffs did not, however, re-offer proof of the contract changes.

We think it was error, however, to inform the jury that "it is the function and duty of the court in the event that you should award damages to treble that amount in the judgment." The sole function of the jury was to determine the amount of the damage actually sustained. The "probable consequence" of advising the jury of the tripling provision of section 4 of the Clayton Act, 15 U.S.C. § 15, "would be harmful—an impermissible lowering of the amount of damages." Such an instruction is an invitation to the jury to negate Congress' determination that actual damages should be treble in order to deter antitrust violations and encourage private enforcement of the antitrust laws. *Pollock & Riley, Inc. v. Pearl Brewing Co.*, 498 F.2d 1240, 1242-43 (5th Cir. 1974).[24]

Defendants suggest that since jurors may be independently aware of the treble damage provision, an explanatory instruction is necessary to avoid jury confusion and the return of erroneous verdicts. "Our immediate reaction is that a district court can sufficiently instruct the jury to determine only *actual* damages. In those cases where an accidental revelation occurs, the court can give curative instructions to alleviate confusion." *Pollock & Riley, Inc. v. Pearl Brewing Co., supra,* 498 F.2d at 1243 (emphasis in original; footnotes omitted).

The judgment for defendants on the termination claim is reversed and remanded for a new trial consistent with this opinion. The judgment for plaintiffs on the sale-of-business claim is reversed and remanded with instructions to enter judgment n.o.v. for defendants. The judgment for defendants on the monopolization claim is affirmed.

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[24] *Accord, Lehrman v. Gulf Oil Corp.*, 500 F.2d 659, 665-67 (5th Cir. 1974); *Standard Indus., Inc. v. Mobil Oil Corp.*, 475 F.2d 220, 223-24 (10th Cir. 1973); *Semke v. Enid Auto Dealers Ass'n*, 456 F.2d 1361, 1370 (10th Cir. 1972); *Sablosky v. Paramount Film Distrib. Corp.*, 137 F. Supp. 929, 941-42 (E.D. Pa. 1955); *Webster Motor Car Co. v. Packard Motor Car Co.*, 135 F. Supp. 4, 10-11 (D.D.C. 1955), *rev'd on other grounds*, 243 F.2d 418 (D.C. Cir. 1957). *But see Bordonaro Bros. Theatres, Inc. v. Paramount Pictures, Inc.*, 203 F.2d 676, 678-79 (2d Cir. 1953); *Cape Cod Food Prods., Inc. v. National Cranberry Ass'n*, 119 F. Supp. 900, 911 (D. Mass. 1954).

GRAY, District Judge, concurring and dissenting:

I am glad to concur in Judge Browning's opinion, except with respect to its holding that the trial court should make no mention of treble damages in instructing the jury. I think that the trial court should "level" with the jury and make sure that the members thereof understand the respective responsibilities of jury and court with respect to damages, just as the trial judge in this case did.

Jurors, like other citizens, are entitled to know what the law is, even with respect to damages in antitrust cases; presumably, many of the people who serve on juries have some awareness in these matters. If no explanation is given as to who does the multiplying by three, the jury might well assume that the responsibility is theirs and thus do it without anyone becoming aware that the "damages" have already been trebled. A judge fixes damages in an antitrust case in full knowledge that the amount will be tripled; I see no valid reason why we should try to conceal from a jury the ultimate effect of their verdict.

Mr. FINE. Mr. Chairman, in that case you have a distribution system in which distributors could sell their businesses so long as they were in good standing. On July 1, 1969, a distributor named Willard Noble was terminated without any reason stated in the notice.

When Mr. Noble was sent the 30-day notice of termination he went in and asked to be allowed to sell his business. The publisher refused. Mr. Noble went to trial in Federal court in San Francisco. He recovered a verdict from a jury of $15,000 which under the antitrust laws was tripled to $45,000. With attorney fees and cost of suit awarded him, Mr. Noble obtained a judgment of a little over $63,000.

The publisher appealed to the Judgment to the United States Court of Appeals for the Ninth Circuit. I have handed to you the Ninth Circuit decision which reversed and threw out the judgment of $63,000.

The Ninth Circuit held that once Mr. Noble's contract was terminated he did not have a salable business right and that the 30 days he had left in his contract after termination was worthless. The end result was Mr. Noble had no right to sell that business even though he could have as long as he had not received the notice of termination.

It demonstrates how badly this legislation, S. 2335, is needed.

In closing, Mr. Chairman——

Senator TUNNEY. Just before you close, Mr. Fine—I unfortunately have another engagement at 11 o'clock— I would like to say that I appreciate very much the testimony you have given and the detail with which you have laid out your argument and the specific examples you have given of abuses.[1]

I might say to the committee that I had opportunity to discuss these matters with Mr. Fine in California and it was his logical explanation and very detailed graphic report of the situation that encouraged me to become a supporter of this legislation.

I am glad that other members of the committee have had opportunity to listen to Mr. Fine. I think in questioning him you will find his knowledge of the specifics goes far beyond just his written statement and the formal presentation that he has given to us.

Thank you very much.

Mr. FINE. Thank you, Senator. You are very kind.

Senator Moss. You may finish your statement, if you would like, Mr. Fine.

Mr. FINE. Thank you, Mr. Chairman.

In my prepared statement NFAC sets forth certain improvements which we think should be considered at markup of the bill. I will not go into them in any detail.

I do want to mention one proposed change because the FTC in its support of the House bill, H.R.. 8349, also supported this particular change. This change pertains to what happens when at the end of 5, 10 or 15 years the franchise agreement is up for renewal.

Naturally, during the term of a franchise agreement, time and technological changes have occurred so that the franchisor wants to

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[1] See page 344.

propose a different agreement on renewal. Also, the franchisee may want changes also. But they cannot reach agreement. They are at logger heads.

After good faith negotiations the franchisor and franchisee are unable to come to a meeting of minds on the agreement that should govern them in the future. What should be done?

Both the FTC and NFAC suggest that the solution lies in binding arbitration.

We think this is an innovation which is particularly desirable because, one, the courts are not equipped to decide future contractual terms; second, arbitrators can be experts in the industry and know its particularities and problems and so through binding arbitration the franchisor and franchisee can have the problem solved in an equitable manner in terms of what is fair, just, and equitable. This proposed change would mean that the franchisee would not lose his business or submit to whatever is dictated by the franchisor.

As we are becoming more and more technological and industry more concentrated, I think we have to look more to the expertise of arbitrators. I would like to suggest as an innovation and one which I think will prove of great wisdom, that if the franchisor and franchisee cannot agree on the term of renewal then the matter of the terms of renewal, at the request of either party, shall be submitted to binding arbitration.

With that I will close and thank you very much for taking your time to listen to me today.

Senator Moss. Thank you, Mr. Fine. You have a fine statement which is in the record in full. You have discussed some of the points with us. We appreciate that very much.

One of the provisions of the legislation provides for the payment of compensation for lost good will. My question is, How does the court compute just compensation?

We will have to write a report and make some legislative history, and that is a little bit baffling.

Mr. FINE. There are two methods used in courts today to determine the goodwill value of a family-owned, closely held business that has not had a market history of sale. One is the comparability method. If you are, for example, a newspaper distributor in the Chicago area and your business is destroyed by unlawful action of the publisher, then you can come into court with sales of comparable newspaper businesses and through the comparability approach, relating the income of the comparable business to its sales, its potential growth, all of the factors that go into the value of the business, give the jury enough fact so they can make a decision.

The second approach is the way the State and Federal tax appraisers handle it when they are appraising these closely held businesses for State and Federal tax purposes. That is the capitalization approach. They look at the history of earnings, sometimes over a 5-year period. They look at the degree of labor input by the owner into the business. The appraisers assign a value to the owner's labor. They capitalize the earnings, less the owner's labor value, by a factor of five or whatever the norm in the business. These are the two ways of measuring the goodwill value of a business. One is the comparability approach and one is the capitalization approach.

Senator Moss. On this transfer of a franchise by selling, isn't that largely a transfer of goodwill, in any event?

Mr. FINE. Yes, it is, Mr. Chairman.

Senator Moss. You talk about the independent newspaper dealers and there seems to be a common thread running through the statements that you have that determination did not result in any compensation to the franchisee and that the reason for termination was given as the company wanted to engage in direct marketing of his product. Why should a producer of an exclusive product not be permitted to change the manner in which he produces and vends that product? Why can't he go into direct distribution of his newspapers, for example?

Mr. FINE. That is an excellent question. The greatest changes that are now occurring in the franchise and distribution field is what we call vertical integration or direct distribution. In industry after industry, not just newspapers, the franchisors and suppliers want to take over the distribution now that they have accumulated the capital, generally from the efforts of the franchisee, to now engage in their own distribution.

The way the courts have looked at this under the antitrust laws is that if the change in distribution will increase the franchisor's market power over what he had in the first place and he already enjoys what we call a dominant market position, this increase in the franchisor's dominant market power is looked upon as an antitrust violation. See *Industrial Bldg. Materials, Inc.* v. *Interchemical Corp.*, 437 F. 2d 1336 (9th Cir. 1970).

There seems to be a thread running through the decisions that if you are the *Northern Virginian Sun* or a small newspapers without market power, and you want to change your distribution system, the courts will allow you to do so for good business reason because you are just a pygmy and not dominant. On the other hand if you are the dominant paper in the market, such as the *Washington Post*, and you change your distribution system you are now extending your market power to the ultimate customer and that extension of power is an antitrust violation.

It depends on your market position in the relevant market.

Also, the courts have said, if you purpose is to fix prices, to restrain competition, to engage in territorial restrictions, such changes in distribution are also unlawful.

You have a mixed situation, depending on your position in the marketplace and your purposes for making the change.

Senator Moss. The House hearings with which you are familiar, I am sure, had the objection raised by those who opposed the legisla- from that sword being used arbitrarily or capriciously, then there would be a reduction in franchising. What do you make of that statement. Has there been a case in the States where franchising termination laws have had that result?

Mr. FINE. I'm unaware of any cases where the enactment of a State law has resulted in a franchisor changing his distribution system because of that law. I'm faced constantly with these arguments that if this is passed or done, you are opening up a pandora's box and the end result will be worse than the remedy. All I can say to

that argument is that under the Moss bill, S. 2335, that instead of vertical integration or direct distribution coming about because of it, this bill will, in fact, put an end to this trend. The bill defines marketing area withdrawal as prohibiting the franchisor, when he withdraws from a market, from reentering the market for 5 years. So, that if a franchisor is not making money, say, in Alaska, he can legitimately withdraw from that market and not have to continue his franchise system there. This is fine with us.

He shouldn't be required to maintain an unprofitable operation.

But on the other hand, if the franchisor as a subterfuge wants to withdraw his franchising system from, say, the State of Virginia and then put in company-owned units, this bill would stop that situation because he would have to stay out of Virginia for 5 years before he could come back in.

Senator Moss. Senator from Kentucky.

Senator FORD. Thank you, Mr. Chairman.

Mr. Fine, am I correct that you and Mr. Waldie are representing the same group?

Mr. FINE. That is correct, sir.

Senator FORD. I suggested to Mr. Waldie a moment ago and he gave his answer and I understand that you now have elaborated a little more on the antitrust legislation and the field of antitrust. Do you feel that this bill would infringe in any way on the antitrust laws?

Mr. FINE. No, I don't, Senator. I would like to emphasize what I think would be the greatest benefit from this bill. That is its fallout effect. There are many abuses in franchising. We are not here to advocate an omnibus bill to cure all abuses.

It is my observation if you deal with the franchisor's sword of Damocles, the power to terminate and cure the abuses emanating from that sword being used arbitrarily or capriciously, then there will be a fallout effect, which will eliminate many, many other abuses that occur. It will give the franchisee, say the automobile dealer, the courage to say to Ford Motor Co. "I do not want"——

Senator FORD. You are not representing Ford today, is that correct, sir?

Mr. FINE. That is correct, sir, but we do have a second group of automobile dealers we represent, which is called the Independent Dealers Committee Dedicated to Action. It is a cross section of dealers from all brands, all manufacturers and they are a constituent group of NFAC. Their representative will be testifying later on.

We do represent car dealers through that group.

I'm saying this bill will have a beneficial fallout effect that will give the courage to many franchisees to make their own decisions and say, "I do not want these excess cars forced on me." "I want to buy my syrup from the best and most reasonable source." The bill, S. 2335, will have a beneficial effect throughout the entire franchising industry and cure many other abuses that the bill is not even really aimed at.

Senator FORD. Mr. Fine, are the attachments to your statement a pretty good cross section of the abuses being experienced now?

Mr. FINE. They are a cross section of the abuses that are being experienced by newspaper dealers throughout the country.

Senator FORD. Newspapers only?

Mr. FINE. That is correct, sir.

Senator FORD. Any reason why you don't attach abuses in other fields to your statement?

Mr. FINE. I'm counsel to the American Newspaper Dealers Association, and I had personal contact with many clients and persons and was able to readily obtain these.

We do have other statements that will come before you from other counsel and witnesses. These were readily available to me and I was able to put them together on short notice.

Senator FORD. I'm trying to get in a position to understand. I'm asking questions that are not necessarily pro. I think it is important that you have an opportunity to answer these questions. If I asked only the good questions, we won't get to the meat of the nut.

Mr. FINE. I prefer the tough questions.

Senator FORD. I'm not a lawyer and you are.

Mr. FINE. Claude Winslow, my wife's great uncle was from Mayfield, Ky., and he asked good questions.

Senator Ford. It shows you have a little good judgment in marrying a girl whose mother was from Kentucky.

I understand we will get into the other abuses of franchising but it appears that these were all newspaper and they didn't get into the broad scope, which this piece of legislation will involve. As you indicate, we will be getting some of that later on in other testimony from those who represent other groups.

Mr. FINE. I went through volume after volume of hearings that were held by the committees of Congress over a course of 12 years. In those hearings, which are set forth in my prepared statement there is a wealth of abuses from a cross section of franchisees.

Senator FORD. I wish I could read them all.

Mr. FINE. I couldn't get through them all either.

Senator FORD. Mr. Fine, as a former small businessman, would you agree and these are the questions that bother me, as a businessman looking on both sides that the private contract obligations between the franchisor and franchisee might be changed by this proposed legislation?

Mr. FINE. Very definitely.

Senator FORD. So really we are passing Federal legislation which in effect says what the contract will be.

Mr. FINE. I believe you are doing that through correcting abuses. It is corrective legislation.

Senator FORD. What I'm saying to you, and I would like to have a yes or no answer, aren't we by Federal legislation dictating what a contract shall be?

Mr. FINE. In certain respects, yes.

Senator FORD. How far would it be wise to alter such contracts by legislation of this kind?

Mr. FINE. It would be very desirable. I look on a contract the same way you do. When I negotiate with someone about the terms of a contract usually we both are in the position to give and take. I believe in the sanctity of this private right of contract.

On the other hand, where you have a situation where you are on a take it or leave it basis, the contracts are in a printed form, some-

times they are on a tablet and they are pulled off the tablet and you are asked to sign it or forget it. I don't look upon this in the same way as I do the other situation. Because you have two parties, one who is not in a position to negotiate and the other who is saying, take it or leave it.

I think that in this situation and with the abuses that have been documented, the Congress should come in and provide relief that will restore an equality of bargaining power.

Senator FORD. In your legal experience, isn't there a lot of contracts already printed up that are usual and normal contracts to be signed in any phase of legal transactions. I suspect you have a drawer full of them at your office that you can pull out and fill in the blank spots and have two people sign it.

Mr. FINE. There are those situations certainly.

Senator FORD. When a young couple makes their decision to purchase a home, wouldn't the mortgage form be printed and you tear it off a tablet and you ask the young couple to sign it?

Mr. FINE. Yes, but I add that many States including Kentucky, California and Virginia——

Senator FORD. You got two important Commonwealths.

Mr. FINE. I was raised in Virginia. I want to say that the State and Federal Governments have passed laws which we, as attorneys, must be cognizant of in drafting these printed forms and if we are not, we know what the consequences are. Both Federal and State laws have circumscribed what can be placed in these type of contracts.

Senator FORD. Disclosure is very important. Is not the franchisee when he signs the agreement aware of his obligations under the contract and is he not obligated to enter into the contract if he doesn't like the agreement? He is not obligated to sign the contract.

Mr. FINE. That is correct, sir. Again, we are dealing with an industrial society that is vastly different than 30 or 60 years ago. Today you have enormous disparity between the parties. If we are going to make this free enterprise system of ours work, as we have in the banking industry and security industry and in respect to labor management relations, we have to have a certain amount of refereeing, which is the way this Congress has acted in curing abuses, rather than nationalizing various industries.

I would like to point out that the Congress responded to the inequities and abuses in the employer-employee relationship by passing the National Labor Relations Act, the Taft-Hartley Act and the Landrum-Griffin Act setting forth certain parameters as to what the parties can and cannot do, so that the system can work. That is what the legislation will do. It will enhance, not detract from the free enterprise system.

Senator FORD. When a franchisee signs a contract form, say zero to 20 years, say 20 years, should renewal be required—this franchise ought to be required to renew unless there is some good cause.

Mr. FINE. The renewal question should be handled in our judgment by good faith negotiations between the parties. If they cannot agree on the term of renewal, then we believe that it will enhance the marketing system, which we call free enterprise, by having an

independent arbitrator make a binding decision on both parties after they have presented all of their facts to his expertise. That is the way it should be handled.

Senator FORD. Mr. Fine, this is my last question. Mr. Fine, what is wrong with our system when we have to make Federal laws that supercede all other laws in order make the free enterprise system work?

Mr. FINE. I think it is a recognition of what has happened in the last 76 years in terms of changes in the industrial scene. It is recognition by this Congress that you want the free enterprise system to work, but with 500 of the largest corporations in America owning the great majority of assets, that to keep that system working properly and to give the incentive to the small businessman to put in his time, labor, effort to build a business that will not be taken away from him without cause or forfeited at the will of the large corporation—if you want the free enterprise system to survive you must breathe life into it by passing S. 2335.

Senator FORD. That reminded me of a story that came out of the hills of Kentucky. A fellow was driving down the road taking a survey. That is important today. He stopped this fellow on the road and said, "Who are you for for Governor?" and he said, "I'm for candidate X."

He said, "Why are you for candidate X?" and he said, "He will divide all the assets and make us equal" and the other guy said, "Well, the smart one will have it all Saturday night anyhow," and the man said, "But candidate X will divide up Monday morning again."

Thank you, Mr. Chairman.

Senator Moss. You said we are a Nation of 50 independent States, but we are one great common market. Isn't that what you are talking about?

Mr. FINE. Yes, Mr. Chairman.

Senator Moss. We do thank you for your coming and bringing this information to us.

I'm glad to have it in our record. Thank you.

[The statement follows:]

STATEMENT OF TIMOTHY H. FINE, GENERAL COUNSEL, NATIONAL FRANCHISE ASSOCIATION COALITION

My name is Timothy H. Fine. I am an attorney licensed to practice in the State of California and have my law office in San Francisco, California. I am the general counsel to the National Franchise Association Coalition ("NFAC").

I. INTRODUCTION

S. 2335, "Fairness in Franchising Act", is aimed at the single most serious problem in the franchise relationship—the substantial imbalance of economic power in favor of the franchisor which exists in most franchise arrangements through the right of franchisors to terminate, cancel or fail to renew franchise agreements without cause and without payment to the franchisee for the value of his business. The dominant economic power of the franchisee is admittedly "inherrent" in the structure and economics of the franchise relationship. However, NFAC is not seeking economic parity and S. 2335 is not designed to make the franchisor and franchisee economically equal. Rather, S. 2335 deals with the part that termination (and nonrenewal) and the threats of termination (and nonrenewal) contribute to the already existing economic disparity of

bargaining power. The power to terminate or not renew the franchise agreement without cause and without payment to the franchisee for the value of his business magnifies the "inherent" dominant economic power of the franchisor over the franchisee many times over. This was made clear in the decision of the Supreme Court of the United States in *Federal Trade Commission* v. *Texaco, Inc.*, 393 U.S. 223, 226 (1968):

"Nearly 40% of the Texaco dealers lease their stations from Texaco. These dealers typically hold a one-year lease on their stations, and these leases are subject to termination at the end of any year on 10 days' notice. At any time during the year a man's lease on his service station may be immediately terminated by Texaco without advance notice if in Texaco's judgment any of the 'house-keeping' provisions of the lease, relating to the use and appearance of the station, are not fulfilled. The contract under which Texaco dealers receive their vital supply of gasoline and other petroleum products also runs from year to year and is terminable on 30 days' notice under Texaco's standard form contract. The average dealer is a man of limited means who has what is for him a sizeable investment in his station. He stands to lose much if he incurs the ill will of Texaco. As Judge Wisdom wrote in *Shell*, 'A man operating a gas station is bound to be overawed by the great corporation that is his supplier, his banker, and his landlord.' 360 F.2d 470, 487."

II. THE ABUSES

The resulting effect of the power of the franchiser to terminate, cancel or fail to renew the franchise agreement without cause and without payment to the franchisee for the value of his business has led to great many abuses that have been documented by the Congress through 12 years of hearings that have been held by committess of both the Senate and the House on franchise legislation and on distribution problems affecting small business. Those hearings are as follows:

1. Hearings before Subcommittee No. 4, Select Committee on Small Business, House of Representatives, 88th Congress, on Distribution Problems Affecting Small Business—May 8, 9, 16, 22, 23, 28, June 3, 4, 5, 7, 13, August 5, 12, 23, 26, September 13, 16, 23, 30, October 7, 14, 18, 21, November 1, 4, 8, 18, December 9, 10, 1963 (nine volumes);

2. Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, 89th Congress, on Distribution Problems Affecting Small Business—March 2, 3, 4, 1965, January 18, 19, 20, 26, 27, June 21, 22, 23, 27, 1966 (three volumes);

3. Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, 90th Congress, on Franchise Legislation—October 10, 11, 13, 16, 17, 31, and November 1, 1967 (one volume);

4. Hearings before and Report of the Select Committee on Small Business, United States Senate 91st Congress, on Impact of Franchising on Small Business—January 20, 21, 22, 27, March 30 and April 24, 1970. Report is dated November 13, 1970; and

5. The Economic Effects of Franchising, Select Committee on Small Business, United States Senate, 92nd Congress (Report prepared for the Small Business Administration by Urban B. Ozanne, D.B.A., and Shelby D. Hunt, Ph. D. Graduate School of Business, The University of Wisconsin).

As stated by Senator Philip A. Hart, Chairman of the Senate Antitrust and Monopoly Subcommittee on April 15, 1969:

"At these hearings we heard repeated examples of franchisors who required price-fixing, exclusive dealing, territorial allocations, full-line forcing, requirement contracts and other practices which are treated extensively in most antitrust textbooks.

"Perhaps even more important, we heard repeated examples of franchisors reserving the best customers for themselves; competing unfairly with their own franchises by selling to potential or current franchisee customers at prices below those available to the franchisee himself. Further, we heard about franchisors who let the franchisee build up a good territory and good customers, then moved in and took the territory of customers away.

"Why can't the "franchisee" ignore the orders and fight for his own customers? Generally, he can't because of the economic muscle of the franchisor. The result, of course, is the double standard of independence I have been talking about.

"When those hearings had been concluded, I firmly believed something needed to be done. It seemed to me that the crux of the power of the franchisor was his ability to whip the franchisee into line by threat of termination or cancellation."

That these termination abuses are real and continuing all of the time is made crystal clear by the attached statements of 22 former franchised distributors who lost their businesses or portions of their businesses as a result of arbitrary action by their supplier.

One of the worst abuses occurred in October 1975 when 314 independent franchised distributors of the Los Angeles Times lost their businesses because this Congress would not give The Times Mirror Company, publisher of the Los Angeles Times, and other newspaper publishers an exemption from the Anti-Trust Laws of the United States which would permit the publishers to engage in vertical price-fixing—that is permit the publishers to fix the prices at which their distributors resold the newspapers. In May 1975 representatives of The Times Mirror Company testified before the Senate Antitrust & Monopoly Subcommittee of the Committee on the Judiciary in support of this exemption. The Subcommittee rejected this exemption and as a result in October 1975 The Times Mirror Company notified its 314 independent franchised distributors in Los Angeles and Orange Counties that they would be terminated the first of the year and replaced by employees or so-called delivery agents. The reason for the changeover was to enable Times Mirror to fix retail prices of the Times. Speaking on this problem the Honorable John V. Tunney, United States Senator, stated in December 1975:

"I am very deeply concerned by the recent trend of events that has taken place with regard to franchises. And the ability that the franchisor has to, at the snap of his fingers, cut off a franchise, or refuse to extend a franchise when the contract has expired."

"And there is no question in my mind that over a period of years a franchisee builds up a substantial equity in his business which goes far beyond just the value of the contract. There is a lot of good will involved and also, there is a lot of capital investment that is involved.

"But the way the laws now read, it is possible that when the contract expires, or if there is no terminal date to the contract, when the franchisor decides at will to terminate the franchise, the franchisee is left holding the bag."

"That has to change. That is not right. There is no question in my mind that one of the major dangers . . . is the increasing concentration of wealth in the hands of a very few. There is one example down south where when a corporation didn't get what it wanted by way of legislation, they are now seeking to eliminate the franchisees and make them employees of the company."

"Well, that is not right. It is not fair. And we have got to be not only dependent on the courts, but also on the Congress of the United States to redress the wrongs."

III. ANTITRUST LAWS ARE INADEQUATE

Legislation is badly needed because present antitrust laws are inadequate. Case and after case under the antitrust laws has held that unless the termination of a franchise is pursuant to or in furtherance of a violation of the antitrust laws, the termination of a franchise agreement does not violate the Sherman Antitrust Act. And this is true even though the termination as it usually does, ends the business of the terminated franchisee. The Committee is directed to the following decisions of the United States Court of Appeal indicating how inadequate the antitrust laws are as a remedy to a terminated franchisee:

1. *Joseph E. Seagram & Sons, Inc.* v. *Hawaiian Oke and Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969), *cert. denied* 396 U.S. 1062 (1970), *reh. den.* 397 U.S. 1003 (1970);

2. *Ricchetti* v. *Meister Brau, Inc.*, 431 F.2d 1211 (9th Cir. 1970), *cert. denied.* 401 U.S. 9399 (1971);

3. *Cartrade, Inc.* v. *Ford Dealers Adv. Ass'n.*, 446 F.2d 289 (9th Cir. 1971);

4. *Bushie* v. *Stenocord Corporation*, 460 F.2d 116 (9t hCir 1972);

5. *Scanlan* v. *Anheuser-Busch, Inc.*, 388 F.2d 918, 920 (9th Cir. 1968);

6. *Anaya v. Las Cruces Sun News*, 455 F.2d 670 (10th Cir. 1972);

7. *Ace Beer Distributors, Inc.* v. *Kohn, Inc.*, 318 F.2d 283 (6th Cir. 1963);

8. *Schwing Motor Co.* v. *Hudson Sales Co*, 138 F.Supp. 899 (D.Md. 1956), *aff'd* 239 F.2d 176 (4th Cir 1956);

9. *Packard Motor Car Co.* v. *Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir. 1957); *cert. denied*, 355 U.S. 822 (1957).

Furthermore, the harsh effects of termination are clearly indicated by the recent decision of the United States Court of Appeals for the Ninth Circuit in the case of *Noble* v. *McClatchy Newspapers*, 5 CCH Trade Reg. Rptr., Para. 60,594 at 67,627 (9th Cir. November 14, 1975). There, the distributor Noble had the right under his contract to sell his business as a going concern to a qualified purchaser so long as he was in good standing with the publisher McClatchy Newspaper. However, that right to sell his business was extinguished once Noble received a letter of termination from the publisher because he had nothing to sell. The Court of Appeals reversed a jury verdict in favor of Noble in the sum of $63,334.04 upon the ground that "upon receipt of the letter of termination, as defendants accurately put it, 'plaintiffs owned nothing but a contractual right to distribute the Bee for thirty-odd days.'" This, the Court of Appeals held, was "worthless."

IV. FRANCHISE LEGISLATION IS PROCOMPETITIVE

There is no question that this legislation is in the interest of the consumer and strengthens the effectiveness of the anti-trust laws. Under the anti-trust laws, the burden of proof is upon the franchisee to prove that the franchisor overtly used termination or the threat of termination to coerce the franchisee into engaging in an anti-trust violation. However, such overt acts are not necessary to obtain franchisee compliance with suggested prices, suggested products to handle and confining one's sales to the primary area of responsibility if the franchisor not only has dominant economic power over the franchisee but more importantly, has the power to terminate, cancel or not renew the franchise agreement without cause and without payment to the franchisee for the value of his business. This was so indicated in the Supreme Court decision in *Federal Trade Commission v. Texaco, Inc., supra.* where the facts of the case did not prove that Texaco had used "overt coercive practices" to force its dealers to purchase the sponsored brand of TBA. Nevertheless, the Court held that the sales-commission system for marketing TBA was inherently coercive and was an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 because with:

"The dealer's supply of gasoline, his lease on his station, and his Texaco identification subject to continuing review, we think it flies in the face of common sense to say, as Texaco asserts, that the dealer is "perfectly free" to reject Texaco's chosen brand of TBA. Equally applicable here is this Court's judgment in *Atlantic* that '[i]t is difficult to escape the conclusion that there would have been little point in paying substantial commissions to oil companies were it not for their ability to exert power over their wholesalers and dealers' 381 U.S., at 376, 85 S.Ct., at 1509." 393 U.S., at 229.

S. 2335 would require "good cause" before the franchisor could determine or "legitimate business reason" in the case of nonrenewal and the burden of proof would be placed upon the franchisor to establish such "good cause" or "legitimate business reason." The effect of this would be to eliminate the inherent coercion upon the franchise to follow the franchisor's suggestions. This legislation protects the economic freedom of franchisees to exercise their independent business judgment and initiative in the operation of their businesses without fear of retribution from franchisors. Thus, S. 2335 is in actuality in aid of the competitive processes in that it gives franchisees the courage to make their own decisions on pricing, products to sell and places and customers to sell.

In addition, as made clear in the decision of the United States Court of Appeals for the Tenth Circuit in *Adolph Coors Co.* v. *Federal Trade Commission*, 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 95 S.Ct. 775 (1975), the Federal Trade Commission cannot re-write Coor's distributor contracts to require "cause" for cancellation even though there was substantial evidence in the record to support the Commission's holding that "Coors used the threat of speedy termination to force its distributors into anticompetitive behavior." Coors distributor contracts provided that they may be cancelled in their entirety by either party without cause upon 30 days' advance written notice. The ground for the Court of Appeals decision that the Commission could not re-write the distributor contracts as a remedy for the anti-trust violations was as follows:

"The law Judge was correct in stating that the termination provisions of Coors and its distributors, based upon their contractual obligations, are a matter of private contract and are not subject to interference by third parties. The termination provisions are reasonable but may not be used by Coors to force any unlawful conduct. Therefore the Commission's attempt to re-write Coor's contract termination provisions in paragraphs 12 and 13 of its Order must be set aside. The contract termination provisions do not violate Section 5 of the Federal Trade Commission Act." 497 F.2d, at 1189.

Thus, what this legislation does that the antitrust laws do not do in terms of promoting competition is to eliminate the sword of termination or non-renewal without cause that hangs over every franchisee's head and inherently coerces him in his day to day decision making. Furthermore, not even the Federal Trade Commission can eliminate this sword of termination when there has been proven abuses in violation of the antitrust laws.

V. THE NATURE AND EXTENT OF THE ABUSES REQUIRE A FEDERAL SOLUTION

Federal legislation is required to solve the problem of the arbitrary termination of franchise agreement for two separate reasons. First, as testified to by Mr. Grant Mauk, first vice president of the International Franchise Association, at the 1963 hearings on the impact upon small business of dual distribution before the House Select Committee on Small Business, Subcommittee No. 4, the "franchise system sets up an interrelationship between the franchisor and the franchisee in which a proven package is sold to the franchisee". Mr. Mauk stated that "the use of the trademarks, patents, copyrights, advertising materials, and other *legally* protected products, methods, goods, or names are included in the franchise package." p. 1729. (Emphasis added). Thus, federal patent, trademark and copyright law is the basis of the franchisor's power over the franchisee. Since federal law pre-empts state laws that are in conflict it is necessary that federal law speak to the issue of the termination of the franchisees' rights to use the franchisor's patents, copyrights and trademarks.

Second, what we are dealing with is a matter of national scope. This was virtually admitted by the International Franchise Association at the 1963 hearings when it listed (at p. 1734) the following advantages of franchising to the franchisee:

1. Nationally known name and trademark;
2. Consumer-recognized system and reputation;
3. National publicity and promotion;
4. Nationally recognized product or service;
5. Standard product and quality;
6. Standard management system and methods;
7. Standard accounting method and inventory control;
8. Aid in financing business;
9. Bulk purchasing advantages and merchandise buying techniques and sources;
10. Proven system of operations, business manuals, sales kits, etc.;
11. Scientific site selection for locations and assistance with leasing arrangements;
12. Psychological testing for screening franchisees;
13. Benefit of counsel of business experts' experience not otherwise available;
14. Training programs for franchisees and key employees;
15. Design of facilities and advice on fixtures, displays, signs, etc.;
16. Planning and advice on local promotion of business including opening of shop and proven sales techniques;
17. Guidance in selection of inventory.

VI. BROAD INDUSTRY WIDE LEGISLATION IS REQUIRED

S. 2335 is designed to apply to all, with few exceptions, franchise relationships. NFAC admits that there are many different relationships and they vary from industry to industry and from one end of the country to the other. But we look upon this bill as a charter of independence that has the broad language necessary to cure the abuses—much like the language of the antitrust laws. Its beauty is its broad application to a major section of the economy—franchising.

Naturally, if you are going to regulate many different franchise relationships, and cover everything from McDonald's franchisees to automobile dealers, then you must use language that is, in the words of Mr. Justice Holmes, of constitutional breadth. NAFC is in support of a bill that will survive the great technological and economic changes that will occur over a period of time. This, like the antitrust laws, requires constitutional type languages. Naturally, the Courts are going to have to deal with such language so as to effectuate the bill's purposes, and in light of changing conditions.

NAFC believes that this problem should not be handled on an industry by industry approach. Such narrow legislation has proven to be ineffective. When the Washington Representative of the International Association, Philip Ziedman, was General Counsel to the Small Business Administration, he admitted in that capacity:

"There are many who believe that the Automobile Dealers' Day in Court Act has not been effective, and has not achieved its goal. Perhaps they are right."

VII. FRANCHISING IS NO LONGER AN INFANT—IT HAS GROWN UP

Today, franchisors are big business—including many conglomerates. They read among Fortune's 500 largest corporations. As examples the following large diversified corporations purchased successful franchising systems:

(1) United Fruit has purchased both A & W Root Beer and Baskin-Robbins Ice Cream;

(2) Great Western United, the Colorado-based conglomerate, has purchased the large Shakey's Pizza franchise system;

(3) Consolidated Foods has purchased Chicken Delight franchise system;

(4) General Foods has purchased Burger Chef;

(5) Pillsbury has purchased Burger King;

(6) Pet, Inc., has gained control of Stuckey's;

(7) Union Tank Car has absorbed the Lindsay chain; and

(8) Household Finance has purchased the Ben Franklin system, White Stores, and the National Car Rental franchise system.

The long standing argument of the franchisors that Congress should not interfere with the development and evolution of franchising is no longer valid today.

VIII. SUGGESTED IMPROVEMENTS IN S. 2335

(1) The National Franchise Association Coalition ("NFAC") supports the substitution of "good cause" in place of "legitimate business reason" in Section 6(b)(1)(B) of the Bill. Such a change makes good sense because the effect of termination or non-renewal is basically the same to the franchisee. This is clearly indicated by the International Franchise Association when it states "the term of this agreement may be short or long, renewable or non-renewable" Testimony of Phillip F. Zeidman.

(2) NFAC recommends that the Bill deal with the problem created when the franchisor and franchisee are unable to agree upon the terms of renewal. Because of great differences existing between different franchise systems, the only equitable method to handle this kind of problem is through binding arbitration. The courts are not particularly situated to resolving such matters. NFAC recommends the following provision be added to the Bill.

"In the event the franchisor and franchisee are unable to agree upon the terms and conditions of renewal of the franchise after good faith negotiations then either party shall have the option to request binding arbitration of the terms and conditions in dispute in accordance with the provisions of Section 8(b) hereof. Good cause for nonrenewal of the franchise shall be deemed to exist if the franchisor requests arbitration of the terms and conditions in dispute and the franchisee is unwilling to submit to such arbitration. Good cause for nonrenewal of the franchise shall be deemed not to exist if the franchise requests arbitration of the terms and conditions in dispute and the franchisor is unwilling to submit to such arbitration."

(3) NFAC recommends that Section 3(7) be modified to read as follows "there is no subsequent commercial reentry, directly or indirectly through another person or entity, into such region, state or area within five years thereafter". The new language suggested by NFAC is underlined. NFAC believes that the new language more clearly effectuates the purposes of the Bill to

prevent the franchisor from utilizing a legitimate marketing area withdrawal as a subtefuge to eliminate his franchise or vertically intergrate.

(4) NFAC recommends that Section 8 of the Bill pertaining to arbitration include a provision that the Arbitrator shall hear the arbitration within the county that the franchisee does business under the franchise agreement.

(5) NFAC recommends that the Bill include a specific provision providing that it covers all existing agreements, contract, leases and understanding. There is no merit to the contention that federal regulatory legislation is unconstitutional as applied to existing private agreements or arrangements.

(6) NFAC recommends that the Bill contain a severability clause.

7. NFAC recommends that the Bill be amended to provide that in the event there is good cause for termination of the franchise agreement or nonrenewal of the franchise agreement then the franchisee shall have the right during the 90 day notice period to sell his franchised business to an acceptable purchaser. Such a provision would prevent the extreme situation of "forfeiture" and the resulting unjust enrichment to the franchisor that such forfeiture creates.

(8) NFAC recommends that the Bill contain a provision that the Act in nowise preempts or supercedes any legislation passed by the States dealing with franchising.

IX. CONCLUSION

No subject concerns the franchisee more than the termination of his franchise agreement or the refusal of the franchisor to renew it. The franchisee's economic existence and that of his family is at stake when the franchise agreement is terminated or not renewed. The termination of the franchise agreement or the refusal of the franchisor to renew it is the sword that every franchisor holds over the heads of his franchisees. Unlike the employee who has in many cases a labor union to represent his interests the franchisee stands alone against the strength and power of the franchisor. It is for this reason that Congress must give legislative protection against arbitrary termination of or failure to renew the franchise agreement. Solve this problem and the great number of abuses that presently result from the dominant economic power of the franchisor over the franchisee will also be solved. S. 2335 is the Magna Carta for franchisees in much the same way that the National Labor Relations Act is the Magna Carta for employees.

(The following information was referred to on p. 49:)

STATEMENT OF FACTS PERTAINING TO FRANK L. COSCHI TERMINATION

My name is Frank L. Coschi and I reside at 1383 Bustleton Avenue, Feasterville, Pennsylvania, 19047. My telephone number is [redacted].

I have been a franchisee of The Philadelphia Inquirer, 400 N. Broad Street, Philadelphia, Pennsylvania, for approximately ten years. I paid approximately $12,500 for my franchise. This payment was made to a third party who sold to me with the approval of the publisher. I have seven employees.

On January 28, 1976, I was terminated as an independent newsdealer by The Philadelphia Inquirer for no other reason than the publisher's displeasure with my pricing policy.

On January 29, 1976, the publisher's personnel visited my home to inform me of my termination. They indicated that they would pay me $8,000 for my cooperation in the transition. The publisher refused to place a value on my inventory, goodwill, etc. They recognized no proprietary interest in my route and failed to take into account my wife's and my years of hard work building up goodwill which I believe makes my route worth far in excess of the $12,500 that I paid for it. My route has increased in number as well as in net profits over the last ten years.

The publisher followed me, by utilizing their employees with two-way radios, to learn my route, and immediately following my termination they began to serve my customers with their own personnel. At the time of the termination, I was also delivering the Philadelphia Bulletin and a local publication, The Trenton Advertiser. Without the means of my distribution business, the Philadelphia Bulletin and The Trenton Advertiser, both competitors of the Philadelphia Inquirer, had no means of distributing their papers.

Immediately following my termination, I made arrangements to purchase newspapers from other independent dealers. I am paying higher prices, have

increased labor costs and transportation costs as a result of this substitution of supply. I find it very difficult to maintain my business. Almost every one of my customers has remained with me; however, keeping my route intact has been an extreme financial hardship for myself and my family and I sincerely feel that I will not be able to carry on much longer because of the financial stresses.

The publisher was quite disturbed with my ability to continue to service my customers and my customers' loyalty in staying with me, which indicates to me the fact that my customers were satisfied with my pricing policies and services in the past.

Immediately following my termination, the publisher increased their surveillance of me and my fellow newspaper dealers in an effort to determine the source of my supply. I do believe that this surveillance was a threat of an antitrust violation in that the publisher was imposing territorial restrictions on the various suppliers as they did not want them to distribute outside their assigned areas and any delivery to me would be a distribution outside the boundaries approved by the publisher.

I managed to obtain the license numbers of the vehicles used by the individuals who were following me and I proceeded in a local district court in Bucks County, Pennsylvania, with a harassment charge under 18 Purdons Statutes, Section 2709, and all of the publisher's personnel were found guilty of harassment.

I also directed my attorney to proceed with an antitrust action in the United States District Court for the Eastern District of Pennsylvania which is captioned "Frank L. Coschi, et al. v. Philadelphia Newspapers, Inc., Civil Action N 76–285." A motion for preliminary injunction has been filed and is awaiting disposition by that Court.

The action in the District Court is based upon violations of the Federal antitrust laws with regard to price fixing and enforcing territorial restrictions. There are also several state counts for tortuous interference with my contractual arrangements and violations of the state antitrust laws.

Since filing this suit, I have been intimidated by the publisher's personnel who follow me during the early hours of the morning while I am delivering my papers and I have good reason to believe that said personnel of the publisher maliciously attacked a fellow independent newsdealer, Patricia Kundert, forcing her to receive medical attention at the emergency room of Bailey Memorial Hospital in Paoli, Pennsylvania, and to receive extensive private medical attention thereafter. Her attackers informed her that they were out to get her and the president of our national independent newsdealers association, Thomas Buchanan. This has been reported to the Pennsylvania State Police and it is my understanding that they are presently undergoing an investigation of this matter.

I have continued to operate my business under great emotional stress since my termination, living in constant fear of being attacked, after the episode related above occurred. I have been frustrated by the fact that although I believe myself to be clearly right and to have been a very sound businessman in the operation of my route, there is no legislation to protect me in this situation. I now find that I have to engage counsel and proceed with lawsuits in Federal Courts. I have been advised by counsel that I cannot obtain immediate and prompt results, but, rather, that this cause of action will be appealed to the Court of Appeals and may very well be appealed by the publisher to the Supreme Court.

I find it difficult to comprehend the fact that a small businessman in our system of justice has to expend the sums of money required to proceed with an antitrust action and go through the entire Federal judiciary system to get rights which I have always believed to be mine. In this arena, I cannot possibly compete with the financial resources of The Philadelphia Enquirer who will continue, by filing various motions and appeals, to delay and frustrate my efforts to get what I believe to be a "fair shake."

I sincerely trust that you will consider these remarks, make them part of your record, and give proper weight to them when discussing the legislation that is before your Subcommittee.

STATEMENT OF FACTS PERTAINING TO DONALD LINDE TERMINATION

My name is Donald Linde and I reside at 448 Brookwood Road, Wayne, Pennsylvania. My telephone number is [redacted].

I have been a franchisee of The Philadelphia Inquirer, 400 N. Broad Street, Philadelphia, Pennsylvania, for approximately ten years. I have also been an officer of the local independent newsdealers association in the mid-Atlantic region.

For several years now, I have been attempting to purchase additional routes so that my family and I can live in the life style in which I wish to live. Because of my association with this trade association of independent newsdealers, I have been continuously frustrated from purchasing additional routes because of the unwarranted decision of the publisher not to approve my purchases, even though the other dealers were willing to sell to me.

I have proceeded with two lawsuits in the Philadelphia Court of Common Pleas for tortuous interference with my contractual arrangements and have personally sat through depositions of Inquirer personnel conducted by my attorney before various court reporters. I was shocked to find the decision to be completely arbitrary and capricious in that at no time did any Inquirer personnel ever say anything but that I was a good dealer and that they were satisfied with the way I was servicing my route.

Despite these admissions, I continued to have but one limited route and continue to make what I consider to be a substandard living because of the publisher's desire to not allow me to expand. I have been told by my attorney that it takes approximately six years for a case to reach fruition in the Philadelphia court system. This indeed is frustrating in that what my family needs now, especially during those years when my children are young, is for a proper living at this time.

My wife has taken employment and my children will most probably have to forego college educations as a result of the publisher's actions.

I strongly suggest that you consider the legislation currently pending before your Subcommittee and report favorably on the same. The courts are simply no alternative to proper legislation to protect small independent businessmen like myself.

STATEMENT OF FACTS PERTAINING TO RAYMOND W. BRITTINGHAM TERMINATION

My name is Raymond W. Brittingham and I reside at 182 Kent Drive, Lionville, Pennsylvania. My telephone number is xxxxxxxx.

I have been a franchisee of the Today's Post which is published by Montgomery Publishing Company, for approximately two years. I have been an independent newsdealer for approximately fourteen years, delivering various publications in the Chester County, Pennsylvania area. In the Today's Post route, I have invested a great deal of time and money for expansion and increased circulation. I have approximately three employees.

Today's Post is a local, rural newspaper which services the Montgomery County – Chester County areas in Pennsylvania.

On April 18, 1975, the publisher unlaterally terminated and refused to deliver Today's Post to me for sale. The publisher offered me no money for my route and gave me no reason for the termination. In fact, the publisher's employees followed me for some time prior to the termination and illegally confiscated my customer list so that the publisher's employees could deliver the Today's Post subsequent to my termination. As a result of this termination, I have been placed out of the business of delivering this publication. I cannot find an alternate source of supply of the newspaper other than from the publisher who still refuses to sell to me. I have lost approximately $5,000 income per year as a result of this unlawful termination.

I have commenced a lawsuit in the Court of Common Pleas of Montgomery County, Pennsylvania, captioned "Raymond W. Brittingham vs. Montgomery Publishing Company, No. 75–7773." My action is based on violation of the common law of Pennsylvania involving unlawful restraint of trade and an unlawful attempt to vertically integrate the distribution cycle by the publisher. I have also sued for breach of my contractual obligations with the publisher. My attorney tells me that this suit will take approximately three years to reach fruition and may very well be appealed to the Superior Court of Pennsylvania and to the Supreme Court of Pennsylvania. In the interim, I am without a source of income for my family and I feel that I am playing the publisher's game by being forced to bring suit against them since I cannot compete with the publisher's financial ability in payment of attorney's fees, etc. during the period of litigation and during the appeals which may very well follow.

It is for this reason that I strongly believe in the legislation now before your Subcommittee as such legislation would adequately protect the rights of the franchisees who are in most instances small independent businessmen attempting to make an adequate living for their families in the truest traditions of the American way.

RAYMOND W. BRITTINGHAM.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF JAMES H. CLIFTON AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

I was an independent newsstand distributor for The Sacramento Bee from May 1, 1970 through March 1, 1976. On December 29, 1975, I was notified by the Circulation Manager of The Bee that my contract with McClatchy Newspapers (21st and Q Streets, P.O. Box 15779, Sacramento, CA 95813) was terminated effective March 1, 1976.

No employment or remuneration for my business was offered to me even though I purchased my dealership—Newsstand #2—from another dealer in 1970 for $6,000. Since that time, I have invested approximately $10,000 in newspaper equipment, purchased a commercial vehicle, and devoted years of seven-day work weeks to improve service to my customers and to insure that a high level of service was maintained. In addition, my wife and I purchased a home in the South Sacramento area—my prime area of responsibility—specifically to be near the business so that I could further improve service to my customers.

I increased my number of employees from one to three during my tenure as a Bee dealer.

And, as a result of my efforts and investments, my sales increased—in spite of a rise in the cover price of the paper.

Further expansion of my business was planned to accommodate the expected growth in the southern area of Sacramento. My termination on December 29 was totally unexpected. In fact, the Bee's Circulation Manager had assured me over the years that McClatchy Newspapers would try to be fair with me and I was not to worry about any kind of arbitrary termination. Also, in the letter notifying me of my termination, he stated that we "have had a very pleasant business relationship over the years."

To date, I have received no money from McClatchy Newspapers for my newsstand equipment, my business vehicle, supplies on hand, supportive equipment and tools, or my goodwill. Shortly before the termination was effected I canvassed 30 of my commercial accounts and all but one stated that and signed an agreement to the effect that they would prefer to purchase The Bee from me and/or deal directly with me rather than from/with the publisher.

Since no law—federal or state—specifically protected me as a franchisee, I am now seeking injunctive relief and damages under the anti-trust laws of the United States. Unfortunately, the legal battle could be long and promises to be costly.

Because my newspaper distribution business comprised the major portion of our livelihood, we face great hardship as a result of my termination. Although my wife, Jan, is employed as a secretary, her employer organization is currently experiencing financial difficulties. Her monthly take-home pay is less than $650. Our house payment is $283, and monthly maintenance and utilities, $100. This leaves less than $300 for necessary insurance, transportation, medical care, legal fees, and food.

Since McClatchy Newspapers did not remunerate me for my business, I have no capital to reinvest in another business.

Furthermore, the current unemployment rate is extremely high in California, and the recent "layoffs" of California state employees create an even more limited job market—especially in Sacramento. The fact that I have no professional or vocational skills only adds to my difficulty in securing a job. Of course, as a self-employed person, I am not eligible for Unemployment Insurance benefits.

I was drafted directly into the U.S. Army upon graduation from college. My only employment between my discharge and my purchase of Newsstand #2 was as a "driver" for the previous owner of that newsstand. Fortunately (or unfortunately) my parents were able at the time to loan me the money (since paid back) to buy the business on May 1, 1970.

My BA in French literature—with no teaching credential, no teaching experience, and a dearth of available teaching jobs—does not enhance my position in the job market. My wife, a high school teacher with six years of experience, cannot find a teaching job.

Without immediate and gainful employment, I will probably have to sell the few assets we have—including our home. Economic survival, of course, is our goal.

In addition, however, to the economic hardships, my wife and I are already suffering from the uncertainty of our future.

Our life has become a "trading stamp book"—with each crisis (some are average, i.e., a flat tire; some are bonus, i.e., a housepayment that cannot be made) our "book" fills. One day soon, there will be no space for another "stamp." We only have one book.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF HOWARD R. HOEL AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

To: House Subcommittee on Consumer Protection and Finance.
From: Howard R. Hoel, Fair Oaks, Calif.
Concerning: McClatchy Newspapers, The Sacramento Bee, Sacramento, Calif.

My term as an independent newspaper dealer with the Sacramento Bee newspaper started on March 1, 1970, and I was terminated on March 1, 1976. I purchased my dealership from my predecessor, Scott Berry of Sacramento, California, for the sum of $8000.00 on March 1, 1970 with the full consent and approval of the Sacramento Bee Newspaper. The transaction took place in their own offices.

From the time I purchased my dealership to the time of my termination, I have replaced 95% of my vending machines to have modern and up to date equipment. We had a family operated business with my wife working with me until she turned ill two years ago. I, myself, worked mostly seven days a week. At the time of my termination I employed six people, and had two delivery trucks of my own.

On December 29, 1975, myself and eight other dealers were called to a meeting at the Sacramento Bee. We were informed that a registered letter was in the mail to inform us of our termination. No compensation of any kind or offer of a job was made. From January of this year I have been looking for a job. I have found none. Being self-employed I have no benefits to fall back on.

My counsel, Timothy H. Fine, has had this matter before the Federal District Court in San Francisco, California.

Thanking you in advance for your kind attention.

STATEMENT OF FACTS RELATING TO THE TERMINATION OF HAZEL R. ROMANS AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

Franchisee: Hazel R. Romans, DBA Western News Agency, San Jose, Calif.
Franchisor: San Jose Mercury-News, San Jose, Calif.

FRANCHISE BACKGROUND

About February 1964, I was employed by the San Jose Mercury-News as a part-time relief District Manager. My duties consisted of checking two delivery districts to assure that carriers contracted by the San Jose Mercury-News reported to their corners (bundle drops) to make the morning delivery of the San Jose Mercury. If for any reason the carriers failed to report, it was my duty to call at their homes and awaken them. If the carrier could not be located or refused to carry the route, it was my duty to deliver the route. In addition, it was my responsibility to provide papers to correct customer complaints resulting from missing or torn papers, wet papers and incomplete papers. My employment was for Saturday and Sunday work only.

About April or May 1964, I was asked if I would like to be employed as a full-time District Manager and I accepted. My duties were the same as above on a daily basis. In addition, I was required to contract carriers, collect their bill payments, bank the collection in a company account, contact non-paying subscribers for payment, handle carrier injury and subscriber property damage

insurance claims, hold carrier meetings to encourage promotion and good service and file reports on same to the company, take carrier crews on soliciting drives, maintain a company file of subscribers, report stops and starts, etc. I furnished my own vehicle and received a small allowance in return. I was covered by a Company medical plan, received two weeks annual vacation, could become eligible to join the Company pension plan and had week-ends and national holidays off.

I continued as a company employee until April 1966 when I was asked if I wished to take over my District as an independent distributor. I accepted and executed the attached agreement. This made me completely and solely responsible for all activities within the district outlined by specific boundaries. I was required to furnish my own vehicle, equip my own office, work 7 days per week, employ my own help to cover any time off for vacation or illness, be responsible for any business losses or third party claims; I was not eligible for any Company fringe benefits. In addition, I was required to post a cash bond at the rate of $90 per month which ultimately totalled over $9,000. All except a disputed $90 of this has since been returned to me having been replaced by a $16,000. franchise bond for which I pay the annual premium.

During the first quarter of 1966, I earned $1016. as a Company employee. The last three quarters of 1966, my taxable income was $2420. The benefit to the San Jose Mercury-News from this franchise agreement is obvious. I earned less, saved the cost of relief help, eliminated the cost of fringe benefits, eliminated the SJM-N risk of any losses and buffered the Company against any third party complaints, or law suits, and saved the Company the expense of billing individual delivery carriers.

The start-up costs of my business were rather modest. It was necessary to have two vehicles available to assure that transportation was always available to perform the daily work. I provided a room in my residence for an office and subsequently purchased a desk, typewriter, calculator, file cabinets, storage shelves, telephone valet, dictating machine and general office supplies. Making allowance for the fact that both business vehicles were also used for personal purposes, the business start-up costs are estimated at about $5,000. I have worn out an additional $8000 worth of vehicles in the ensuing years.

Although I was earning less money as an independent dealer, I had confidence that I could build the business to a profitable venture. Having to deposit almost $1,100 per annum into the cash bond account, I could not afford to hire any outside help. Consequently, the business was operated as a family business with my husband and children all helping when necessary.

My net taxable in the following years was:

1967	$3,813	1971	6,639
1968	5,295	1972	7,548
1969	5,788	1973	7,468
1970	6,986		

The increase in 1968 was primarily the result of an increase in wholesale and retail rates by the Company. With a great deal of hard effort, the loss in circulation due to the price increase was recovered. I was not as fortunate in 1971 and lost money over the prior year as the result of price increases in November 1970. The loss in circulation did not recover and late in the year, the Company added a motor route to my district. It was a small route of about 50 papers and I contracted my daughter to carry it. This route covered about 13 miles and could not be operated profitably by the carrier. Both the Carrier and I discussed this situation many times with Company representatives and requested a special allowance for the route in line with rates and allowances afforded Company contracted motor route carriers. There was never any response to these requests. In fact the Company interceded in customer disputes and forced the carrier to deliver papers to non-paying subscribers thus further increasing the loss.

In 1973 there was another dip in profits due to another price increase in February 1973. It seemed that every time my circulation began to gain, The San Jose Mercury-News would increase the prices and circulation and my profits would decrease. Over 60 hours per week were being devoted to the business and it was netting only about $20 per day. My contract delivery carriers were earning less than SJM-N contract carriers by about 25¢ per subscriber per month and it was becoming difficult to find carriers. It was obvious that something had to be done.

TERMINATION

A clause in my franchise agreement stated that I could only distribute newspapers at rates specified by the San Jose Mercury-News. I sought legal counsel and learned that this clause was illegal. In January 1974, I decided to initiate a price increase of my own. This increase was to take effect February 1, 1974. My daughter became aware of the impending price increase and decided to effect a price increase to subscribers on her motor route. I ordered some printed notices for the delivery carriers to fill out and pass on to their subscribers informing them of the price increase and the new rates they would charge for delivery. Unfortunately, this material was not received from the printers in time to effect the price increase. My daughter had prepared her own price increase material and decided to continue with the price increase on her motor route.

A few customers called the San Jose Mercury-News circulation department to inquire why they were being charged more than the delivery price as stated in the newspaper. I received an immediate phone call requesting a meeting with the SJM–N Circulation Director by my husband and me. We were instructed to have our daughter roll back her delivery prices to those fixed by the Company. We were told to inform her that the SJM–N would give her an allowance of up to $50 per month or trade her hilly, stretched out route for a good route in the flatlands. We refused to get involved in this price fixing attempt and a month long period of harassment followed. This experience was un-nerving to say the least so I decided to wait awhile before continuing with a general district-wide price increase.

On March 1, 1974 another dealer apparently initiated a price increase. On March 28, 1974, I and eleven (11) other dealers received termination notices. Concurrently, I was served with a summons naming me as a co-defendant in a legal action brought by the newspaper publisher charging me and the other eleven (11) independent dealers with conspiracy and violation of the anti-trust laws.

A court injunction was obtained to permit the dealers to continue the operation of their business pending adjudcation of the case. This case is still pending before the court.

Effective April 1, 1974 the San Jose Mercury-News increased wholesale and retail delivery rates by the highest monthly per centage increase in its history. This was an obvious attempt to preclude any further dealer initiated price increases. My dealership had not recovered from the 1973 price increase and the latest increase caused circulation to tumble nearly 5 percent. I decided it was essential that I initiate a price increase if my business were to survive. I did so on July 1, 1974. As a result, my 1974 taxable income increased to $9420. and my 1975 income was estimated at $16,000 or about $44. per day.

At the time of my termination, I had 27 contract delivery carriers and the good will of about 2,000 newspaper subscribers. I had increased my circulation at an average rate of about 4% per year and built a dependable delivery carrier organization at about this same rate. I was offered no compensation for the take-over of my dealership of the newspaper publisher. The eight years I and my family spent building this business apparently were of no consequence to the publisher. The publisher did, however, offer me employment as a truck driver/manager subject to acceptance by the Teamsters Union. This offer was not acceptable.

FAMILY SEPARATION

In May 1975, my husband was transferred by his employer to Phoenix, AZ. Under the terms of the court injunction, I am prohibited from engaging another person to performing my dealership obligations except for weekends, vacations or other temporary absences due to accidental injury, illness or other emergencies beyond my control. Since I could not sell my business and the outcome of the trial is uncertain, it was essential to our future that we at least be able to rely on his continued employed. He moved to Phoenix in May 1975.

My husband insisted that I join him in Phoenix by the end of September. He purchased a home in Phoenix while retaining our home in San Jose, CA. We petitioned the court to allow me to have my dealership operated by a manager pending outcome of the trial. I arranged for the operation of my

dealership and took a vacation while awaiting a hearing on my petition. I instructed my counsel that if my petition was denied he request permission for me to extend my vacation to three months so that I might spend the Christmas holiday season with my husband. My petition was denied but the extended vacation was approved. (This was the first time I had been absent from my business for more than 72 hours in over nine years). I was asked to file a statement that I would return to San Jose, CA and resume the operation of my business in January 1976. I have returned as agreed while my husband continues to reside in Phoenix.

We have been married nearly 26 years and feel this forced separation is unfair and unjust. This has strained our marital relationship and deprived us of mutual affection and companionship. I find it difficult to believe that our judicial system is such that a wife and husband must be separated in order to protect an asset which is rightfully theirs.

In America I found the confirmation of my hopes and came to understand the reason for the success of this great country; it was the free initiative and free work of a free people. This has been and still remains the wisest and most constructive formula upon which a free, progressive and successful human society can be founded.

IGOR I. SIKORSKY.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF GARY DOWLING AS AN INDEPENDENT NEWSPAPER DEALER

I was involuntary absorbed March 1, 1976 by McClathy Newspapers who publish the Sacramento Bee at 21 and Q streets, Sacramento, California. Since July 1969 to March 1, 1976, I worked seven days a week, to build my business and increase the circulation of the Sacramento Bee.

During these years, I took a minimal salary, choosing to reinvest all other profits back into the business. This involved improving the quality of my vending machines (160), purchasing three vehicles and the building of a workshop which was essential to maintain my machines in good working order.

At the time of my termination, I had six employees, the majority of which had been with me for years. These people and their families through no fault of their own, are suffering too. Many of them are approaching their "Golden Years" and due to the unemployment situation, nobody wants to hire them.

During my years as an independent newsdealer, the Sacramento Bee's management assured me many times that I ran my dealership in an excellent manner and had nothing to worry about in regard to termination. I believed them.

But in fact I was terminated for doing a good job because from my hard work I was making more money than they felt I should, so they wanted my dealership back for nothing after all the work and organizing was done.

On December 24, 1975, the independent dealers of the Sacramento Bee were notified by letter that there would be a meeting on December 29, at the Sacramento Bee.

At that meeting we were told that we would be terminated as of March 1, 1976, and that there would be a registered letter arriving for each of us the next day December 30, 1975.

The management at this meeting informed us that we all had done a good job, but that the company wanted to make more money.

Since my termination, I have not received from McClathy Newspapers any financial settlement for my many costly vending machines, parts, equipment or goodwill for the business that I nurchured, worried over and built to a successfull thriving business.

Being an independent businessman, I am not eligible for unemployment compensation. With my business being confiscated and not bought, I have no capital to invest in other businesses. My wife and I have two children ages nine and six, which attend a church school, where education, religion and being proud to be an American is taught. We believe this to be of paramount importance in their rearing. They will be no longer be able to attend this school due to cost. Our daughter has a serious illness needing close medical

care, and my wife needs medical care due to complications occuring since the removal of her right kidney. Without a livlihood it will be an enormous strain to take care of my family, and support the cost of litigation.

Following my termination six other Sacramento Bee dealers and myself contacted legal council Timothy H. Fine. Mr. Fine filed in San Francisco Federal Court in March, 1976 for injunctive relief. Judge Spencer Williams ruled in favor of the Sacramento Bee. Presently we are awaiting the Appellate Court decision.

Hopefully the committee's support and passage of the Mikva bill H.R. 8349, will prevent operation of these atrocities to small franchises across the nation.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF ROGER A. HARGRAVES AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

My name is Roger A. Hargraves. I live at 5841 Moraga Avenue San Jose, California 95123. My telephone number is [redacted]. I am an independent newspaper distributor for the San Jose Mercury and News Company, Northwest Publications, in San Jose, California. I have been a dealer since August 1, 1970 and my wife has helped in the dealership since that date. Together we have managed (35) to (54) minor aged carriers.

Before starting we had to deposit with the company, $1,200.00 and $100.00 per month was deducted as a bond that would ultimately equal two and a half times my newspaper bill which amounted to $8,000.00. We bought a larger home so that I could dedicate a room to manage our business. It was necessary to purchase office equipment and supplies, an additional car and later an investment was made in a C.B. radio system all transactions except the radio system were consumated within a year of starting business.

On October 30th of 1971 I received notice of termination. The reason was to take away from us, without remuneration, ⅓ of our circulation and about ½ of our territory. If I objected to this my termination would have been effective in 30 days. In April 1973 I retained an attorney for the purpose of negotiating a new contract where this type of thing could not happen again. I also wanted to adjust a lower wholesale price that I pay for my papers and I wanted the 30 day termination clause without good cause eliminated from my contract.

On March 26, 1974, after further negotiations seemed useless, I gave notice to the publisher that I was suggesting a higher retail price to my carriers, I raised my carriers wholesale price thus improving my income the only way possible.

On March 28, I was served with a summons for civil action in Federal Court, which I believe was brought on because I choose to sell my papers at a different price than the Newspaper's published price. My attorney was able to obtain a Federal Court injunction staying the termination until a court trial settles the issues.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF JAMES D. O'KEEFE AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

My name is James D. O'Keefe and I reside at 750 South Griffith Park Drive, Burbank, California, 91506. Telephone [redacted].

I was an independent newspaper dealer for the Los Angeles Times, Times-Mirror Square, Los Angeles, California from December 1968 to January 1976, at which time I was terminated. I originally invested $11,307.00 to obtain the dealership and at the time of termination the Times Mirror Co., bought back the dealership for $9765.00. My loss being approximately $1542.00 on my original investment not including the costs or equipment necessary to carry on this operation. This, of course, does not include the seven hard years of work, seven days a week to help prevent a greater loss.

I received my termination notice in October 1975 along with ninety other street sales dealers. I feel the main cause for the termination was the fact that as of January 1, 1976, the fair trade law was to be repealed and the company wanted to maintain "complete control." I, as a dealer, had not been able to maintain my business as I felt I should because of the company policies

and cost of the product. Therefore, I feel the company in the past had been able to dictate and control the dealers and now was faced with the fact that now the dealers would be able to set their own price of the product in order to receive the profits they were entitled to.

Aside from the company buying back my dealership at a twelve percent loss to me, they purchased my newspaper racks at their price, which is the only equipment they wanted. Other investments such as truck, coin separator and coin counter, locks and miscellaneous machine parts, etc. are still in my possession, although I have made efforts to obtain something for part of their value.

With the loss of my business and income, it has caused a tremendous hardship on my family. I have been unemployed for approximately two months and have just recently secured a menial position with Westside Maintenance Co.

I joined a law suit against the Times Mirror Company because of what I believe was unfair practices. Many of the causes of action include price fixing, territory splits and the right to sell at fair market value.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF WARREN H. CHURCHILL AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

Since December 1969 I was an independent newspaper dealer of the Los Angeles Times. Prior to that time I had been employed in management at the Los Angeles Times and several other large eastern newspapers for more than 20 years.

In 1969 when I purchased the "area" in which I was allowed to distribute the Los Angeles Times the price was approximately $9300. My income was less than many other dealers because the price charged to me for papers was higher than that charged to others. Likewise, by terms of my contract, I could not charge a higher price for the product which I purchased and was distributing.

Three years ago the Los Angeles Times said that I could increase the value of my business if I would pay them approximately $2200 more. My feeling was that I had purchased the business and why should I have to pay again for a business that was already owned.

On January 1, 1976 all independent franchise dealer agreements were terminated. At that time I was informed that the Los Angeles Times would pay me $7812 for my business. My income in this six year period had increased only about 25% but the value of my business decreased almost 17%.

Under a new agreement I am now called an independent delivery agent. The Los Angeles Times directly bills all subscribers and pays me a delivery fee. I am still responsible for all costs of running a business—salaries, taxes, insurance, rent, equipment, etc.

There has been litigation pending in the Los Angeles Federal District Court since June 1972 concerning the independent dealer contract. I am told that this, plus changes in federal and California fair trade laws on January 1, 1976, necessitated the contract terminations so that the Los Angeles Times could continue to maintain the subscription price.

I truly feel that the small businessman needs protection against such arbitrary terminations. Attached to this statement is a copy of the dealer agreement so that your subcommittee can be apprised of actions like those of the Los Angeles Times. I strongly ask consideration and passage of the Mikva Bill, H. R. 8349.

STATEMENT OF FACTS OF DAVID F. GRILL, FRANCHISED DISTRIBUTOR—NEVADA STATE JOURNAL, CARSON CITY

It is my hope that my own personal experiences in operating a small business will shed some light on the relationship of a franchisee as opposed to a franchisor.

I started working for Reno Newspapers, Inc., 402 W. Second Street, Reno-Nevada, on November 1, 1962. Reno Newspapers, Inc. publishes the Reno Evening Gazette, six days a week, and the Nevada State Journal, seven days a week. I worked in management rising from Newstand Supervisor to City Circulation Manager in which position I was responsible for all District Advisors in the city and over 350 Newspaper Carriers morning and afternoon.

On May 30, 1967 I resigned my position with Reno Newspaper, Inc. and began distributing the Reno Evening Gazette and Nevada State Journal as an Independent Franchise Dealer in Carson City, Nevada. I had always paid my bills on time; served my customers in a proper manner; and worked efficiently in promoting increased circulation. I worked happily and profitably for both Reno Newspapers, Inc. and myself until mid 1971; at which time a new Circulation Director was hired for Reno Newspapers Inc.

In early August, 1971 a drive for increased circulation was begun involving a trip to the California State Exposition for any Carrier who sold nine orders. I had twenty-two Carriers at the time and qualified twelve boys for this trip. This was more than any single Reno Newspaper Inc. District Advisor was able to qualify even though some had as many as sixty Carriers.

The bus left Reno Sunday morning and passed through Carson City at 7:30 a.m. on its way to "CalExpo". The trip was a complete fiasco. Among other things the tickets for the rides were not accepted, nor was there a Supervisor or funds available to correct the situation. My carriers therefore spent their lunch money for rides. No dinner was provided for, and my kids did not arrive back in Carson City until 11:00 p.m. Sunday night. Monday was a school day. Needless to say I heard from twelve upset parents.

Since I had planned many such trips in the past, I felt I should discuss the situation with Mr. Ryals, the new Circulation Director. My intention was to assure myself that when I promised a child a good time for his efforts that a good time was had. My discussion with Mr. Ryals ended in raised voices when he accused me of upsetting my Carriers' parents.

Two weeks later I was informed by Mr. Ryals that although I had been doing a great job in Carson City, the town was projected to grow so rapidly that no one person could handle such growth. The option was given to me to keep either the morning or evening paper only. No compensation was offered or received for my customer list and only a token amount was paid for my newspaper racks. No consideration was given to the financial hardship that would be placed on me, my family, or employees. When I asked if this splitting of my dealership could be delayed so that I could arrange my financial obligations, I was told, "That's your problem." I commented on the fact that I was fully capable of handling 350 Carriers and eight District Advisors along with the Secretaries while I worked directly for the paper and that even the projected increase in population wouldn't reach these amounts, my answer was silence.

At this time Mr. Ryals had been Circulation Director a very short time and I have always questioned the circumstances surrounding my termination. If the reason given is to be believed it certainly seems unjust and arbitrary.

No legal action was taken because I felt to question the Publisher's decision would also jeopardize my Nevada State Journal dealership. Financially to undertake any court action would also have been impossible.

I am still suffering from the hardships imposed upon me by this action both mentally and financially. I can only hope that with your help some other franchisee will have some protection against similar actions of such an arbitrary nature in the future.

Enclosures.

RENO NEWSPAPERS, INC.,
Reno, Nevada, October 1, 1971.

Mr. DAVID F. GRILL,
P.O. Box 1441, Carson City, Nev.

DEAR DAVE: This letter is to confirm our decision to split your dealership effective November 1, 1971. It is our understanding that you wish to keep the Nevada State Journal and relinquish the Reno Evening Gazette.

We want to assure you that our only intention is to provide additional leadership for expected growth in the Carson City area. In no way is this any reflection on the job that you have done.

We will appreciate any and all help you can provide us in making this change.

Sincerely,

RENO NEWSPAPERS, INC.,
N. WALT RYALS,
Circulation Manager.

INDEPENDENT CARRIER AGREEMENT

This agreement made this 26th day of May, 1967, at Reno, Nevada, by and between the Reno Newspapers, Inc., publishers of the Reno Evening Gazette, First Party, and hereinafter called the "Company" and David Grill of Carson City, Nevada, Second Party, and hereinafter called the "Contractor."

WITNESSETH:

That for and in consideration of the covenants and conditions hereby agree to be performed and kept by the Contractor, the Company, hereby leases to said Contractor, the territory known as Carson City, Nevada.

1. That the Contractor is not an employee of the Company, but is an Independent Contractor, and as such shall furnish and provide at his own cost and expense, all equipment including automotive, required by him in performing the obligations of this agreement, and further shall have no right or reimbursement from said Company for any cost or expense of any nature or kind incurred or contracted by him in the performance of the obligations of this agreement upon his part to be performed.

2. The Contractor covenants and agrees to indemnify and save and hold the Company free and harmless from any and all loss or damage suffered or incurred by said Contractor or any agent, servant or employee of said Contractor arising out of the performance of the obligations of this agreement upon the part of the Contractor.

3. The Contractor further covenants and agrees to insure all agents and employees of said Contractor in compliance with the provisions of the Nevada Industrial Compensation Act of the State of Nevada, and to comply with all laws, regulations and ordinances of the United States Government and the State of Nevada.

4. That said Contractor further covenants and agrees to deliver the aforementioned publication to every subscriber or retail outlet, in said territory at the earliest possible moment in a manner satisfactory to the consumer, and will take delivery of said papers from said Company at any time or place that will insure the timely delivery of the Company's publication.

5. That the Contractor further covenants and agrees that he shall pay the Company at its office in Reno, Nevada, on or before Friday of each week for all papers ordered by Contractor from said Company for the current week at the rate of .467 per copy daily. Contractor agreees and understands this rate applies to number of copies ordered by Contractor for home delivery.

6. Contractor further agrees that he shall pay the Company at its office in Reno, Nevada, on or before Friday of each week for all single copies ordered for newsstand sales, at the rate of .065 per copy daily. Company agrees to allow up to fifteen per-cent (15%) of newsstand copies to be returned for credit for a period not to exceed four (4) calendar months from the effective date of this Contract; after which, the Company agrees to allow up to ten per-cent (10%) of newstand copies to be returned for credit. Company will bill Contractor weekly.

7. The Contractor agrees to sell said publication to his subscribers at the regularly published price, said Contractor to be responsible for all collections from every subscriber.

8. Said Contractor agrees that all advance payments on subscriptions made by subscribers to said Contractor will be turned over to the said Company when said subscription is paid in advance for a period exceeding six months. It is still further agreed and understood that all advance payments made by the subscribers to said Contractor are the property of the subscriber, and shall be held in trust by said Company until expiration thereof.

9. Said Contractor agrees not to sell, assign, or transfer any part or parts of said route or any interest in this agreement to anyone else, unless written approval of the buyer, assignee or transferee, is first secured from the Company.

10. The said Contractor further agrees to give (30) thirty days notice in writing to said Company of his intentions to give up the route, and upon ceasing to serve as a Contractor, deliver to the Circulation Manager of said Company or someone designated by said manager, all route books, current collection records, and subscription lists, and shall teach his successor the route thoroughly without causing any unnecessary delay in the delivery of papers on said route.

11. The said Contractor agrees to have a qualified substitute who can carry the route at any time in the absence of Contractor.

12. The Company reserves the right to take over and assume charge and management of the route or any portion thereof, any time the management of the said route or the services performed by said Contractor shall fail to prove satisfactory. In the event the Company sees fit to take charge of said route, the Contractor agrees to teach his successor the said route without any delay, and if for any reason the Contractor refuses to teach his successor, the Company shall have the right to charge said Contractor for any expense that might be incurred in teaching his successor the said route.

13. It is mutually agreed and understood that the Contractor shall furnish automotive delivery service to the subscribers heretofore assigned him, and that the Company agrees to allow the Contractor the sum of twenty-eight (28) dollars per week on said route, for operating costs. The Contractor agrees to maintain in full force public liability and property damage insurance policies in the amount of not less than fifty thousand dollars for public liability and twenty-five thousand dollars for Property Damage, and further agrees to submit evidence of such insurance to the Company.

RENO NEWSPAPERS, INC.,
Publishers, Reno, Nevada.
By: ROBERT S. LEN,
for the Company,
DAVID F. GRILL,
Contractor.

Witness:
JAMES M. HARDMAN.
Witness:
JAMES F. COTTER.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF NORMAN E. JOHANNES AS AN INDEPENDENT FRANCHISE NEWSPAPER DEALER

I have worked as an Independent Dealer for the Los Angeles Times, Times Mirror Corp., Times Mirror Square, Los Angeles, Calif., 90053, from Dec. 1963 up to the date of my termination on Jan. 1, 1976.

I took over in Dec. 1963 with a total number of 1138 subscribers and built the dealership to a high of 2600 subscribers. During the first lean years I did my own collecting, billing, inserting of extra sections and delivery of my own route, as well as delivery routes when men were sick or had quit without notice. This was seven days per week. In July of 1973, I was asked by The Times Mirror Co. to purchase the Dealership adjacent to mine. This was due to the fact that they had a high rate of turnover of dealers on that particular dealership, as well as this was the start of the Company laying their groundwork to switch over to their now so called Agency System, unbeknown to myself at that time. I regretfully accepted their offer, having to invest in more equipment, lease a larger building, and handle an organization of 26 part time Employees handling 4300 deliveries daily and 4900 deliveries on Sundays.

I estimate with the purchase of my original dealership, the purchase of the additional area and equipment that I had approximately $18,000.00 invested. The Company did arrange for a seven year payoff on the additional area acquired, however, I was never given the opportunity to pay this off, as they changed their system after only 2½ years. In this length of time, about the only thing I had paid back was the interest.

On Oct. 13, 1975, The Times Mirror Company held a general meeting with all of their Independent Home Delivery Dealers and informed them that the Company was buying back the Independent Dealerships effective Jan. 1, 1976, and changing to a Delivery Agent System. We were informed that if you did not sign the new agreement prior to Dec. 1, 1975, you were considered to be terminated Jan. 1, 1976. There was no consideration of Good Will, Equipment or anything. In other words, the Company was taking over and you would simply deliver their product at their direction, they could also change boundary lines and delivery rates at any time at their discretion.

I did not sign the Agent Agreement and therefore was automatically terminated Jan. 1, 1976. My reasons for not signing the new Agreement were that

it meant an approximate $400.00 per month cut in my gross income. Also I believe that their new contract has all the ear-markings of an Employer-Employee relationship with the Employer not having to pay the benefits such as Social Security, Insurance, etc. A copy of the contract enclosed for your further examination.

Even though the Company will pay me its price for my subscriber list, I was left with the equipment and was able to sell part of it to the Incoming Agent. I was left with equipment that would have been valued at $4000.00 if sold along with the business. There was no consideration taken for the Goodwill I have built up over a period of thirteen years. I believe that I was denied the right to sell my business at the fair market value.

All in all my termination has had a very drastic effect upon my family, cutbacks in standard of living, etc. Also, after two and a half months of diligently looking elsewhere, I have not yet been able to obtain other employment.

I, as well as 43 other former dealers had filed an injunction through our Attorney, Timothy H. Fine, to remain as Independent Dealers, however, our appeal has been turned down and Mr. Fine is now pursuing the matter further in our behalf.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF MELVIN M. MCCURDY AS AN INDEPENDENT FRANCHISE NEWSPAPER DEALER

My name is Melvin M. McCurdy. I live at 7146 Candlelight Way, Citrus Heights, California 95610. My telephone number is xxxxxxxxxxx For the last seventeen years beginning in July of 1959, I was a newspaper distributor for The Sacramento Bee, twenty first and Q streets, Sacramento, California. On December 29, 1976, I was notified of my termination along with seven other dealers. I was offered no compensation of any kind for my years of work and investment. It has been through my efforts and time that my route has built up to its present size. I have a good relationship with all my customers.

I presently own 79 vending machines and two trucks bought with my own money. I have absorbed all losses connected with my business including damage and vendalism to my vending machines, stolen papers, stolen money, and vehicle repair.

Our son was my main employee and consequently he lost his job. He and his wife are expecting a baby at any time and it is pretty tough for them right now. I also had three other employees who lost their jobs as a result of my termination. I cannot pay my bills and I cannot maintain medical treatments which I need as a result of polycythemia, a blood disease, and for my wife who has arthritis. We will lose everything we own.

We are presently engaged in legal action instituted by myself and six other dealers against the Sacramento Bee, to either regain our routes, or the right to buy papers from a dealer who is not terminated, or to obtain damages. At this time the outcome is uncertain.

STATEMENT OF FACTS PERTAINING TO VICTOR A. LARSON TERMINATION

I am beyond the age of forty. In the eyes of an employer I am not employable. The only way I can earn a living is to own a business. I thought in 1964 that I had that all taken care of when my father asked me to join him in his business. He was a newsstand dealer for the Sacramento Bee in Sacramento California and he was in the process of retiring and setting-up a retirement income for himself, an amount to be paid out of the Sacramento Bee dealership.

On December 29, 1975 The Sacramento Bee terminated us. This left my father without that added income and me with an income from a small country delivery contract with the Bee of about $2400 per year. And delivery costs must come out of my $2400.

I can understand franchise terminations for mismanagement, drunkenness, misconduct on the job, and other things detrimental to the business. These things are justifiable. But to cut a man off from earning a living and consequently cut his employees along with him just to satisfy a whim of a board of directors, or to keep a profit margin on the up-turn or for whatever reason other than going broke entirely . . . this I find very unjust.

Last year the Internal Revenue Service made us start paying our drivers as employees instead of independent sub-contractor distributors. Late in the year I received bills from them for income-tax I should have withheld in 1972, '73 and '74. On December 31, 1975 I paid the first part of those bills, $1,518.53. The balance is just over $1800.00, and I owe the Sacramento Bee over $1,000.00 for the papers I bought from them for sale in February and March 1 . . . the day my termination became final.

I still owe my father around $10,000, an amount I expected to pay off without problems, and I was drawing better than $9,000.00 a year from the business. I expected to work on that basis for another 20 years. . . .

And the Bee offered me nothing more than $3,104.99 for a business we had run successfully since 1959 . . . the amount a purchase of my racks and parts.

I think this is unjust and feel something must be done to try stopping this sort of thing so it won't happen to other little guys who bank their whole lives on franchises.

STATEMENT OF FACTS PERTAINING TO ROY W. LARSON TERMINATION

I would like you to know the situation regarding my dealership with the Sacramento Bee here in Sacramento, California. In 1959 the Bee transferred the newsstand street sales to dealers, taking that operation out of the hands of their district managers. The district I ended up with was West Sacramento and it had been run about six months by a young man who had to give it up in order to go on to school.

Since I was already sixty-five I had the Bee put my youngest son on the contract, but they added me as trustee. I paid $10.00 to the previous owner for the one newsstand he had that was coin-operated. Gradually, I began to buy additional coin-operated racks and chains and padlocks. At the beginning I couldn't make any money at all because somebody kept stealing and bustin into my racks. At least twice a week I would take a trip to the city dump to retrieve racks, or the sheriff would bring some in or I'd find some in the river. I had to invest in more expensive racks and padlocks and chains, heavier more break-in equipment. And I took on home delivery areas when the Bee asked me too . . . places they had found they lost money on.

In 1964 my youngest son was ready for college so I had him sell his part of the contract to my next to oldest son, Victor.

From the very beginning I looked upon my dealership as a retirement vehicle for myself and a legacy of a business for my children. Victor and I talked often about passing it along to the grandchildren and of providing summer jobs for nephews and neices. In January 1973 I hold my half of the business to my son, Victor for $18,500. This amount was based on the gross amount of income from the business for 1972. At that time it was common among news dealers to place the value of their businesses on that rule-of-thumb.

I told Victor I didn't want a lump-sum payment but would take the amount of $250 per month without interest until the total amount was paid. Victor was paying me $60.00 a week which made it possible with our Social Security to live well and to even take trips each year to visit our children who live away from Sacramento.

Our income is now reduced to $475.00 per month and since we haven't received any more money from Victor since he was terminated by the Sacramento Bee on December 29, 1975, we are beginning to feel the pinch and there won't be any more trips.

I think the worst part of this is that the Sacramento Bee gave us to understand over and over again in many different ways that if we did the dealership well and followed our contract to the letter we could expect to own it for life.

I think something ought to be done so other little guys won't have the business pulled out from under them just because the parent company has to meet some arbitrary budget, keep a stockholder happy, or control the price of the product.

STATEMENT OF FACTS PERTAINING TO JOHN NAIFY TERMINATION

My name is John Naify. My address is 6987 13th Street, Sacramento, California 95831. I was an independent newspaper distributor from October 1, 1972

thru March 1, 1976. The paper I handled was THE SACRAMENTO BEE published by McClathy Newspapers, 21st and Q Streets, Sacramento, California.

I have a total of $38,500 invested in my dealership. I still owe over $30,000 on the dealership. All of a sudden we were notified by the publisher of our termination. We have not received anything from the publisher for goodwill, inventory or equipment.

At the time of termination I employed three people and myself to run the business. The hardships which immediately arose after the termination have had a tremendous effect on myself, my wife and our two children.

I have hired an attorney to help us in this unfair termination. A lawsuit has been filed against the BEE so that we can recover our losses.

STATEMENT OF FACTS PERTAINING TO ARTHUR O. STANDARD TERMINATION

My Franchise is with the San Jose Mercury newspaper located at 750 Ridder Park Drive, San Jose, Calif.

In March of 1972 I signed a contract with the San Jose Mercury newspaper as an independent newspaper dealer. During the past four years, through the efforts of myself and my family, I have watched our business grow from a circulation of about 2100 to todays circulation of 2860 papers per day. I do not believe this kind of success occurs accidently but rather as a result of hundreds of hours of solicitation, carrier incentives and an insistence on good service. In addition to the hours invested in my business I have invested thousands of dollars in transportation, office equipment and money returned to carriers as incentives for solicitation and service.

During the early part of 1973 I discovered that I was a party to an illegal contract which was in violation of the antitrust laws. This contract required that I and my carriers sell the San Jose Mercury newspaper at a price fixed by the newspaper. I subsequently retained an attorney to negotiate a new contract. After many months of fruitless negotiations I deceided to exercise price freedom.

On about the 20th of March, 1974 I notified the San Jose Mercury of my intent to alter my subscription rates. I was immediately served with a law suit and subsequently a termination notice without compensation.

Since March of 1974 a number of significant events have occured:

1. A federal judge in San Francisco has found the San Jose Mercury guilty per se of violating price fixing laws.
2. The general manager of the San Jose Mercury admitted under oath that the law suit was filed to frighten dealers into maintaining the price structure demanded by the newspaper.
3. A restraining order was issued by the court temporarily prohibiting the termination of my contract.
4. A new contract was signed which did not contain the price fixing condition.

The present situation for me and my family is one of considerable insecurity. I do not know from one month to the next whether I will still have my business, or whether I can rely on a continuing income from this business.

If the San Jose Mercury is successful in terminating my contract without compensation, I will be unable to continue supporting my daughter in college, and it will be imperative that I sell my home to meet my financial obligations.

The uncertainty of the past two years and the potential financial hardship would not be necessary if HR 8349 was law. I respectfully urge your support of this needed legislation.

STATEMENT OF FACTS PERTAINING TO DONALD SCHENK TERMINATION

My name is Donald W. Schenk, Sr. and I reside at 2155 Northeast 124 Street, North Miami, Florida 33181 with my wife and four children. My home and business phone is [redacted].

From May 6, 1972 until April 28, 1975 I was an independent newsdealer delivering the Miami Herald, offices located at 1 Herald Plaza, Miami, Florida. On April 28, 1975 my contract was arbitrarily terminated.

During the periods of May 6, 1972 until April 28, 1975 I had an additional room added on to my house to be used as an office and storage area for my

supplies. I purchased office equipment, such as a desk, filing cabinet, typewriter, adding machine, calculator and various other odds and ends. It was also necessary for me to purchase a truck to be used in my business. This is a part of the material that was necessary to purchase in order to conduct and maintain my business. The total amount of my expenditures totals around $8,000.00, not counting the time I invested. I started out with 250 papers and when my contract was terminated I was delivering 1600 papers. Both my wife and I spent and average of ten hours a day, five days a week for about two years in order to build this business to a point where we could support our family. We did this by solicition by ourselves and contacting doormen and managers of apartment buildings in order to secure customers. We also obtained additional routes. At the time of my termination I had three employees.

I was terminated by the Miami Herald Publishing Company because I refused to sign over my business to them by signing a so-called employee contract. This new contract gave me absolutely no benefits of an employee, all it did was take all my customers and force me to charge a set rate for my services. This rate was then set by the Miami Herald. I refused to sign this agreement and on April 28, 1975, my contract was terminated.

I received absolutely nothing from the Miami Herald for my inventory, my equipment or the good will I had built up over the years. I received no compensation from the Miami Herald.

This termination has placed a great hardship upon my family and myself. This termination as been in effect for almost one year now and we find ourselves falling further behind in our obligations. Since we have three school age children our living expenses are substantial. Since I was an independent dealer I was unable to collect unemployment compensation or any other benefits. My annual income has decreased by about $15,000.00.

At this time I am involved in an action against the Miami Herald charging them with violations of the anti-trust laws of this country. Hopefully it will be resolved soon.

At this time, a copy of my dealer agreement is with my attorney. I will forward it under separate cover.

STATEMENT OF FACTS SUBMITTED BY EDWARD P. PALKOVICE

For the past sixteen years I have been a distributor of the Los Angeles Times, Los Angeles, California. I have invested $15,950, but more important, I have invested sixteen years in being available seven days a week at the early hours of 3 to 6 AM and to cover for any of my twelve employees in case they did not show up for work. I have had no benefits paid by the Times over those years, having to take care of my own vacations, insurance, retirement, etc. I felt that I owned my own business and that compensated me for my extra efforts.

Now they have forced their dealers to sign an agents agreement or be terminated. The contract looks attractive, except when you notice that they can terminate you on thirty days notice for purposes of consolidation, can change your territory to miles away from home, and can change the rate that they originally agreed to pay you with a thirty day notice. The contracts are reviewed and resigned every two years, so that puts me at their mercy for the remainder of my days with them.

Because I entered into an agreement with the Times that I felt would be a lifetime job, I now find that after sixteen years I am at a poor age for looking for a job, and would have to take a cut in income of at least half, if a company is willing to hire a man of 47 at all these days.

Needless to say, with this reduced income, my family of eight will suffer because of this one-sided action on the part of the Times.

These companies that offer contracts, franchises, or dealerships enduce an individual to enter into an agreement to help them expand their business, and after they have realized their goal, they want to case aside the men who helped them.

Congress has seen fit to enact laws that protect the average worker, but they have failed to make these same provisions to protect the small businessman who has been forced to stand alone against big business.

It is on your hands. It is time to get some laws on the books to protect small business.

STATEMENT OF FACTS PERTAINING TO JOHN D. CRUMB TERMINATION

I am currently a franchised newspaper dealer and have been since 6/69 for Northwest Publications 750 Ridder Park Dr., San Jose, California. They are publishers of the San Jose Mercury, San Jose News, and San Jose Mercury News. I received a notice of termination to be effective April 1, 1974 and at the same time notice that I would be allowed to continue as a dealer pending a decision in Federal Court of whether Northwest Publications had a legal right to change its deliver system without compensation to the dealer.

My understanding of the circumstances leading to my termination are as follows. Eleven of seventeen suburban dealers retained an attorney to negotiate a new contract with Northwest Publications that would conform to the Federal Anti-Trust Laws. Our attorney met with the publisher's attorney and top executives two or three times. After these meetings the publishers decided they no longer wanted to talk about a new contract. I then decided I would exercise my legal right to chance the price I was charging the carriers contracted to me. I suggested to my carrier increase their prices that they charged their subscribers so they could enjoy their normal profits. The publishers response was to terminate my contract about one week after they learned of my price change.

I would appreciate it if this letter would become part of the official record of your subcommittee hearing.

I would like to solicite your support of this much needed legislation and you will persuade your subcommittee to favorable report it for passage.

STATEMENT OF FACTS PERTAINING TO THE TERMINATION OF ELIZABETH J. HEIMSOTH AS AN INDEPENDENT FRANCHISED NEWSPAPER DEALER

I have been an independent newspaper dealer for the San Jose Mercury News since April, 1966.

On March 28, 1974 I was served with a lawsuit brought by Northwest Publications, Inc. against me and 18 other San Jose Mercury News dealers. At the same time I was served with a notice of termination pending a court hearing. That hearing has been put off pending the outcome of another case before the Court of Appeals. I am still a newspaper dealer working under a Court Injunction.

I have spent 7 days a week for the last 10 years carrying the entire responsibility of a large district and keeping 37 Newspaper boys on route.

The Publisher wants to change from Dealers to Teamster employees in its City and Suburban areas. Reasons given were "to obtain closer supervision over our circulation within the city and suburban zone with respect to the quality of delivery service, efforts to promote and increase circulation, and to have such control over the subscription price as the law permits." This means that my 10 years of good service, good will and equipment will be wiped away and I will join the long line of the unemployed. My husband is retired and unable to work. I consider it vital that I continue as an Independent newspaper dealer.

My attorney is working on my behalf, but he certainly needs help from our law makers.

STATEMENT OF FACTS PERTAINING TO W. B. KITTREDGE TERMINATION

I have been informed recently, that your subcommittee is considering legislation pertaining to the termination and non-renewal of franchise agreements.

I believe, I was terminated in furtherance of an anti-trust violation involving price fixing and have suffered grave financial hardships since.

I would appreciate very much if the enclosed statement is made part of the record in your subcommittee hearings.

I was an Independent News Dealer from 8–1–68 to 7–1–75, doing business with the Daily Review Newspaper at 116 N. Winston Ave., Hayward, California. Much time, effort and money was spent by me to insure a profitable distribution business. I had approximately 2000 customers, 10 retail outlets and 35 minor carriers to manage seven days a week.

Enclosed please find a copy of my Dealer's Agreement which was found to be a violation of the Anti-Trust laws before the Honorable Charles B. Renfrew, Federal Court San Francisco, California. Even though this agreement was found to be illegal, no compensation has been received for the loss of income, business and good will as a result of it.

I sincerely believe a dealer or franchisee needs protection in the form of proper legislation to insure against unjust or arbitrary terminations by manufacturers or franchisors.

If any additional information is needed by you, involving my particular case, please contact me.

Thank you very much for your committee's attention to this matter. I feel confident in your ability to legislate if given all the facts.

INDEPENDENT DEALER AGREEMENT

This agreement made and entered into this 1st day of August, 1970 by and between THE DAILY REVIEW, INC., a corporation, hereinafter sometimes called the Company and Willard B. Kittredge, hereinafter sometimes called the Dealer,

WITNESSETH:

Whereas, the Company is engaged in the business of printing and publishing in the City of Hayward, State of California, a daily newspaper known as Daily Review and the dealer desires to purchase copies of said newspaper from the Company to sell and distribute same to subscribers and to perform these functions as an independent contractor and not as an employee of the company,

Now therefore, it is understood and agreed as follows:

That the Company will sell to the Dealer such quantities of Daily Review as he shall order, at the mutually agreed upon rate of $1.583 cents per subscriber, per month, up to and including 2,010 subscribers and all subscribers over 2,010 at $1.88 cents per subscriber, to supply the needs of his territory or route known as District #4.

That said rate and territory or route shall be subject to renegotiation upon the giving of ten days notice by either party to the other.

That the Dealer will keep his subscription list correct and current, including a record of subscribers' accounts and amounts paid in advance, and will make said list available to the Company on request so proper audit can be made.

That the Dealer will sell the Daily Review at the current subscription rate that would be adverse to the best interests of the Company.

That the Company will on the first of each month furnish the Dealer with a bill or statement for the total number of papers furnished the Dealer during the preceeding month, together with any charges for supplies ordered by the Dealer.

That the Dealer will pay said bill on or before the 10th day of the month received, payment to be tendered at the Company's office in Hayward, California.

That the Dealer will sell the Daily Review at the current subscription rate to his individual subscribers and cause same to be delivered to them each date of publication in a manner consistent with the best interests of both parties to this agreement. That the rate at which the Dealer sells to accounts for resale will be set by himself or through negotions between himself and the account.

That the Dealer will not stamp upon or insert into the Daily Review any matter or material not supplied by the Company. That the Dealer is otherwise free to distribute any other material which is not in direct competition with the Company's newspaper, and which other activity does not adversely interfere with his proper performance of this agreement.

That the Dealer will provide a cash and/or corporate surety bond in the sum of $8.000.00. Dealer shall deposit with the Company the sum of $1,600.00 which shall be returned to the Dealer with interest within forty-five (45) days after termination of this agreement providing the Dealer has satisfied all obligations owed the Company.

That the Dealer shall be responsible for selecting the bonding company with whom he wishes to contract if surety bond is utilized.

That the Dealer, in the event of termination of this agreement in any manner, or in the event of his transfer of his interest hereunder, will immediately pay to the Company a sum equal to the total amount which he shall have collected or may collect from subscribers to the Daily Review in his territory in advance for subscriptions covering any period subsequent to the date of such termination or transfer.

That the Dealer will, for the purpose of increasing his own and the Company's sales and profits, work to create, maintain and extend the circulation and good will of the Daily Review and to that end agrees to perform his work in a business like, creditable manner in all respects.

That all persons employed or contracted by the Dealer shall be his employees or agents exclusively and shall be subject solely to his direction, control and responsibility. Without being construed as limiting or derogating the Dealer's status as an Independent Contractor, he agrees to maintain such insurance to cover the persons, vehicles or liabilities consistent with the operation of his dealership, comply with provisions of Workman's Compensation Act of the State of California and to maintain such payroll information and tax deductions as required by law, and does hereby agree to indemnify and hold the Company harmless from any and all damage or liability whatever, for or on account of any loss, damage or injury.

That all costs incident to operating the Dealer's territory—e.g., supplying and maintaining vehicles, assistants or substitutes; extra, loss or stolen papers; supplies, bad debts, etc., will be borne by himself as an Independent Contractor.

That should the Dealer decide to transfer his rights under this agreement to another part, he will duly advise the Company of his intent sixty (60) days prior to transfer. The Dealer agrees, however, that he will first ascertain that prospective transferee is bondable, has the qualifications and ability necessary to perform all responsibilities under this agreement, to the satisfaction of the Company. The Dealer agrees not to turn territory over to successor until he is fully trained and able to assume responsibilities to the satisfaction of the Company, accounts have been properly audited to permit an orderly transfer with mutual financial protection for parties concerned, and a contract has been executed with the new Dealer.

That either party hereto may terminate this agreement in its entirely upon the giving of thirty (30) days advance notice to the other party or less if mutually agreeable.

In witness whereof, this Agreement has been executed the day and year herein written.

THE DAILY REVIEW, INC.
FLOYD ———,
For the Company,
WILLARD B. KITTREDGE,
Dealer.

Senator Moss. We will now hear from Mr. David Bradwell of Bradwell & Associates, San Francisco.

We are glad to have you with us today.

We will place your full statement in the record and ask you if you can summarize or highlight. We would appreciate that.

STATEMENT OF DAVID BRADWELL, DAVID BRADWELL & ASSOCIATES

Mr. BRADWELL. My paper deals with the changing structure of the franchising industry. In the findings you will note that a number of large corporations have recently acquired franchise chains.

We also have a very significant structural change going on in the other direction. Franchisers are entering the retail market, operating company stores in increasing numbers. This trend is increasing very rapidly. It is facilitated by the cash assets which successful franchisors have accumulated over the years.

As these systems have matured their operating policies have changed, the original nexus between the franchisee and franchisor has been weakened by the franchisors' growing interest in operating stores rather than in making franchises available for the small independent businessman to operate.

If we were dealing merely with the provision of trademarks our task would be simple. Franchising encompasses many different role relationships between franchisor and franchisee. Many franchisors, particularly in the food industry are the franchisees' landlord, his teacher, his inspector and his supplier of goods and services.

Consequently, any legislation affecting the franchisee-franchisor relationship also potentially affects these multiple roles. Many of the problems and abuses that have arisen in this industry have arisen in the context of multiple-role relationships rather than merely in the supply of a trademark or business format.

In recent years, a number of industry leaders on the franchisor side have advocated increasing of the number of outlets which should be operated by the franchisor. One of the implications of this is that the successful franchisee is potentially penalized by his success through his business being targeted for acquisition.

In addition, a number of franchising operations have, by virtue of their entry into the real estate market, found it profitable to assign stores which are inherently unprofitable to a succession of franchisees.

The legislation particularly impacts the marginal franchisee and also the very successful franchisee by providing more equitable terms for termination or renewal of the franchise agreement.

In the late 1960's, and continuing into the Nixon administration, there was hope that the franchising form of organization would assist minorities in obtaining an ownership stake in American industry. With the change in emphasis on the part of franchisors toward company-owned operations, these minority businessmen are now finding that the promise that was held out is being taken away.

We have a number of such businessmen in the bay area, some of whom have very large Small Business Administration loans. If terminated they would find themselves back on the job market saddled with a very large debt burden. Legislation of this kind can help to prevent such a situation.

Insofar as alternatives to this legislation are concerned, the antitrust laws and industry self-policing are being raised as potential alternatives. Given the vast disparity in balance of power between the franchisor and franchisee, I'm not optimistic about industry self-policing being very effective in prevention of the abuses being recorded.

Insofar as the antitrust laws are concerned, the small businessman earning, say, between $10,000 to $25,000 a year, if terminated, may face a 4- or 5-year wait to obtain justice. On the franchisor side a large corporation with in-house counsel and the services of prestigious law firms, has a significant advantage in an antitrust action.

An example is *Albrecht* v. *Times Herald*. Mr. Albrecht was finally awarded the sum of $13,000 after many years of litigation. This doesn't begin to pay the expense of fighting an action of this kind.

The bill, in addition to requiring franchisors to state their reasons for termination and circumscribing the termination and renewal re-

lationship, provides for an FTC study of the franchisor-franchisee relationship.

I would like in closing to suggest that this study be guided by a policy advisory committee consisting of franchisors, franchisees, consumers, and, perhaps, State government experts in the franchising field.

In addition, we have noted in the San Francisco Bay area—and I believe this is true of the entire Nation—an attempt to subvert the antitrust laws through vertical integration.

A case in point is Winchell's Donuts where the franchisees were presented by the division manager of the parent company with an agreement which they had to sign under penalty of termination, making them store managers.

However, in their new role of store managers, they still carry the same financial risks. They still pay the business license and property taxes. Their salary is dependent on the profits of the business. Their position has only changed with respect to the control they have lost over the business.

I would suggest that, given this trend toward company-owned operations, the study go somewhat beyond pure franchising to look at the fringe types of relationship which have some of the qualities of franchising.

Senator Moss. Thank you very much, Mr. Bradwell.

Is there a trend toward this vertical integration as you spoke of now? Are we seeing that trend?

Mr. Bradwell. Yes, sir. If I may quote some figures from the report.

In the direction of automobiles and trucks; for example, 1970, 10 percent of the outlets were owned by the franchisors. This has increased to 15 percent in 1975.

In fast foods we have seen the percentage go from 24 to 32. In gasoline we have had the identical figure to three decimal places for 7 years. I don't know how the oil companies achieve that.

Hotels and motels, franchisor ownerships increased from 25 to 32 percent.

In the recreation, entertainment, and travel industries it has increased from 3.9 to 4.6 percent. In convenience foodstores it increased from 53 to 57 percent.

This trend toward increased franchisor ownership is quite pervasive.

Senator Moss. Is it your conclusion that this legislation would serve to contain this, slow it down, this vertical integration?

Mr. Bradwell. It would have it occur under more equitable arrangements. I made a telephone survey last week of all of the McDonald's stores in the San Francisco Bay area. We found that the company-owned stores were concentrated in the wealthier counties and the franchisee-operated stores were concentrated in the ghettos and lower income counties.

We have a selectivity going on in this transformation to franchisor-owned operations with the franchisees bearing an increasing percentage of the risk and leaving the plums to the franchisors.

Senator Moss. I introduced you as a consulting economist. I wonder if you could give, for the record, a little more background so

when we discuss your testimony and quote you we will have on the record more background as to what you had and how you became a consulting economist.

Mr. BRADWELL. I have a bachelor's degree in engineering from the University of Bristol in England and a Ph. D. degree in economics from the University of Oregon in Eugene, Ore.

After spending 2 years with Arthur D. Little, Inc., an international consulting firm, I went into independent practice 10 years ago. Since that time I have divided my time between small business and local government problems.

And I have represented over just the last 18 months some 50 small businessmen who were engaged in antitrust-type litigation. I have also assisted a large number of small businesses in fast foods, in clothing and business, and personal service in site selection and business organization and management.

Senator MOSS. That is your full-time occupation now, being an economic consultant; is that right?

Mr. BRADWELL. Yes; I reversed the normal process. I have an occasional teaching assignment, but my primary occupation is being an economic consultant.

Senator MOSS. We thank you, Mr. Bradwell, for your contribution to our record and we appreciate it very much.

Mr. BRADWELL. Thank you.

[The statement follows:]

STATEMENT OF DAVID BRADWELL, PH. D., CONSULTING ECONOMIST, SAN FRANCISCO, CALIF.

I. INTRODUCTION

This report has been prepared by David Bradwell, Ph.D., Consulting Economist, San Francisco, California, on behalf of the National Franchie Association Coalition in support of Senate Bill S. 2335, the "Fairness in Franchising Act." This paper draws from our San Francisco Bay Area small business case files, the professional literature on franchising, and a recent survey of over 100 San Francisco Bay Area franchisees.

Senate Bill S. 2335 is designed to provide franchisors and franchisees with certain remedies to assure fairness and to protect against overreaching, unjust enrichment, and unjustifiable termination.

The Bill also recommends the commission of a $1 million study of franchising in the United States to be undertaken by the Federal Trade Commission.

II. SUMMARY OF FINDINGS AND PRINCIPAL RECOMMENDATIONS

A. The franchising sector covers the full gamut of franchisee-franchisor relationships ranging from mutually satisfactory to forms of involuntary servitude too horrible to contemplate. S. 2335 can assist the bad situations without adversely affecting the satisfactory situations.

B. There is a high degree of concentration within franchising with the top 50 franchisors operating 71% of the units.[1]

C. Franchising now accounts for nearly 30% of the nation's retail trade and is making rapid advances in the personal and business services fields.

D. The increasing percentage of company-owned outlets in franchising systems and concomitant vertical integration will be arrested by S. 2335.

E. With maturity, the franchisor amasses large cash balances which make the acquisition of franchise fees and royalties less important than revenues

[1] U.S. Department of Commerce News, August 13, 1971.

from real estate and company-owned outlets. The former community of interest between franchisor and franchisee is potentially strained by a franchisor expansion strategy favoring company-owned stores. S. 2335 can ensure that the franchisee's equity and goodwill are protected in such a transformation.

F. The premium rents charged, costs of goods supplied, franchise royalties, and advertising expenses give the franchise form of operation more of a psychological than an economic advantage over the independent small businessman. S. 2335 can reduce the unfair advantages of the franchising form of distribution by requiring franchisors terminating franchisees to demonstrate good cause or pay adequate compensation.

G. The franchisor is oftentimes the supplier of trademarks, engineering and organizational know-how, source of needed supplies, landlord, inspector, consultant, and mentor of the franchisee. These multiple-role relationships increase the potential severity of the termination sanction. S. 2335 can assist the franchisee in obtaining equitable termination or renewal of his business.

H. Minorities who entered the franchising field in the last decade are among those suffering the consequences of changing corporate policies in favor of company ownership. S. 2335 can provide relief to minority businessmen threatened by this development.

I. The antitrust laws have proven inadequate for many of the problems of small franchised businessmen subject to territorial restraints, price-fixing in the face of inflation, and termination to achieve vertical integration. S. 2335 is a valuable supplement to the antitrust laws for the small businessman.

J. The proposed FTC study should not be invoked to delay the passage of understanding of the changes occurring in the structure of franchising. The S. 2335. The need for S. 2335 is clear-cut. There is a need for increased study would benefit from continuing input from franchisees, franchisors, and governmental and consumer representatives.

III. WHAT IS A FRANCHISE?

A franchise provides the franchisee with the right and the obligation to sell the product or service of the franchisor within specified territories or to specified classes of clientele utilizing the trademarks, recipes, formulas, technology, and organization of the franchisor. The strength of franchising rests upon three basic foundations:

a. The copyright laws of the United States.

b. The penchant of the American public to seek out familiar images and known products, terms, and conditions of service.

c. The entrepreneurial spirit, willingness, and ability to work hard to achieve economic success of franchisees.

Franchising provides the would-be franchisee with the benefits of national and regional advertising and the risk reduction attendant upon a proven business format.

From the viewpoint of the franchisee, the prospect of financial success is enhanced and the risk of commercial failure reduced by offering a proven product or service in a standard format.

From the viewpoint of the beginning franchisor, a greater degree of market penetration can be achieved with given capital resources and borrowing capacity than is possible through company-owned outlets. This greater market penetration is achieved, initially, at least, by a sacrifice in the profits received and as a percentage of the gross sales of his franchise product or service.

The franchising form of organization is pre-eminent in the fast foods, gasoline retailing, and bottling fields. In recent years the franchising form of organization has expanded to encompass a variety of personal and business services. The U.S. Department of Commerce estimates that 30 percent of the nation's retailing is conducted by franchise systems.[2]

The franchisor seeking to maximize his own profits and protect and enhance the reputation of the franchise system characteristically will modify his basic distribution strategies as his business matures and gains financial strength.

The relatively new franchisor is heavily dependent upon his franchisees for expansion capital and for the creation and dissemination of the corporate

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[2] Franchising in the Economy 1973–75, U.S. Department of Commerce, Washington, D.C.

image. The mature franchisor inevitably has a different relationship to his franchisees. As financial strength is gained, company-owned outlets in selective locations become more attractive than the establishment of additional franchisees except, perhaps, in marginal and sub-marginal markets.

The mature franchisor can be more selective and charge a higher price for his franchises than a beginning franchisor.

Termination of any one outlet has a negligible impact upon the mature franchisor's corporate revenues.

Whether the franchisor is beginning and relatively unknown to the investing and consuming public or mature and a household word as a consequence of advertising paid for by his franchisees, the key sanction he possesses over the franchisee is that of potential termination of the franchise and forfeiture of the goodwill developed through the combined results of the franchisee's efforts and the franchisor's conceptualization of the business opportunity.

IV. MULTIPLE ROLE OF THE FRANCHISOR

Franchisors are oftentimes more than a provider of trademarks, engineering, and other technical and organizational knowhow. The franchise agreement may also specify supplies to be purchased from the franchisor himself or from approved suppliers. Many franchisees perceive supplies from franchisors to be over-priced relative to prices offered by competing sources.[3]

The franchisor may provide financing assistance to the franchisee in initial inventory build-up and property development.

The franchisor may also be the franchisee's landlord through ownership or lease of the property on which the franchisee operates. The franchisor can, by requiring the franchisee to lease his premises to the franchisor and then leasing them back at a premium rate, obtain absolute control over the franchisee's real estate. This and other financial policies have given the McDonald's Corporation the epithet of being "an annuity on a bun" [4] to its stockholders.

The franchise agreement may restrict the franchisee from participating in the line of business he is most familiar with in the neighborhood he is most familiar with for two or more years after termination.

It is these functions, in combination, coupled with potential forfeiture of the rights and rewards associated with a franchise fee of $2,000–100,000, that make termination so disastrous for the franchisee.

Passage of S. 2335 can introduce greater fairness into the negotiation of franchise termination or renewal by requiring the trademark owner-inspector-banker-landlord-supplier of goods and services to state reasons for the termination or non-renewal and pay adequate compensation if good cause is not given. This is a minimal change in the direction of greater economic justice for the franchisee.

A more farreaching change which may ultimately prove necessary to preserve any semblance of franchisee freedom and independence is to enjoin franchisors from participation in multiple-role relationships with their franchisees. These limitations on role relationships are now being explored in respect to the petroleum industry.

V. THE GROWTH OF COMPANY-OWNED UNITS

In 1960 the ratio of franchisee-operated stores to company-operated stores in fast food franchise chains was 81:1. By 1970 this ratio had fallen to 10:1.[5]

The financial incentives for a mature franchisor to convert franchised units to company-owned units are not insignificant. In 1970 the mean fast food franchise unit had sales of $150,000, whereas a company-operated unit was enjoying sales of $271,000.[6]

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[3] See "Cramping the Business Style of Franchisers,' Business Week, June 16, 1975, p. 82; see also C. D. Snyder, "Selling the Hustings Instead of Headquarters" Marketing Magazine, January 24, 1972, p. 19.

[4] See Carl F. DeBiase, *A Critical Analysis: McDonald's Corporation, North American Operations*, The Fourteen Research Corporation, New York, 1974, p. 66.

[5] Shelby D. Hunt "The Socioeconomic Consequences of the Franchise System of Distribution," Journal of Marketing, Vol. 36, July 1972, p. 34.

[6] Shelby D. Hunt, "The Trend Towards Company-Operated Units in Franchise Chains," Journal of Retailing, Vol. 29, Number 2, Summer 1973, p. 7.

John Y. Brown of Kentucky Fried Chicken has stated, "We'll make more profit from 300 company-owned stores than we will from 2100 franchise outlets." [7]

Likewise, McDonald's Corporation as of 1970 received two-thirds of its revenues from the company-owned units which comprised less than 30% of its stores.[8]

William Ware of PKI Foods, Inc. (Aunt Jemima's Kitchen) reiterates: "More profits can be gained from company-owned stores. A break-even analysis of operations in the $220,000–300,000 range show this fact to be very true. Since our stores average $270,000 per unit per year and some clear between $50,000 and $100,000, it becomes evident that our stores are more profitable than if franchised." [9]

Lawrence E. Singer, President of Royal Castle System, Inc., has noted, "We make more profit per company-operated unit than we could possibly make in franchising. This fact has been acknowledged by many of the franchise operators. For this reason we operate company-owned stores." [10]

John J. Hooker, addressing the fifth International Management Conference on Franchising, said, "As all of you know, the name of the game is not really franchising—the name of the game is company stores. I was looking at some figures not too long ago and saw where a big company in America had 1600–1700 units and only 200 of these were company-owned. But the 200 company units were producing 60% of the net after taxes. It becomes obvious to you, if 200 company-owned units out of 1600-1700 overall units produce 60% of the net after-tax profits, the real name of the game is owning the stores yourself." [11]

The above quotations suggest that we are moving beyond the stage where the franchisor needs to woo franchisees as a primary strategy of corporate expansion. The honeymoon is over insofar as the franchisee-franchisor relationship is concerned. While still promoting the "be your own boss" theme, financially mature franchisors are moving rapidly towards a higher percentage of company-owned outlets. (See Table 1.)

TABLE 1.—PERCENT OF SALES BY FRANCHISOR-OWNED OUTLETS

Sector	1970	1975	Percent change
Auto and truck dealers	10.0	15.1	+51
Fast foods	24.4	32.5	+33
Gasoline	20.0	[1] 20.0	0
Soft drink bottlers	3.7	[1] 3.7	0
Hotels and motels	25.7	32.7	+27
Recreation, entertainment and travel	3.9	4.6	+18
Convenience food stores	53.9	56.8	+5

[1] Estimated from industry sources.

Source: U.S. Department of Commerce, "Franchising in the Economy," 1969–71 and 1973–75, Washington, D.C.

The proportion of franchisor-operated units is increasing in: Recreation and Entertainment; Miscellaneous Business Services; Soft Drinks; Fast Foods; Retailing Establishments; Accounting Credit Services; Collection Agencies; General Business Systems; Rental Services; Educational Products and Services." [12]

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[7] "Franchising's Troubled Dream World" Fortune, March 1970, p. 121.

[8] "The Chains Profit by Buying the Links." Business Week, June 27, 1970, p. 55.

[9] William Ware, "To Franchise or Not—How to Decide" in C. L. Vaughn and D. B. Slater (eds.), Franchising Today, 1966–1967, New York, Matthew Bender & Co., Inc., 1967, p. 29.

[10] William Ware, "To Franchise or Not—How to Decide, Con: Why Company-Owned Units," in C. L. Vaughn and D. B. Slater (eds.), Franchising Today, op. cit., p. 29.

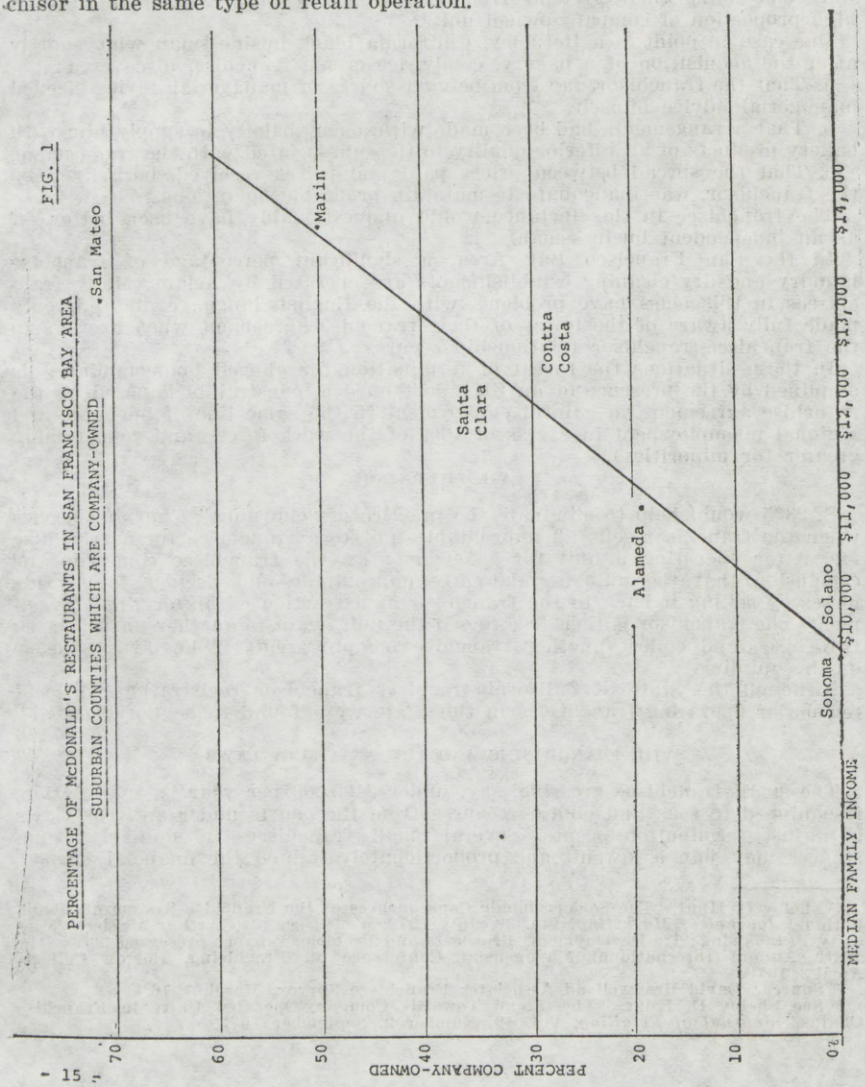
[11] John J. Hooker, "The Story of Minnie Pearl," in Franchising Today, Lynbrook, N.Y., Farnsworth Publishing Co., Inc. 1970 p. 171. Minnie Pearl along with other celebrity-associated franchisors, later fell on hard times. See "Minnie Pearl's Grand Ole Disaster," Sales Management, January 24, 1972, p. 20.

[12] See Franchising in the Economy, 1973–75, U.S. Department of Commerce, Washington, D.C., 1975.

Within the franchising sector, the top 132 franchisor companies in the United States, as of 1971, accounted for more than 90% of franchise system sales and 88% of establishments."[13]

Company-owned stores tend to enjoy higher revenues than franchisee-operated outlets. Franchisors claim that this differential is due to higher levels of management skills. However, in the maturing franchise systems where many franchises will be reaching the end of their term in the next few years, the franchisor is in the advantageous position of selective acquisition of franchisee-operated stores for company ownership.

A recent telephone survey of McDonald"s restaurants in suburban counties of the San Francisco Bay Area suggests that there is considerable selectivity occurring in the choice of units for company ownership. Fig. 1 shows that the percentage of company-owned McDonald outlets is greater in the counties where median income is high than in counties where median income is low.[14] Thus, the franchisee bears a greater amount of risk than the mature franchisor in the same type of retail operation.



[13] See U.S. Department of Commerce News, August 13, 1971.
[14] Source: David Bradwell and Associates, Telephone Survey of Franchises, March 1976.

VI. FRANCHISING AND ETHNIC MINORITIES

Although ethnic minorities comprise 16% of the U.S. population, they only account for 1.5% of the fast food franchises.[15]

Beginning with the Johnson administration, hopes were raised that franchising would provide an appropriate vehicle for ethnic minorities to learn management skills and gain the financial and other rewards of business ownership. Under the encouragement of the Small Business Administration, the Defense Services Administration, the Office of Economic Opportunity, and the Office of Minority Business Enterprise, many ethnic minority persons were encouraged to try the franchising route to economic success. Many who have done so had their hopes dashed by a combination of governmental red tape and changing franchisor policies and commitments.

As minorities began entering the franchising field in significant numbers, leading franchising firms had reached a level of financial stature where they were converting their systems from almost wholly franchisee-operated to a high proportion of company-owned units.

One case in point is a Berkeley, California black businessman who, shortly after the acquisition of a bakery, candy, ice cream franchise, discovered:

a. That the franchisor, far from being a source of managerial advice, needed managerial advice himself.

b. That arrangements had been made with a new bakery to supply him with bakery products of an inferior quality to those associated with the trade name.

c. That the spread between prices paid and prices received, both fixed by the franchisor, was inadequate to maintain profitable operations.

The franchisee in this instance would unquestionably have been better off as an independent businessman.

In the San Francisco Bay Area, a significant percentage of franchise laundry and dry cleaning establishments are operated by Asians. Many franchisees in this class have problems with the English language and are only made fully aware of the terms of their franchise agreement when a crisis in the franchisee-franchisor relationship occurs.

In these situations the threat of termination for alleged non-compliance is amplified by the presence of an SBA debt burden, constraints imposed by the franchise agreement on gainful employment in the same line of business, and regional unemployment in excess of 10% of the work force (and considerably greater for minorities).

VII. CHURNING

S. 2335 would help to eliminate the practice of "churning." Churning occurs when the franchisor sells an unprofitable unit to a franchisee for a franchise fee. After operating a unit for a few months, the franchisee comes to the conclusion that the unit is inherently unprofitable and decides to cut his losses by selling it back to the franchisor at a fraction of his original investment. The franchisor is then free to sell the unit again to another unsuspecting franchisee and collect another franchise fee plus rents if he owns a lease on the building.

Although the State of California requires franchisor registration, at least ten major operating franchisors in the State were found to be unregistered.[16]

VIII. FRANCHISING AND THE ANTITRUST LAWS

The small franchisee grossing, say, under $100,000 per year is, in isolation, ill-equipped to seek and obtain recourse from the courts under antitrust laws if unjust termination occurs. Several small franchisees in similar circumstances may join a lawsuit and proportionately lighted the financial burden.

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[15] Shelby D. Hunt, "The Socioeconomic Consequences of the Franchise System of Distribution," *Journal of Marketing*, Vol. 36, July 1972, p. 34; see also Arthur McZier, "Minority Franchising: Its Development, Prospects and Problems," paper presented before the Sixth Annual International Management Conference on Frachising, Boston College, April 3, 1970.

[16] Source: David Bradwell ad Associates Franchisee Survey, March 1976.

[17] See Shelby D. Hunt, "The Trend Towards Company-Operated Units in Franchise Chains," *Journal of Retailing*, Vol. 49, Number 2, September 1973.

Even under these conditions the trauma and disruption of a 3-6-year legal battle exacts a high price on winners and losers alike.

A case in point is Mr. Willard Noble, a Sacramento newspaper distributor. 1969.[17] In June 1969 a lawsuit was filed. The case was tried Nov.–Dec. 1971, with Mr. Noble received a notice of termination from the Sacramento Bee in May a judgment in favor of Mr. Noble rendered in January 1972. The case was appealed in January 1974, and the Court of Appeals reversed the lower court's decision, announcing its findings in November 1975. In December 1975, some six and one-half years later, a petition for rehearing was filed.

The passage of S. 2335 can greatly streamline the resolution of termination issues such as this by taking them out of the courts and submitting them to binding arbitration.

A survey of 117 fast food franchisors in 1972 showed that 50% did specify the prices of the franchisee's products. Twenty-eight percent required the franchisee to purchase paper goods from the franchisor, and 85% of the franchisors assigned an exclusive territory to their franchisees.[18]

Paradoxically, the antitrust laws make illegal between the franchisor and franchisee practices which are legal between parent company and wholly owned retail outlets. Thus, attempts at antitrust enforcement have precipitated changes in distribution from franchisee-franchisor to wholly owned chains.

In this regard, Winchell's Donuts in California in recent years has canceled its franchise agreement and offered former franchisees positions as store managers. However, these "managers" receive a nominal salary plus commission. This commission is dependent upon the store's operating revenues and expenditures. The managers are required to pay the local business license tax fees, all property and sales taxes, and to purchase supplies at prices prescribed by the parent company. For example, in this instance the parent company was charging $50 per hundred pounds for sugar at a time when sugar was available on the open market at $25 per hundred pounds.[19]

In the brewing industry, the large brewers have attempted, through retail price-fixing, to pass the burden of inflation on to their wholesalers. One Fresno, California wholesaler, although performing at a level superior to the statewide average for his brand of beer on a per capita basis, incurred the displeasure of the brewer. He was terminated on 24 hours' notice. Prior to his termination he was pressured by the brewer representative into making inordinate increases in his inventory of beer, thus providing the incoming distributor with a full inventory. The wholesaler, after some five years of litigation, has achieved an out-of-court settlement of this matter.

Had S. 2335 been in effect, his legal position and the legal position of other beer wholesalers in the state subject to similar price-fixing and termination threats would have been immeasurably improved.

In the newspaper home-delivery field, publishers nationwide are re-evaluating their present form of distribution and seeking a greater degree of control over retail prices through the substitution of independent newspaper distributors with "agents" and employee-operated systems. Attempts are now being made to terminate independent newspaper distributors in Sacramento, San Jose, and Los Angeles, California without payment of compensation. The passage of S. 2335 would help to reduce abuses in this field.

IX. STRUCTURE AND CONTENT OF THE PROPOSED FTC STUDY

The two-year time frame for the $1 million FTC study is probably realistic in terms of the time required to design the study, formulate hypotheses, obtain Office of Management and Budget approval of questionnaires, select a prospect list, conduct interviews, process and analyze results, and disseminate findings and recommendations to interested parties. However, it would be a mistake to delay the implementation of the proposed legislation pending the results of this or similar studies. The structural conditions in franchising are clear. The legislation has been needed for many years. Further delay could

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[18] Shelby D. Hunt, "The Socioeconomic Consequences of the Franchise System of Distribution," *Journal of Marketing*, Vol. 36, July 1972, p. 36.

[19] Source: David Bradwell and Associates, Survey of California Franchisees, March 1976.

result in acceleration of the existing trend toward vertical integration in retailing.

The FTC study would benefit from a policy advisory committee of franchisees, franchisors, consumer interests, and governmental interests at all levels of government.

Franchising spans a range of business relationships from simple supply of a trademark for a consideration through a complex of landlord-supplier-consultant-inspector relationships where the franchisee is little more than an indentured servant of the franchisor. A broadening of the scope of the study to include company-owned chain store preparations, particularly those with management incentive programs and independent single-unit retail operators, would provide the needed basis of comparison with the franchise form of operation.

The study might examine the alleged differentials between supply prices asked by franchisors and prices in the open market.

The franchising system allegedly has a low rate of failure compared with other forms of retailing. Such statistics may be inflated by forced sales of franchises back to the franchisor or to other selected franchisees at sacrificial prices. An examination of all franchisee terminations would help set the record straight on this point.

The trend in franchising toward franchisor leasing of places of business needs to be examined for its impact upon the market for commercial space.

The claim for scale economies in franchising systems compared with independent outlets appears not to be borne out in practice. Comparative cost analyses in studies such as this could reveal the true strengths and weaknesses of the franchise system of distribution.

Senator Moss. We will turn to Richard F. Bolinger. In fact, we'll have a panel, Mr. Charles Lister and Mr. Ralph Baker representing various franchises.

Mr. Bolinger is a former Dunkin' Donuts franchisee, Mr. Lister, a former Philadelphia Inquirer franchisee and Mr. Baker is a former McDonald's franchisee.

We welcome you gentlemen before the committee. We ask you to be brief because our time will run out on us. Under the rules of the Senate we will be turned off fairly soon.

STATEMENTS OF RICHARD F. BOLINGER, JR., FORMER DUNKIN' DONUTS FRANCHISEE; CHARLES LISTER, FORMER PHILADELPHIA INQUIRER FRANCHISEE; AND RALPH BAKER, FORMER McDONALD'S FRANCHISEE

Mr. Bolinger. I am one of what is certainly many former franchisees who have lost out big in the franchise game. Had there been legislation similar to the Moss Act, which I will refer to as "the Bill," enacted earlier, my wife, Jolene, and I might have been saved from a financial disaster. My presence before you today is solely in hopes that it will help someone else avoid the losses we suffered. I am presently employed full-time as a teacher, have no investment or interest presently in a franchise, and have nothing to gain or lose personally, regardless of what happens to the bill.

On June 12, 1972, I was in my Dunkin' Donuts shop at 2210–12 Franklin Street, Michigan City, Ind., anxiously awaiting the arrival of Mr. Vincent Brown, who was then and is presently a supervisory employee of my franchisor, Dunkin' Donuts of America, Inc. Mr. Brown's duty that day was to take possession of my store for the franchisor, and thereby relieve my wife and I of a severe financial

strain. Upon his arrival, his first remark was "What, no tears?" Here we are awaiting an end to an adventure that had cost us some $80,000, and his whole attitude that day was "Well, here's another franchisee down the tube, and another store we'll have to take over." It was just one more routine day in his life, that's all, and he was extremely callous about it.

But my wife and I are reminded about that eventful day at least once a month, and will be for about 5 more years, at least until we pay off a substantial loan at the rate of $347.25 per month. This loan was one of the severe penalties of our drastic mistake.

It all started in 1969 when my wife and I decided that we would like to invest in a small business for additional income. I was working full-time as a teacher, but wanted to invest in a business to supplement my teaching income. It was not my intention to quit teaching; at least, not permanently.

We had two basic choices, buy a franchise, or open our own unfranchised business, in either instance hiring a manager to operate the business. We selected the franchise route because of the national image, the training and other help that we thought the franchisor would furnish. We understood that franchises had a much lower "failure" rate that unfranchised small business, and considered this of great importance.

After some initial shopping, Dunkin' Donuts appealed to us. A Dunkin' Donuts franchise salesman, whose name, I believe, was Donald Skoglund, assured us that there should be no problem in operating the shop through an employed manager, that there would be no need for us to spend full-time in the shop. (Mr. Brown later advised us that the company had a poor experience with shops not personally managed by the franchisee.)

Our franchise agreement was signed June 27, 1969. The store was built, and we opened for business June 19, 1970. We had to pay Dunkin' Donuts a down payment of $14,100, and sign two notes. The first note was for equipment and required us to pay $817 a month for 36 months. The second note was for our sign, and required us to pay $109 a month for what I presently believe was 48 months. We incorporated our business.

We also had to pay rent to the franchisor of $1,225 per month. This brought the total monthly payments to $2,151, exclusive of the continuing royalty fee (4.5 percent for a limited period, thereafter 4.9 percent of gross sales) and advertising fee (2 percent of gross sales).

We started off with 22 employees, other than ourselves and other members. We had to cut down to 10. This resulted in a severe strain on my wife and I, my parents, and my sister. The franchise agreement required us to stay open 24 hours a day. This was especially burdensome.

I averaged 80 hours per weeek from the time the store opened until we closed June 12, 1970. My wife worked there 56 hours per week until she had our first child, working up to the very day she gave birth, and later return to work 16 hours per week. My mother, Elsie C. Bolinger, helped us 40 hours per week until she had to slow down because of high blood pressure in June 1971, at which time

she began a 16-hour per week schedule. My father, Richard F. Bolinger, Sr., worked 25 hours per week during the entire period. My sister, Pamela J. Bolinger, worked 20 hours per week during the school term, 50 hours per week during other periods. Total salary checks to myself and the other members of my family here named were $7,700 for about 17,000 hours of work, or about 45¢ per hour.

Meanwhile, we had to pay Dunkin Donuts $17,300 in royalties and advertising fees and over $28,000 in rent and make our note payment. Dunkin' Donuts representatives tried to blame us for our financial problems. They concentrated more on criticizing our operation than trying to help us.

I realize these are probably disputed issues. I was on the first of now three operators in the same store. The present operator advises me that although his rent is only $433 a month, he still loses money and may have to quit himself.

We wanted to remain a franchisee and get help from the company. The only help they were going to give was to permit us to pay the same rent but in weekly installments.

After profiting twice from the resales of the same store and after stripping us of thousands of dollars and putting us in hock for 5 more years they have reduced the rent, almost $800 a month but that was to another franchisee.

We tried to get permission to operate a satellite store in a nearby shopping center where there was more traffic. This would have increased our sales without a comparable increase in overhead. They absolutely refused. They were completely oblivious to your problem and we continued losing. As our own financial resources became depleted we saw we couldn't continue.

Efforts to sell the store to other franchisees were unsuccessful. We were hampered by the lack of assistance from the company and by a contractual prohibition which said that we could not use the name of the company in advertising for sale.

Finally, after long delays and after we were down to nothing, the company took the store off our hands and recaptured our equipment and sign which at that point had been substantially paid for by my wife and me.

The company threatened that, if we filed corporate bankruptcy, this would be treated as an abandonment. They would take over the store within 24 hours and hold us personally liable on all debts.

This venture cost us $80,000. Our future good mortgaged. My wife must work instead of take care of our 2 small children. Somehow we have to pay off a loan for the next 5 years at the rate of $347.25 a month. After reviewing the Moss bill and discussing it with Mr. Klein, I am convinced it would have helped us either continue operating the store with some substantial adjustment in our obligations or made a much better deal on resale.

If the bill were enacted, it would have given us an opportunity to hold the franchisor accountable for its failings such as poor site selection and failure to perform services. Had we been able to get substantial return on our investment, we could have gotten rid of our debts. Dunkin' Donuts has sold the same store and profited from the continuing tribute it exacts from the franchisees. We are trying to look to the bill as how it would have helped me.

This is fine. But I look at the bill as to how it would help franchisees in the future. It would encourage franchisors to exercise more responsibility in all of their dealing with the franchisees. They could no longer ignore the plight of the franchisee suffering from a franchisor-originated problem.

The franchisor, instead of being able to terminate and resell the same franchise over and over, the burden it imposed on its junior partner, the franchisee.

That concludes my prepared remarks. You have been furnished a more comprehensive statement which I request be included in the record.

If you have questions, I'll answer them.

Senator Moss. Your statement in full will be in the record.

I appreciate your giving us this experience which is a very traumatic one to realize how completely disastrous your economic situation became. Was it lack of disclosure? If the details had been disclosed in advance would you have known better than to get involved this deeply?

Mr. BOLINGER. We had counsel at the time but we had not very much choice. We had limited funds. I had the choice of going with a franchisor or opening up Riggs Donut Shop on the corner and competing with the franchisor.

Senator Moss. You felt the strength of the franchisor behind you gave you a better opportunity than opening a shop on your own.

Mr. BOLINGER. Right. Because I relied on their expertise in choosing site and in their training.

Senator Moss. Was there an attempt by the franchisor to help you sit down and work out your problems?

Mr. BOLINGER. We requested many times that they come and help us. They talked about shortages of district sales managers and that someone would come as soon as they could. They had come out on occasion. Instead of giving us constructive help, they were just derogatory in all respects.

Senator Moss. Thank you very much for helping us with our record.

[The statement follows:]

STATEMENT OF RICHARD F. BOLINGER, JR., A FORMER DUNKIN' DONUTS FRANCHISEE, CROWN POINT, IND.

Mr. Chairman, Members of the Subcommittee: I am one of what is certainly many former franchisees who have lost out big in the franchise game. Had there been legislation similar to the Moss Act, which I will refer to as "the Bill," enacted earlier, my wife, Jolene, and I might have been saved from a financial disaster. My presence before you today is solely in hopes that it will help someone else avoid the losses we suffered. I am presently employed full-time as a teacher, have no investment or interest presently in a franchise, and have nothing to gain or lose personally, regardless of what happens to the Bill.

On June 12, 1972, I was in my Dunkin' Donuts shop at 2210–12 Franklin Street, Michigan City, Indiana, anxiously awaiting the arrival of Mr. Vincent Brown, who was then and is presently a supervisory employee of my franchisor, Dunkin' Donuts of America, Inc. Mr. Brown's duty that day was to take possession of my store for the franchisor, and thereby relieve my wife and I of a severe financial strain. Upon his arrival, his first remark was "What, no tears?" Here we were awaiting an end to an adventure that had cost us some $80,000, and his whole attitude that day was "Well, here's another franchisee down the tube, and another store we'll have to take over." It was just one more routine day in his life, that's all, and he was extremely callous about it.

But my wife and I are reminded about that eventful day at least once a month, and will be for about five more years, at least until we pay off a substantial loan at the rate of $347.25 per month. This loan was one of the severe penalties of our drastic mistake.

It all started in 1969 when my wife and I decided that we would like to invest in a small business for additional income. I was working full-time as a teacher, but wanted to invest in a business to supplement my teaching income. It was not my intention to quit teaching; at least, not permanently.

We had two basic choices, buy a franchise, or open our own unfranchised business, in either instance hiring a manager to operate the business. We selected the franchise route because of the national image, the training and other help that we thought the franchisor would furnish. We understood that franchises had a much lower "failure" rate than unfranchised small businesses, and considered this of great importance.

After some initial shopping, Dunkin' Donuts appealed to us. A Dunkin' Donuts franchise salesman, whose name, I believe, was Donald Skoglund, assured us that there should be no problem in operating the shop through an employed manager, that there would be no need for us to spend full time in the shop. (Mr. Brown later advised us that the company had a poor experience with shops not personally managed by the franchisee.) Representatives of Dunkin Donuts sold us a bill of goods on the store we eventually purchased. They made numerous representations as to traffic count, competition, income level of neighborhood, etc., that convinced us beyond doubt that the selected location was a sure winner. Based upon the facts Dunkin's representatives disclosed to us, the location was better than average for its shops.

Our franchise agreement was signed June 27, 1969. The store was built, and we opened for business June 19, 1970. We had to pay Dunkin' Donuts a down payment of $14,100, and sign two notes. The first note was for equipment and required us to pay $817 a month for 36 months. The second note was for our sign, and required us to pay $109 a month for what I presently believe was 48 months. We incorporated our business.

We also had to pay rent to the Franchisor of $1,225 per month. This brought the total monthly payments to $2,151, exclusive of the continuing royalty fee (4.5% for a limited period, thereafter 4.9% of gross sales) and advertising fee (2% of gross sales).

We had long anticipated the opening of our Dunkin' Donuts shop. Our manager had been hired and trained at DDU. My wife and I were prepared to provide substantial help, most particularly the first year or two to help get the business on its feet. I decided to take a year off from my teaching job to help the new business start.

Our anticipations became a complete disaster. Business was very good at first. The Miss Indiana contest was going on nearby, and brought us many customers the first two weeks. But when September arrived, business dropped drastically. Michigan City, Indiana is heavily dependent on summer vacationers, something we didn't know before. And then we really began suffering.

We started off with 22 employees, other than ourselves and other family members. We had to cut down to 10. This resulted in a severe strain on my wife and I, my parents, and my sister. The franchise agreement required us to stay open 24 hours a day. This was especially burdensome.

I averaged 80 hours per week from the time the store opened until we closed June 12, 1970. My wife worked there 56 hours per week until she had our first child, working up to the very day she gave birth, and later returned to work 16 hours per week. My mother, Elsie C. Bolinger, helped us 40 hours per week until she had to slow down because of high blood pressure in June, 1971, at which time she began a 16 hour per week schedule. My father, Richard F. Bolinger, Sr., worked 25 hours per week during the entire period. My sister, Pamela J. Bolinger, worked 20 hours per week during the school term, 50 hours per week during other periods. Total salary checks to myself and the other members of my family here named were $7,700 for about 17,000 hours of work, or about 45¢ per hour!

During the same period we paid a continuing royalty fee of $12,070, and an advertising fee of $5,218, on top of our rent and note installments, all of which were paid through the date the company repurchased our store. In order to pay our employees, Dunkin' Donuts and other creditors, and to support our family, we had to liquidate personal assets and obtain personal loans to the limit of our ability.

Representatives of Dunkin' Donuts always tried to blame us for our financial problems. However, on the company's visitation forms, we were rated good to excellent on product, and excellent on service. The city health department consistently rated us above average on sanitation. The same store has now been sold twice over. The second owner, an experienced franchise operator, abandoned the shop and left town after only a short period of operation. Dunkin' Donuts subsequently sold the shop to a third operator who, although paying only $433 per month rent, as compared to our $1,225 per month, has advised me he is losing money and may have to close it himself.

The reasons for the continuously poor operation originate with Dunkin' Donuts. It is a poor site, contrary to the representations made to us when we purchased the franchise, and despite the "expertise" of the franchisor in selecting sites. We were handicapped by further deficiencies of the franchisor. After the initial opening and set-up period, the company provided very little assistance operationwise. Months would go by without even an appearance of a district sales manager to help us. Requests for assistance during our financial crisis were ignored. On the rare occasions when company supervisory personnel did visit us, we were insulted and subjected to false derogatory remarks about our operation.

Despite all of this, Dunkin' Donuts prospered from whatever revenues we did receive. The franchisor received $12,070 in continuing royalty fees and $5,218 in advertising fees, in addition to rental payments, and payments on equipment and signs, during our 2 year operation. The company repurchased our franchise, equipment and sign for $2,000 cash and an assumption of the remaining payments due on our sign and equipment notes, which had been assigned to third parties, and then amounted to about $14,700. So Dunkin' Donuts was able to purchase from us our two-year old equipment, franchise, and sign, that had originally cost over $43,000, for about $16,700, and resell the same items twice over, realizing what we understand to be over $125,000 from the three sales.

When we decided that we could no longer continue the business, having been drained of substantially all assets from which we could pay our employees and creditors, an attempt was made to find a buyer. Our efforts were fruitless. We were seriously handicapped by a provision in our franchise agreement that prevented us from using the Dunkin' Donuts name in any advertisement for sale of the business. Dunkin's Donuts, although it was the best source for prospective buyers, was of no help whatsoever. And once the company agreed to take the store back, there was a thirteen week delay. In response to our mention of corporate bankruptcy, the company threatened to hold my wife and I personally accountable for all debts of the business, in addition to taking the store back.

This business venture was a very expensive proposition to us. We had to liquidate personal assets and borrow money from a bank in the total amount of approximately $70,000, and use the $2,000 we received from the company, to meet our payroll, pay all of our creditors, and support our family. My wife has been forced to work and leave our two small children, presently aged 5 and 1, to help repay the bank loan at the rate of $347 per month. These payments will continue until about 1981.

After the company repurchased the store, it was temporarily closed, and many of our employees had to file unemployment claims. We were not the only ones to suffer.

We would have been in a much better position to avoid such a serious financial loss were it more difficult for the franchisor to terminate us for failure to pay rent, continuing royalty fees, etc., to it, assuming, of course, that we could have satisfied a court that our plight was substantially attributable to Dunkin' Donuts' shortcomings, rather than our own. If Dunkin' Donuts knew that it didn't have such absolute power of termination, we would have gained much leverage in dealing with the company. We might have been able to get a substantial reduction in our continuing financial obligations to Dunkin' Donuts if it looked as though this would enable us to operate profitably. Or if we were going to have to sell the store back, we might have been able to get a much better price, perhaps even some damages, rather than have to sacrifice the business and have to give Dunkin' Donuts a release from liability for whatever damages we may have suffered attributable to it. In any event, there is no question in my mind that we would have been much better off if the com-

pany's ability to terminate us under the existing conditions was restricted in such a way as to afford us an opportunity to demonstrate the equities in our favor.

Readjustment of our continuing obligations to Dunkin' Donuts is an alternative that should have been available. The company has, in fact, reduced the rent on the store to the present operator to $433 per month, so he advised me. Apparently, considering all the other revenues the franchisor receives from this shop, it considers it more advantageous to keep the shop operating as a franchised Dunkin' Donuts store than to close it and sell or rent the property for other purposes, as it admits to have done with many other marginal locations in the 1974 and 1975 Annual Reports.

A substantial adjustment in our financial obligations to Dunkin' Donuts would have been a tremendous help to us. We had only 13 more equipment payments of $817 per month, and about 24 more payments of $109 per month on our sign.

I have been told that some people contend that the answer to franchising abuses lies in disclosure laws and regulations. Some, not all, of our major complaints did arise out of what we contend were gross misrepresentations of important facts upon which we relied when deciding to purchase our Dunkin' Donuts shop. But, regardless of what we would have done had we known all of the true facts, disclosure laws fall short of preventing the many abuses that plagued us, and have plagued many other franchisees.

What if the franchisor does not live up to its obligations in helping a franchisee once a store is opened? How does a disclosure law help there?

How would a disclosure law have helped us recover losses arising out of the failure of Dunkin' Donuts to provide service to us once the store was opened?

How would a disclosure law have helped us if a court found that, although Dunkin' did, in fact, select a very poor location, it was not guilty of any fraud or misrepresentation? Must we still lose our complete family fortune and mortgage our future, while Dunkin' profits from rebuying the store from us at a sacrifice price and reselling it over and over again at substantial profits? Although not guilty of fraud or misrepresentation, shouldn't the franchisor have to bear a substantial part of the burden of its mistakes and be equitable with us. We paid it for its "expertise" in selecting a good site. If its "experts" make a mistake, shouldn't it properly share a greater part of the burden?

Although I believe there should be effective disclosure laws and regulations, the best answer to many of the abuses which have plagued the industry, and which continuously threaten the industry, is to pass a law that would give the franchisee, not just the FTC or some other regulatory power, the right to prevent unjust and unreasonable terminations and refusals to renew through the equitable powers of the courts.

Disclosure laws and regulations would be helpful, but they are not enough. The range of possible material facts that might require disclosure are much too broad. There are too many abuses, or possible abuses, that can occur after and regardless of full disclosure. And, as I said before, a franchisee doesn't want to have to leave the future of his franchise up to the bureaucrats in a federal agency, such as the FTC, to protect, as will be the case under the proposed FTC disclosure regulations (16 CFR Part 436).

Had our lawyer advised us that we could not be terminated by Dunkin' Donuts without "good cause", as stated in Section 6(a) of the Bill, and that we might be able to show that there was not "good cause" for termination in our case because we had "a reasonable excuse or justification (see Section 3(4)(A) of the Bill) for not being able to timely pay our obligations to Dunkin' Donuts, we very well might have decided to stand our ground, fight the company on termination, and try to arrange a substantial adjustment of our obligations to the franchisor, or negotiate for a higher price and damages on resale back to the company. Unfortunately, we were burdened with a completely one-sided contract written by Dunkin' Donuts that gave them the right to terminate and evict us, without regard to any equities pertaining to the real blame for our financial delinquencies, the shortcomings of Dunkin' Donuts itself, and could expect little help from the law. We had been so advised, and acted accordingly.

It is no excuse to say that we were over 21 and competent at the time we signed the franchise agreement. If we wanted to go into a small business, there weren't a lot of options available. Sure, we could have gone out and opened

"Rick's Donut Shop," and perhaps hired a manager, especially when we look with hindsight at the money raised when our backs were to the wall. But then we would have had to compete with Dunkin' Donuts, Mister Donut and the other nationally advertised and backed franchise chains. Perhaps a "Rick's Donut Shop" would have been the answer in the 1950's before all the growth of and competition from franchised small businesses. But times have changed.

In light of the circumstances, we really didn't give much consideration to competing with the franchised businesses. We wanted, in addition to the national image, training and support we thought came with the national franchise, the security it promised in view of the supposed low "failure" rate in comparison to nonfranchised small businesses. Giving us added confidence was the fact we were dealing with a well-known and supposedly reputable franchisor, not a fly-by-night organization. With the added credibility of the Dunkin' Donuts name, coupled with the foregoing factors, we were easily convinced by the Dunkin' Donuts franchise salesman's pitch that we were going to succeed, and that the termination provisions were just routine terms that the lawyers inserted for use on very rare occasions, and didn't warrant serious consideration.

The effect of franchise terminations is especially burdensome in cases such as ours, where Dunkin's Donuts was both our franchisor and our landlord. We lost not only our Dunkin' Donuts franchise, but also our business. After losing the franchise, we could not stay in the same location and continue business as "Rick's Donut Shop." And, even if we could have afforded the expense, we could not move our equipment to a new location. We not only had a restrictive covenant in our franchise agreement, we would not have been able to "sell" our shop back to Dunkin' Donuts and be reasonably assured that subsequently the company wouldn't sue us personally on our indebtedness, as it threatened to do if we abandoned the shop.

CONCLUSION

As you can see, we were drawn into investing in a Dunkin' Donuts franchise by several factors, the national image, the training and support available from a big company, the supposed low "failure" rate among franchised businesses, all coupled with what we consider serious misrepresentations of material facts. We suffered from the poor location our "expert" franchisor selected and poor service from the franchisor. We had to sell our franchise back to Dunkin' Donuts at a substantially reduced price, and have written-off about $80,000, not to speak of our time that certainly could have been spent more productively. Meanwhile, Dunkin' Donuts has profited from reselling the same franchise over and over again and from receipt of continuing revenues from franchise operators at this location, despite their inability to operate at a profit.

We were at a serious disadvantage to Dunkin' Donuts in avoiding our financial disaster, primarily because Dunkin' Donuts could terminate our franchise, recapture it from us without compensation, and sue us for any indebtedness we may have owed it, all without adequate legal remedy on our part to prevent the termination.

Legislation, such as the Bill, would have been a substantial help to us in arriving at an equitable solution to our problems, and in either eliminating or reducing our losses.

Senator Moss. I want to hear from Mr. Lister, and then from Mr. Baker.

Mr. LISTER. Thank you, sir.

I would like to say not in my wildest fantasy could I ever put myself in this state. Why this system does work here in the United States of America.

I bought my present Inquirer route starting in 1961 in two sections, from a John Fessler, who had started it with horse and buggy and developed in over the years.

Transfers were made in the Inquirer's offices in total payments coming to $40,000. It was paid over a 10-year period. This $40,000 I would like to add, is for a list of customers only. That is what you are buying when you buy a newspaper route.

The present market value of the route is $80,000.

About June 15, 1975, the district field manager of the Philadelphia Inquirer called requesting that I meet with him and the local roadman. This happened occassionally. The meeting was canceled because of a strike at the plant and later set up the same way for June 30. At 11 o'clock on June 30, four men from the Inquirer came, led by Mr. Davis. Mr. Davis told me for five reasons the Inquirer would not deliver papers to me any longer. I was terminated.

The five reasons he gave were that I have an answering device and that Inquirer employees could not reach me in the daytime. My day starts at 2 in the morning.

A vending box in one apartment wasn't served properly.

My returns were too heavy.

Number four, my circulation was down while Ecar circulation was up, and I had nondelivery complaints on new business.

I would like to add, I paid my bills promptly.

Mr. Davis offered me $24,000 in my stands for transferring customers. He asked me to decide in 1 or 2 hours that day. Later, he said he would be in his office until 5, and said I could contact him up to that time.

I called Mr. Davis that afternoon, telling him I had a buyer for the route, and I said I would like to arrange a sale.

He said the Inquirer wouldn't allow a transfer at this time. I said I couldn't accept the $24,000 offer, it wasn't enough.

I haven't received papers from the publisher since that time, but my fellow carriers have supplied me on a regular basis every day since. The reason they have is because there have been so many carriers terminated.

I have a record of being a new carrier, so maybe through me they could stop the termination process.

On July 1, I found to my dismay that Inquirer employees were delivering from an accurate route list of my customers and included in the paper they delivered, was a note to my customers telling them that the Inquirer was changing the method of delivery in my area, and that the paper was to be delivered at a lower price than I could deliver it.

In the following weeks, three letters from each side went to the customers who were getting two papers a day delivered. Through my attorney. I have sought injunctive help in Federal court.

The first hearing was 5 weeks after I was terminated in the first week of July. At the hearing the question was raised, where are your papers coming from?

I wouldn't answer that question because there were 40 other fellow carriers supplying me with papers and I knew the reason the Inquirer wanted to know was so they could retaliate.

For this reason the injunction was not granted. We are still awaiting an appeal at this time. I am told that the final outcome in the court will be quite a few years off.

To date the Inquirer has taken 15 percent of my home-delivery business. They didn't get any of my wholesale business, and they have replaced the original employees with independent adults who did not pay for the routes. On the 15 percent of the route, they now have other independent adults working that.

I feel this bill would have protected me just by its presence. I don't think the Inquirer would have attempted to do such a thing had this bill been in effect. I feel that the 90-day protection that the bill would have given me would have given me time to iron out my difficulties. I think the 90 days would have given me time to work out any difficulties or give me time to seek the protection of the court.

Senator Moss. Thank you for your reporting this very unhappy situation.

You are still involved in litigation and you don't expect the final answer for sometime?

Mr. LISTER. That is right, sir.

Senator Moss. What about these five reasons that Mr. Davis gave. Had he advanced them at any other time and told you you were falling down in any way?

Mr. LISTER. No, sir. There was no prior discussion of it.

I felt I was in fine shape.

In one area; yes, sir, the box was discussed. That was corrected.

From 5 or 6 months prior to June 30, I had been informed that my returns were too heavy and they were right, they were too heavy and I corrected the situation.

I hadn't had any problems with the other three reasons. I didn't know they were displeased with me.

Senator Moss. So your testimony is that you did correct two areas where you had known there was some delinquency?

Mr. LISTER. If I had been aware of the other three, we could have ironed that out, too.

Senator Moss. The other three you hadn't heard of?

Mr. LISTER. Yes, sir.

Senator Moss. It was a take it or leave it. He offered you $24,000 but said he was going to take the route anyway?

Mr. LISTER. Yes, sir.

When the offer was made, they had gone to a lot of trouble to get an accurate customer list of my route. They must have realized I couldn't accept the offer they were going to make to me because they knew how many customers I had.

Senator Moss. You are able to keep up part of your route now, being supplied by other agents, other franchisees of the Inquirer?

Mr. LISTER. A lot of people are going to a lot of trouble and risk to keep me in business; yes, sir.

Senator Moss. That is heart warming to know they will assist you that way, and I can understand their fear of reprisal if their identity would be disclosed.

Mr. LISTER. It is a real fear; yes, sir.

You said it is heart warming. My fellow carriers would go to this trouble is heart warming. Eighty-five percent of my customers have decided, although I charge more than the Inquirer, they would charge them. I still have 85 percent of those people with me 8 months later.

Senator Moss. That is a good recommendation for you.

Mr. Baker?

Mr. BAKER. I am Ralph Baker, and I grew up in a suburb of Chicago, Ill.

During my college years I became interested in McDonald's system. In 1962 I went to the McDonald's office at Waker Drive in Chicago and found out it took $25,000 at that time to obtain a franchise.

I was 19 years old at that time. I set out to attain that goal, even though every year the price went up, to raise enough capital to be able to qualify for a McDonald's restaurant.

When I was 28 years old, I was in a position to get involved with McDonald's. That was in 1972.

After lengthy investigation and interviews by and with the McDonald people, I was put on the list to get a restaurant. I was offered, finally, the store in Midland, Tex. This unit was presented to me as a store that would produce $700,000-plus a year volume. It was substantiated by the formal P. & L. presented by the McDonald Corp.

In addition, the site plan I got from McDonald Corp. indicated that I would have a common access into the largest shopping center in that town.

Based on these representations made by the McDonald's Corp., I accepted the unit. I invested $197,000 into the McDonald in Midland, Tex.

When I arrived in Midland, I was told that although the lease had common access to the shopping center, it would not be obtained at that time due to legal and survey problems between McDonald's and the shopping center.

In the months that followed, I paid rent and service fee based on $700,000 a year volume, or $56,000 a month, broken down into a 12-month period. This involved $4,500 a month in rent, 3 percent of volume for service fee, and 1 percent went to advertising to the company.

I involved myself in community activities on McDonald's suggestion. Further, I pursued a major advertising and the employee-training programs outlined by McDonald. Yet the store was doing $30,000 to $35,000 a month. This was indicating a projected annual volume of $410,000.

Yet, I continued to pay rent on $700,000 worth of volume. That was based on their projection and rent requirements.

In August 1975, finally after months of broken promises and great financial setbacks, I begged the regional office of McDonald's to help me and correct the lease and rent situation.

I was told to quit rocking the boat, that the McDonald Corp. had special lease arrangements in the Oak Brook office. I was told that McDonald would pull my license and terminate my lease and get me out of McDonald for good if I did not quit complaining.

In October 1975, at McDonald's invitation, I attended with my wife a meeting in Houston, Tex., for McDonald operators. I was promised that everything would be corrected. I left with new hope.

Four weeks later my McDonald's field consultant came into town unexpectedly and my wife and I met him at the store for breakfast. We were told at this meeting to get out of McDonald's, that we were bad for the system and that the promises of Houton were canceled. McDonald's was going to terminate my lease and license.

Further, if we did not cooperate with McDonald, they would kick me out the hard way, bankrupt me and take my house.

My wife was in her fourth month of pregnancy and that day she miscarried because she was so upset.

On January 23, after many meetings and negotiations with McDonald, McDonald came to take my store.

On Friday, January 21, 1976, I consulted with my attorneys and they consulted with Noel Kaplan. I was informed that McDonald corporate office in Oak Brook would have a meeting with me on the following Monday to come up with a final solution on the problems. I was to meet them Monday in Chicago.

At 8 p.m. that night, I was informed by the manager that the McDonald people were on my parking lot to take over the store.

I was never notified orally or otherwise of their intent. They did not give me the 5 days notice called for in their own lease and license.

All during the night the McDonald people flagged away trucks that were carrying in merchandise to sustain the business.

At 11:45, the McDonald people entered my store and I was handed papers to sign that said I was abandoning the store.

I said I could not sign papers like that without my attorney reviewing them. Further, they were not supposed to be there.

Anyhow, we were to meet in Oak Brook.

McDonald people began to threaten me and my manager, telling me they knew how to take care of people like me.

I had to seek medical attention because I was so upset which I did and the McDonald people were in the store for 2 hours without any of my people being present. When I returned, there was not enough merchandise to operate for Saturday morning.

At 3 a.m. the McDonald people returned and threatened, cursed, and coerced me again. They told me they knew how to take care of people like me.

I ejected them from the store and since there was not enough products left to open for Saturday, I put up a sign, "Closed for Remodeling."

Several days later, McDonald burned through the locks and opened up the store. They have never gone to court to evict me. They just took the operation.

Since that time I have begged to meet with the McDonald people anywhere, any time, but to no avail. I followed all of the procedural guidelines they laid out and they just don't want to meet.

I filed a lawsuit in Federal court in Midland, Tex. If there had been a law such as the one proposed here, I would still be in business today. But without the protection of the law, all the McDonald threats have come to pass. I am financially ruined, unemployed, my wife is under doctor's care, and I will probably lose my house.

The indigent in this country have the protection of social agencies and Justice Department. The corporations have big bankrolls to sustain legal bills, but the franchisee is the last group of independent entrepreneurs to be protected and emancipated.

I have a full statement which I would like included in the record.

Senator Moss. We will include that in the record in full.

You are involved in litigation with McDonald?

Mr. BAKER. Yes, I am. It is in the Midland Federal district court.

Senator Moss. Federal district court in Midland, Tex. Are you now living in Midland?

Mr. BAKER. Yes, sir.

Senator Moss. You are unemployed at this time?

Mr. BAKER. Yes, sir, I am.

Senator Moss. The McDonald Corp., Mr. Clifford H. Raber, has submitted a letter to us together with allegations in your complaint. I will put that in the record just to explain what the current status is.

We, of course, can't supersede what the court is going to do, and we don't try any lawsuits here, but I do think your story needs to be on the record because of what you have been through, along with these other gentlemen that we have heard.

Naturally, the corporation is entitled to give its side if it wants to do it.

The way you described the termination is the very thing that this bill is trying to get at. There can't be precipitous termination without adequate reason and notice and time to work out the problems. In fact, one of the witnesses has suggested we have a mandatory arbitration when anything like this going to go on.

We are glad to have the story on the record and realize what we deal with, the various economic tragedies that have come out of the franchising system, and try to make a more equitable way of doing business in this country.

I appreciate your testimony, Mr. Baker, Mr. Lister, and Mr. Bolinger, and thank you for coming.

Mr. Baker. Thank you, Senator.

Mr. LISTER. Thank you, sir.

[The statement follows:]

STATEMENT OF RALPH P. BAKER, MCDONALD'S OF MIDLAND, TEX.

I grew up around the Mc'Donald's stores and wanted a store since I was nineteen years old. It was my life-long dream.

October 1972: Met with Jeff Seeberger of Mid-West Region and he put me in touch with Larry Ingram, the licensing man from Atlanta, Georgia, Larry said I was just what McDonald's was looking for and that at 28 years of age I would be one of the youngest operators ever in McDonald's.

December 1972–July 1973: My father took very ill and I told McDonald's that I would have to wait for a time to start the necessary training program.

November 1973: Met with W. Curtis Smith, the new licensing man. I went through O.J.T. and started training at his insistence in a multiple operation.

November 1973–July 1974: Trained at Tom Webers and Joe Lyons store in Chicago. McDonald's picked these people as they were very successful multiple owners.

August 1974: Roland Bruce offered me the store in Midland. Showed same site plan that appears in lease. When I asked about Odessa's volume of $400,000, he said shopping center will make the difference. He said McDonald's is not off more than 5% on projections. The store was projected at $700,000. Additionally, Odessa's "F" operation would mean I would get it as well. Based on these factors I accepted the store in Midland.

September 1974: Went to Midland for groundbreaking ceremony with my wife Janice. Store was to open in late October or early November.

October 1974: Store delayed—will open early December due to construction problems. The Howard Corp., owners of the shopping center, contacted McDonald's about plans in rear of store (this is in their files). Thomas Smith, Vice-President of Howard Corp., confirmed this. McDonald's told Smith they were going through whether Howard Corp. like it or not. No one from McDonald's notified me of the problem.

Norm Weber, my field consultant at the time, ordered all the equipment, uniforms, etc. and signed his name with my initials (I have copies of invoices). All I did was send money.

Presented site plan to Bank of River Oaks, Calumet City, Illinois, as a representation of McDonald's store #3193 in Midland, Texas. Based on this Bob Rainsberger, President of the Bank, agreed to loan me $107,000.

Later in the month McDonald's is officially notified by Howard Corp. that they will sue McDonald's with gas and power companies because surface lease

had been granted years ago. Ron Petty of McDonald's Real Estate began negotiating with Howard Corp. Again, no one told me and I did not find out about any of this until December 1975.

November 1974: Told by Don Fowler of McDonald's that building would be delayed again and store would open late December. Additionally, I must take a Jay Buckbinder decor package. Went to Oak Brook office because I could not understand JBI prices. Met Norb Humpa, the Corp. coordinator for building and decor and he told me the store was not planned to open until January or February 1975. Also, Norb said that Paul Dodds had a special McDonald's store decor package at a much less price than JBI. Don Fowler was very mad and said he would not work with Paul Dodds. I took Dodds package anyway because it was less expensive and was made specially for McDonald's.

December 1974: Attended Basic Operations Course (BOC) in Dallas and Don Fowler got really upset about Dodds decor. Norm Weber recommended Ron Hamm of Oklahoma City market as manager and on his suggestion I hired Ron Hamm. No one told me that Hamm had been discharged for dishonesty, sexual relations with crew girls, and incompetence. I was told that the store would not open until late January due to building problems. During the month of December Ron Petty of McDonald's Real Estate agreed with Thomas Smith of Howard Corp. that McDonald's would not put through rear drive. Again, I was not informed. Sent Norm Weber, Ron Hamm, and Ronald McDonald down to Midland for Christmas parade on Weber's suggestion.

January 1975: Attended A.O.C. (Hamburger University). The months of Nov., Dec., and Jan. I was training with Jim Pihos in Milwaukee, Wisconsin. Left for Midland. Don Fowler tried to the very end to stop Dodds decor, but finally Norb Humpa got involved and took care of the problem.

February 1975: Got to Midland. Ron Hamm was hiring people. Went to site and found that there was no rear entrance. Asked Bruce Davis, Raymond McKitrich's job foreman, about driveway and was told then that there were legal problems. Asked Norm Weber and he said that Tencon signs had been sent back, but Ron Petty was working on problems and it would be solved in a matter of weeks. McDonald's knew they could not get ingress/egress in October 1974 but never notified Ralph Baker. I found out in December 1975 from Thomas Smith of Howard Corporation that in the Jan. 14 letter from McDonald's Petty agreed not to put the drive through in and McDonald's agreed with Howard Corp. From this time on Ron Petty would send letters to Howard Corp. everytime I asked about the drive and would tell me he was working on it. The store opened February 25. No normal punch list was ever run; it was drawn on the back of a match box by Don Fowler with Norm Weber, R. McKitrich, J. Jinks, and T. Thompson walking through the store. In the fall of 1975 I found that the air conditioner had never had shipping tape removed from fresh air intakes. I never signed that I accepted the store and always asked about rear entrance.

February 15, 1975: I was told 10 days before opening by Norm Weber (Field Consultant) that there were legal problems and the ingress-egress into the Sears parking lot could not be put through, but that the Real Estate Department would get right on it.

February 25, 1975: Opened store—many many construction problems. Tom Thompson was assigned as new Field Consultant. Hired Ron Hamm, former company employee, as manager. He was recommended by Norm Weber, current OPS Director of Tulsa, Okla.

March 1975: The lease and license were mailed in certified mail with plot plan in error. Petty promises drive will be put through.

April 1975: Nothing happened about ingress-egress. T. Thompson promises the construction problems and drive will be worked out.

May 1975: My P & L shows a food cost 10% higher than normal and I ask for help because I could not find the error with my accounting firm of Peat, Marwick and Mitchell. T. Thompson said McDonald's would help find the problem. I received no help.

June 1975: Wayne Shake, McDonald's Regional Accountant, came out and looked over Peat, Marwick and Mitchell's bills and laughed, said he should have notified me that they were overcharging. In fact, in July at Tan-Tara he made public note of an operator who paid $1,000 to have books set up. Where was field service when this went on? Weber, Thompson and Jinks approved of Peat, Marwick & Mitchell and in my previous business I had used CPA firms.

In any case, this is just one example of what 3% of gross by an operator buys. Further, he could not nor did he try to find 10% food costs in May. He did not even look at the books. Still no change with ingress-egress.

July 1975: Went to Tan-Tara, Missouri, for Operators' Convention. Asked for rent relief from Larry Ingram. Ingram refused. Asked about drive-through. Ingram said they were working on it. I know they never contacted Howard Corp. during this time.

August 1975: Jesse Jinks came into town and said McDonald's would help me set up a training program if I would get rid of R. Hamm. Jinks also said he was displeased with the store, but would recommend rent relief and he offered to buy the store himself. I have letter from Jinks but the offer to buy was not put in writing.

Tom Thompson came into town and my wife and I joined him for dinner at Montana Mining. All this day I had questioned Thompson about the ingress-egress and really pushed for it. Finally, he said the lease and license were not the legal documents between McDonald's and that there were other papers I did not have. During dinner I again brought up the subject of lease and license and Thompson said they were not the final documents. I also asked about the disposition of the store in Odessa since I had been promised it by Ronald Bruce and Norm Weber and had staffed my store accordingly. Thompson then said the whole deal was off, that I was rocking the boat (McDonald's) and ran a bad operation. He gave no explanation of this.

We came back to my house and I asked Thompson to work on a stat report that was in question. Thompson felt that Ron Hamm might be a thief and said that he (Thompson) had knowledge that he was a thief in Oklahoma City. This was the first time I heard that Ron Hamm was dishonest.

I asked Thompson to put my wife on the lease and license and he said that there were no partners in McDonald's, especially husband and wife because of a divorce situation. He again said there were special secret records in Oak Brook (McDonald's headquarters) concerning leases/licenses that took precedence over what I had. Thompson went on to say that if I did not get in the store and make hamburgers and stop the community activity programs I would be in trouble. I stated that Norm Weber, my former field consultant, said I should have a good manager to run the store and I should work in the community at being Mr. McDonald's. Thompson said that had all changed and if I did not do things his way and quit making trouble (reference to parking lot entrance) he would see that my license was pulled and I would be out of McDonald's for good. This incident was very nerving for my wife and myself.

Late in August I went to a meeting in El Paso and complained to Jesse Jinks about Thompson's threats and not having the ingress-egress. Jinks also said there were special documents in Oak Brooks and the lease and license were not the final documents.

Ron Hamm was terminated after failing a polygraph test given to try to find stolen product.

September 1975: I told my wife Janice that it would take someone more important than Thompson to pull my license and not to worry that McDonald's takes care of its operators.

Held Sept. training classes headed by Thompson and he had a bad attitude. Didn't care if employees showed up or not. Furthermore, he gave no notice of coming to town that week for the purpose of holding the classes so workers had not allowed free time to attend. Thompson continues to be more and more abusive.

Ben Cox, Company Auditor, comes into the store to perform the audit I asked for in May. Results were that $4,000 to $8,000 of raw product were taken and Ron Hamm, who was suspected by the company for bad performance, was probably responsible. Ingress-egress still not in. Construction problems not solved—no help from the company.

October 1975: My wife and I went to a meeting in Houston for downstore operators. At this meeting there were 60 other operators attending one at a time that had problems. McDonald's representatives Jerry Newman, Executive Vice-president; Larry Ingram, Regional Vice-President; Jesse Jinks, Field Service Manager; Jim Mueller, Advertising Manager, Dallas Market; Jeff Seeberger, National Advertising Manager, and other Corporate people were present. At the meeting I was promised a drive-thru window, ingress-egress, and $20,000

advertising program all on a priority basis. My wife and I left feeling very confident and happy.

Jesse Jinks came into town the week of the 20th and asked if I wanted to sell to him as he could get me out with no debts. He said he had money in Mississippi and Louisiana for 100% financing. This week I also got a letter of commitment from the company. Jesse Jinks also stated the store was a satisfactory operation. No results in the ingress-egress. Jinks stated that Midland was key market for 5 or 6 stores in the next 5 years.

November 1975: I receive a letter from Ron Petty stating that the ingress-egress could not be put in. I called Thomas Smith of the Howard Corp. and he explained the entire matter.

T. Russell and K. Boring of McDonald's Advertising came into town to lay out advertising program. This was a follow-up on the Houston promise.

November 21, 1975: My wife sees her doctor and he states she is at the end of her third month of pregnancy and doing fine.

November 23, 1975: Tom Thompson came into town on a Sunday night and is caught sneaking around the store by one of my assistant managers, Bill Moore. I confront Thompson that he is supposed to call me when he comes into town.

November 24, 1975: Thompson harasses my employees and myself the entire day.

November 25: Tuesday A.M. my wife Jan comes over to the store with my son Brent for breakfast. While she was at the table Thompson sat down and I joined them. Thompson started in about the fact that I was not doing things the way he wanted. One order of scrambled eggs was a minute and a half past the holding time and should be thrown out. He made a big issue that I was not after my employees enough to get them to adhere to the proper holding times. This was typical of Thompson. All he ever did was walk around with a stop watch and demine my employees, my family and myself.

Thompson to the Bakers: McDonald's at my suggestion is not going through with the advertising program and the drive-thru window.

Bakers to Thompson: Why? We were promised everything would be finished in November 75?

Thompson to Bakers: You two do not have ketchup in your blood, don't put enough time in the business, and are bad operators and should get out of McDonald's. If you don't get out of the business you will end up in bankruptcy and lose the store anyway.

Bakers to Thompson: What about the promises in Houston?

Thompson to Bakers: Jerry Newman is not in a position to make operational decisions.

Bakers to Thompson: How can McDonald's make promises and a few weeks later take them back?

Thompson to Bakers: That is just tough. I told you in August at your house what would happen if you continued to push Dallas.

At this time I had to leave the conversation to attend to matters in the store.

Thompson to Jan: You had better get out of McDonald's. You and Ralph are not putting enough time and effort into the business.

Jan to Thompson: Ralph is working 16 hours a day every day and is giving the business all he has. We have had a hard time getting good managers, especially managers that get along well together. If he isn't working with them in the store he is in constant communication with them by phone at home.

Thompson to Jan: I don't care to hear any excuses. It is apparent at the way this store is run that he should be putting in perhaps 20 hours a day if necessary to train the people properly. If you don't get out we will get you out the hard way and you will go bankrupt—we can see to that. You just better get out before we get you out.

All this had been very upsetting to Jan and she and Brent left. The time was about 10:30 A.M.

11:30 A.M. I went to the bank.

11:45 A.M. Jan calls to tell me she has started to bleed.

12:00 P.M. Jesse Jinks and Ben Cox come into town.

12:15 P.M. Thompson, Jinks, Cox and myself meet in my office. Cox was there to present the formal audit report. When Jinks and Thompson started out by saying Larry Ingram did not know about this meeting, Ben Cox said he wanted

no part of it. He was there only to present an audit report. Jinks and Thompson went on about getting me out and they would do it the hard way and bankrupt me. My wife called during the meeting and said the doctor had ordered her to stay in bed.

3:00 P.M. the meeting ends and McDonald people leave for Odessa.

7:00 P.M. I arrive home to find my wife in bed with labor pains.

10:00 P.M. I joined my wife in bed—bleeding getting severe.

11:30 P.M. I called the doctor who says to bring Jan to the hospital.

November 26, 1975: Thompson arrived at the store whistling. He showed no signs of sympathy at the loss of our child. In fact, he mentioned to Rae Bellamy, an assistant manager, that he supposed I wouldn't be in to work that morning and that shows how much I cared about my business. Jan was in surgery that morning at Midland Hospital. Thompson left town 1:00 P.M.

December 1, 1975: Called John Cook, McDonald's Ombudsman, for help.

December 10, 1975: Larry Ingram, Jesse Jinks, and Thompson came to town. They say the store is satisfactory, but still feel my selling is best for everyone. I finally agree to explore their avenue. John Cook calls me to say he will not make it to Midland—he talked to Regional Office.

December 11, 1975: Roland Bruce calls to say he has a buyer who can get me out with no debts.

December 15, 1975: Victor Moore from Los Angeles comes to Midland. He offers $193,000 on the suggestion of Jesse Jinks and Roland Bruce. On this day Larry Ingram and Jesse Jinks both agree that the operation is satisfactory, that I run a good store, and sign statements.

December 19, 1975: Called Larry Ingram and begged for a better price and asked about Roland Bruce's promise to get me out whole. All during the Christmas holidays I tried to work within the system to get John Cook, Operators Association Stu Pritchard to help get justice but to no avail.

January 9, 1976: Went to Operators Review in Lubbock. Talked to Ed Schmidt in Oak Brook. He said I would get out clean. At the operators review Ingram, Jinks and Thompson rated the store as an unsatisfactory.

January 12, 1976. Meeting in Dallas Regional offices with Larry Ingram, John Foley, and Roland Bruce. Brought the accounts payable and hoped this time McDonald's and Ed Schmidt would keep their word. Foley, on Ingram's insistence, would not raise the price, even though McDonald's had all my P & L statements and knew the accounts payable situation. Ingram said that since his office was incapable of making an error, the losses were my fault and even if they were the company's fault it would set a bad example to bail me out. They offered $215,000 and gave me 3 days to make up my mind. Additionally, they wanted me to work with Foley on some way to defraud creditors and got mad when I refused. They said I had no money in the bank (they had checked) and I could not afford a good attorney so had to settle.

I tried every method to get McDonald's headquarters in Oak Brook, Illinois, to meet and help settle this matter. No one was interested.

January 20, 1976: Filed suit. Talked to J. Foley. He said $230,000 best offer. They wanted to default me on the lease and defraud creditors. Same thing he said January 12th in Dallas.

January 23, 1976: 4:00—Roland Bruce called and said that I was going to default store. I said I would agree to the default as of January 12 per John Foley and that there would be no letter to sign. J. Foley would give me a letter to have payroll and employee records, accounts payable, etc. available. They were already with Tom Harrell, my account, for McDonald's people.

5:30—Steve Cohen, Attorney, and A. Kramer, Attorney, called for the third time today (I no longer use them as attorneys). Kramer said do not turn over the store to McDonald's people because Noel Kaplan said it is OK to close store. (Rucker at home when I was talking). He said to tell Rucker that there will be a big meeting at 4:00 p.m. Monday in Oak Brook. McDonald's in Dallas will not take over store.

8:00—I get a call from Bill Moore that since 7:00 p.m. McDonald's people were parked at Pittsburgh Paint store next to McDonald's and that an American Farms truck will be in at 8:00 p.m. McDonald's people on the lot flag away the truck. They had already set up a Martin Brower warehouse in Midland.

11:45—McDonald's Dallas people come into the store—John Franke, Dave Dixon, Oklahoma City manager, etc. They started taking inventory, have my

people unload an American Farms truck, take over operation. During inventory J. Franke gives me papers to sign saying I abandoned the store, an responsible for operations, bills, etc. I asked for time to have my lawyer review the papers. Franke said I better sign or we will get the store anyway and we know how to "take care of people like you." I got chest pains and had to go to the emergency room. Bill Moore took me. McDonald people left the store. They had unloaded trucks and then reloaded trucks. I had an EEG and heart tests. When I returned to the store there was not enough product left to open Saturday.

3:00 A.M.—McDonald's people return and threaten me that they will get me if I don't sign the papers and since I don't have enough food to open Saturday anyway they will get the store. Dave Dixon says I am a child and crazy.

I threw them out of the store and put up closed signs. They had the store since 11:45 and took money and materials to operate. The sign on the building said "Closed for Remodeling."

January 24, 1976: McDonald's people hold crew meeting with my employees and take them to Sambos for coffee. This goes on all day. They say they will open Monday.

January 26, 1975: McDonald's went to court to take over the store. They say I am crazy and they are acting in my best interest to protect the trademark. The judge refused their action.

January 28, 1976: McDonald's opens store.

January 30, 1976: McDonald's pays all my employees but three.

March 1, 1976: Returned to Midland. Found out that McDonald's had been bad-mouthing me all over town and had fired all my people. McDonald's had promised to keep these people employed.

March 12, 1976: Went to San Antonio in hopes of meeting Ed Schmidt to find out what went wrong. The southwest operators were having a meeting. Larry Ingram told me to leave or I would be in trouble with the law. Finally, I left because Stu Pritchard, the Association President, asked me if I would meet with McDonald's. I said all I ever wanted was a fair hearing.

March 24, 1976: Carl Bates called me and said McDonald's Corp. said that the Advisory Board should stay out of my situation. So once again McDonald's closes the doors. And so it goes.

OWNER REVIEW—JANUARY 9, 1976

Talked to Ed Schmidt of McDonald's Corporation at 9:00 A.M.

Present at Review: Jim Mueller, Larry Ingram, Jesse Jinks, L. Thomas Thompson, Bill Gray, Ralph Baker.

Larry Ingram asked for breakdown: Q. S. C.

Q—Holding time, store shops—4 min. overtime. Egg McMuffin—when I was there OK. Disapproved of Ron Hamm and Rae Bellamy as managers. J. Jinks said breakfast procedures not followed properly (experimental store)—stopped by T. Thompson. Meat was being turned properly, but needed reminding of salting meat. Grade U.

S—Grade between U & S by T. Thompson. I requested explanation. Low S, but an S—improved.

C—Grade U—Wall in kitchen, lot condition, trash containers because of city, papers around area, lack of store awareness of managers or crew on sweeping. Constant need of T. Thompson to remind management that lobby needed to be clean.

T. Thompson sent Bill Moore to Farmers Branch—Ben Cox worked with him.

Training: When I am not there managers made QSC errors. Jesse Jinks and T. Thompson request priority to get service up. No. 6 step followed—had to go over and over to get customers back.

L. Ingram asked T. Thompson to project volume for next year and Thompson projected $500,000 to $525,000 if the improvements I had made continued. If they did not, there would be a 20% decrease. Ingram agreed. J. Jinks thought it would be $425,000.

This was all done without a full field inspection. Thompson and Jinks didn't feel it was necessary. Yet McDonald's Corp. says every operator will have a full field inspection before his operators review.

THE HOWARD CORPORATION,
Dallas, Tex., November 17, 1975.

Re Town and Country Shopping Center, Midland, Tex.

Mr. RON PETTY,
Franchise Realty Interstate Corp.
Houston, Tex.

DEAR MR. PETTY: In response to your letter of November 6, this will advise that The Howard Corporation's position concerning a driveway from McDonald's onto our parking lot has not changed.

Yours very truly,

TOM E. SMITH,
Assistant Vice President.

QUESTIONS PEOPLE ASK ABOUT MCDONALD'S LICENSING POLICIES

When considering a McDonald's License & Lease, you probably have many questions about our policies and operation. The following questions and answers can help you decide whether you wish to file a formal application. We will, of course, answer all additional questions in full detail in a personal interview after receiving your application and determining that you have the potential for success as a McDonald's licensee.

1. Q. Do I find my own location and build my own store? A. No. Our real estate department selects the location, using higly scientific methods, and our construction department supervises the building of the store.

2. Q. What is the total cost of a McDonald's License & Lease? How much do I pay in cash? A. The total cost exceeds $110,000, including at least $65,000 in cash. A break-down of costs is included with this brochure. Various options will increase these costs.

3. Q. What monthly payments do I make? A. Presently on the License & Lease Agreements you pay 3% of monthly net gross sales as a service fee and 8.5% of monthly net gross sales in rental. (Net gross sales are total sales after deduction of any local and state sales taxes.)

4. Q. Will McDonald's help me obtain financing? A. No. McDonald's neither finances nor guarantees the obligations of your licenses. You must obtain financing on your own credit rating.

5. Q. May I talk with other McDonald's licensees to find out what I'm getting into? A. Definitely. We want you to do this, and we want you to talk with some of our competitors, too. In fact, we require you to work at least 25 hours, on your own time, in one of our stores before you are registered for a license. After you are accepted, we like you to spend another 100 hours in a store before going to Hamburger University for intensive training. This gives you the background you need to take full advantage of your Hamburger U. education.

6. Q. What return can I expect on my investment? A. In 1969 the pre-tax profit margin of a well-run store ranged between 12% and 15%. Our licensees normally pay off their original investments in three to five years. Many of our older stores gross in excess of $500,000 annually and $1 million is not impossible.

7. Q. Do I have to buy any of my supplies from McDonald's? A. Absolutely not. We help you find quality suppliers and we save you money by arranging volume buying contracts, but we do not sell you anything.

8. Q. Can my McDonald's have indoor seating? A. Installation of indoor seating depends on an analysis of market factors underlying the potential for success, such as heavy walk-in traffic.

9. Q. Does indoor seating cost extra? A. Yes. You will pay for the tables, decor and chairs. The cost depends on location, number of seats, type of seating, etc.

10. Q. How long do I have to wait for my store? A. That depends on a number of variables, including site availability in a marketing area we want to enter; construction time in that area; the number of prospective licenses ahead of you on our waiting list. A store may be available to you almost immediately if you are willing to move and do not request a specific area.

11. Q. Am I required to advertise? A. Yes, you must spend at least 4% of your net gross sales on advertising. Advertising materials will be supplied you at our printing cost.

12. Q. What kind of training will McDonald's give me? A. After spending at least 100 hours working in a McDonald's store, you will receive training at Hamburger University, learning every operational and managerial phase of the

business. This is supplemented by periodic regional seminars, plus comprehensive manuals and training materials.

13. Q. Do I get any other help after I open? A. You certainly do. Field consultants will visit you at regular intervals and help from our regional offices is as close as your telephone. Our regional offices also are staffed by experts in purchasing, personnel, training and advertising, and our national public relations and advertising agencies develop programs for your use at the local level.

14. Q. If I have to move to another city, will McDonald's pay my expenses? A. No. Remember that you will be an independent business man, not an employee of McDonald's.

15. Q. Must I have prior experience in the restaurant industry? A. No. In fact, only about 1% of our licensees had been associated with the food industry in any form before coming with us. What it takes is a head for business, a "feel" for people, the desire to get ahead on your own, and the willingness to work hard for success.

16. Q. May I form a corporation or must I sign on a personal signature? A. You may form a corporation or partnership to help you finance your kitchen equipment package, sign package and miscellaneous equipment. Under a partnership, the operating partner must own at least 51 per cent of the company, but you must sign the license and the lease agreements on the basis of personal signatures. The agreements then will be assigned to your corporation.

17. Q. Why do you feel that coming in alone, I must have managerial personnel before you accept me as a registered applicant? A. When you see a McDonald's store in operation, you will realize that no one person can handle all the managerial and operating functions without competent assistance.

How Much Cash Is Needed To Start A McDonald's?

We are often asked "What cash outlay is needed to start a McDonald's?" The following is an approximate breakdown:

McDonald's Site Development Fee Selection and analysis of location and inspection of parking area and building during construction.	[1] $2,500
McDonald's System, Inc. License Fee Exclusive license, assistance in obtaining local supplies and opening the unit.	[1] 10,000
Security Deposit against the lease	15,000
Total approximate net price (Including installation) of signs and neon work $13,500.00.	[2] 2,500
Total approximate net price (including installation) of the food service equipment $55,000.00.	15,000
Approximate cash requirement for miscellaneous equipment, landscaping and opening expenses. Cost of Miscellaneous equipment varies depending on optional items and terms of purchase.	18,000
Total cash	$63,000

[1] The cash requirement can be reduced by agreement to a service fee of 4.0% (instead of 3.0%), by waiver of the $2,500.00 Site Development Fee and the $10,000.00 License Fee.

[2] Cash down payment.

The fresh product inventory, food, paper and condiments cost approximately $5,000.00 which are needed to open the unit. Usually these items are not paid for until after the unit is in operation. The above investment requirements do not contain any provision for the cost of tables and chairs needed for building with provision for inside seating.

This is merely an estimate of the items to be covered. The balance of the monies due on the food service equipment, signs and neon work (approx. $51,000.00) is usually financed. A loan must be obtained on the operator's own credit rating from some independent financial source. McDonald's neither lends money nor guarantees the obligations to its operators.

McDonald's System, Inc.,
Dallas, Tex., August 14, 1975.

Mr. Ralph Baker,
McDonald's, Midland, Tex.

Dear Ralph: I would like to take this opportunity to thank you for your time and attentiveness during my recent visit to your McDonald's restaurant in Midland.

I would like to recap our conversations that took place during my visit there. Mr. Ingram and I have approved rent relief for your store at the rate of 10 percent of net sales. This request has been submitted to Chicago for final approval and will be effective August 1, 1975. This request has been made for a three-month period only. This is subject to final approval at the Oak Brook office.

Ralph, as I discussed with you Tuesday, it is necessary that you take full charge of that store and become manager/owner of your restaurant. Your actions Tuesday did not in any way reflect that you were, in fact, in charge of your store during the peak lunch hours between 11:30 and 4:00 o'clock. It is your responsibility to take full charge of the day-to-day operation of that store and guide and direct your people. You must assume this responsibility immediately.

Ralph, also as we discussed Tuesday, at the present time your so-called training program certainly is not working to any extent. Right now, it is the blind leading the blind. All of your problems with production, service and cleanliness stem from the fact that your employees are so ill-trained.

As we discussed, Tom Thomson will prepare the necessary training outlines and will conduct training classes himself for all of your crew people and the crew people in the Odessa McDonald's. It is an absolute must that you and all of your management team plan to attend these sessions in order that they, themselves, may become more qualified to be trainers. At this time, you have no one in your store who is qualified to train your crew people. You must take advantage of this offer by the Corporation in order to upgrade your operations.

Ralph, at the end of October we will analyze your operation thoroughly and scrutinize your Profit and Loss Statements deeply to determine if you have made substantial improvements in operations and in controls. You have needlessly wasted tremendous sums of money in the first five months of operation. It is time that you started making the good judgmental decisions that affect the cost of operations in your store. If you have not substantially upgraded the operations of your store and proven to us that you can control costs to the point that you are making money, then we will be inclined to discontinue the rent relief on the Midland store.

Ralph, we all feel deep down that you have the necessary qualifications to become a good McDonald's operator if you will set your goals and objectives to that point. Let me assure you that we in the Dallas Regional Field Service Department will give our best efforts in helping you make it.

Much success!

Sincerely,

JESSE G. JINKS,
Field Service Manager, Dallas Region.

McDONALD'S CORP.,
Oak Brook, Ill., October 23, 1975.

Re Restaurant #3193, Midland, Texas

Mr. RALPH P. BAKER,
McDonald's Restaurant, Midland, Tex.

DEAR MR. BAKER: To confirm the agreements made during our meeting in Houston last week, following is a summary of the items discussed:

I. DRIVE-UP WINDOWS

A. McDonald's will initially pay for the building cost (approx. $25,000) and the equipment cost (approx. $18,000) and give you a note payable under the following terms:

1. Interest from the date of the note at the greater of 10% or 2% plus the prime rate in effect on the day the remodeling is completed.

2. If the store's volume does not increase $150,000 during any consecutive twelve month period in the two years following completion of the remodelling, the note will be voided and no repayment will be required.

3. If the store's volume does increase $150,000 during any consecutive twelve month period within two years following completion of the remodeling,

the note will be repayable in thirty-six equal monthly installments beginning on the second anniversary of the date the remodeling was completed. The accrued interest will be added to principal at the end of the two years and included in the monthly installments.

II. RENT RELIEF

A. Rent relief was extended, subject to our obligations to lenders under certain loan agreements, on restaurant #3193 for the period beginning September 1, 1975 and ending March 31, 1976 so that the rent (not including amounts paid for insurance and taxes) shall not exceed eight-and-one-half percent of sales.

B. Rent payments for restaurants on relief are due on the fifth of the following month. As an example, 8½% of January's sales will be due on February 5th.

III. ADVERTISING PROGRAM FOR DOWN-STORES

The regional advertising department will put together a special advertising program for your store. All costs for this program will be paid by McDonald's.

IV. OPNAD RELIEF

It was recommended that Opnad relief be applied for at the November Opnad meeting.

V. PAYABLES DUE M'DONALD'S

A. McDonald's will take a note for August and September rent and service fees. No payments will be due for twenty-four months. Interest will accrue from the date of the note at the rate of 10% per annum. At the end of the two years, the accrued interest will be added to principal and the total will then be payable in twelve equal monthly installments.

B. Beginning with October, all obligations to McDonald's must be paid when due.

VI. LICENSING AGREEMENT

The Licensing Department will forward the proper papers to you for adding your wife to the license agreement.

VII. EGRESS AND INGRESS TO RESTAURANT

If it is now legally permissible, McDonald's will put in the rear entrance at no cost to you.

VIII. TRAINING

McDonald's will give assistance in crew training, but the major responsibility for this training is yours.

Please feel free to contact us if you have any questions regarding the above.

Sincerely,

McDONALD'S CORP.
GERALD NEWMAN,
Executive Vice President.
LAWRENCE K. INGRAM,
Regional Vice President.

McDONALD'S SYSTEM, INC.,
Dallas, Tex., November 28, 1975.

Mr. RALPH BAKER,
Midland, Tex.

DEAR RALPH: I would like to take a few minutes of your time to recap our meeting and conversation of Tuesday, November 25th, 1975. This meeting was held with Tom Thomson, Bon Cox and myself in attendance. There was a general discussion of your audit report of the first week of October 1975. It was noted that you have made much progress in several areas that were covered by the audit report. The most progress of course has been noted in the area of control. You have now brought your cost controls into line with the norm for standard McDonald's operations. This is very good.

However, it should still be noted that to date you have lost in excess of $60,000 on your operating statement. Ralph, as I stated that day, this is a tremendous loss for an eight month period. It was also noted during this conversation that while you have brought controls and operating costs into line, the basic operation of quality, service and cleanliness has not maintained McDonald's standards. As I stated to you, Ralph, in the nine months that you have been an operator of McDonald's, you have not shown the ability to put it all together and have full control of all situations. You have not shown the capabilities of taking charge and being totally the manager of your store in all respects of operating a McDonald's restaurant. As I expressed to you, the total McDonald's owner/operator has total awareness of all things—quality, service, cleanliness, controls, advertising, personnel and training under his control at all times. You have not shown the development of all of these skills to date.

So therefore, it was my recommendation to you, Ralph, that you make a total self-evaluation of your own personal abilities and perhaps the decision should be that Ralph Baker is not for McDonald's, and McDonald's is not Ralph Baker's balliwick. It was my recommendation that you give strong consideration to selling your McDonald's at this time rather than anticipate any further losses. Your personal financial statement at this time is in good shape. However, if things continue as they are now going in the Midland market, in another nine months Ralph Baker will not have lost $60,000 but somewhere in the area of $125,000. With this Ralph, all of your personal assets would be gone and you would have nothing to show for your past life's labor.

Ralph, as of today, I am putting Tom Thomson out of your market place for the period between now and January 8th. Tom will be available for telephone consultation and any help that he might give you this way. But I feel that you, Ralph, need this time to prove to yourself and to us that you truly can be a totally dedicated McDonald's man fully aware of the total McDonad's operating picture. I will expect from you an answer on January 8th as to which alternative you will take. One, sell your McDonald's while you can still salvage some part of your assets or two, a total dedication to being a complete McDonald's operator totally aware and fully capable of managing your McDonald's in Midland, Texas.

Ralph, we at McDonald's want to make every operator a total success. We want you to be a success and as always, you have a full backing of the Field Service staff of the Dallas Region at your beck and call. If we can help in any way, do not hesitate to call upon us.

Sincerely,

JESSE G. JINKS,
Field Service Manager,
Dallas Region.

DECEMBER 11, 1975.

To Whom It May Concern:

Ralph P. Baker has been for the last year the owner/operator of Store #3193, Midland, Texas. Due to the financial situation of the store, Ralph personally with our agreement has decided to sell.

Ralph does not have any problems or trouble with McDonald's Corporation. Ralph's strong areas seem to be P & L controls, promotion, public relations, and community service. It is the general feeling of those who have been affiliated with him and myself that he would excel in public relations, sales or representing a product or service.

LARRY INGRAM,
Regional Vice-President,
Dallas Region.

DECEMBER 11, 1975.

To Whom It May Concern:

Ralph P. Baker has been for the last year the owner/operator of Store #3193, Midland, Texas. Due to the financial situation of the store, Ralph personally with our agreement has decided to sell.

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and community service. It is the general feeling of those who have been affiliated with him and myself that he would excel in public relations, sales or representing a product or service.

JESSE G. JINKS,
Field Service Manager,
Dallas Region.

FRANCHISE REALTY INTERSTATE CORPORATION,
Houston, Tex., November 6, 1975.

TOM E. SMITH,
Assistant Vice President,
The Howard Corporation,
Dallas, Tex.

DEAR TOM: Has your company changed its position concerning the opening of a drive way between your Shopping Center and the McDonald's?

The proposed drive way would be next to the trash enclosure, which is located on the back of our property.

We would be responsible for the construction of the drive way at our cost.

Any consideration your company can give to this request would be appreciated.

Please advise as to your position on this matter.

Sincerely,

RON PETTY,
Real Estate Representative.

THE HOWARD CORPORATION,
Dallas, Tex., December 11, 1975.

MR. RALPH BAKER,
Midland, Tex.

DEAR MR. BAKER: This letter is in response to your recent request for a statement explaining why we will not consent to an entry onto our shopping center property from the rear of the McDonald tract.

The area in question is a part of our parking area which is not designed or used for thru traffic. There are no thru traffic or driving lanes in the area into which traffic from the rear of the McDonald tract can be channeled. Such traffic will cause deterioration to the surface of the parking area and will create potential liability problems.

All our records and information show a thirty (30) foot private drive on the rear end of the McDonald tract extending east to the Andrews Highway (State Highway 158). Without expressing any opinion regarding this private drive, it appears that it may offer an exit from the rear of the McDonald tract.

Yours very truly,

TOM E. SMITH,
Assistant Vice President.

STATEMENT OF MCDONALD'S CORPORATION, OAK BROOK, ILL.

McDonald's Corporation would like to take this opportunity to submit for the record our views on certain aspects of S2335, and to respond to certain statements and allegations made at the April 7 and 8 hearings on this legislation before the Subcommittee.

We do not wish to address in this submission the broad, general issues such as the constitutional questions; the availability of existing judicial and statutory remedies; the vagueness and lack of clarity; and the many specific difficulties created by S2335. We have reviewed the testimony of the International Franchise Association, of which we are a member, and believe that it ably states the arguments of franchisor companies such as ours in opposition to this bill.

We believe, however, that certain of McDonald's views on this bill may should be of interest to the Subcommittee. We are a mature and uniquely successful franchisor which has become one of the best-known business enterprises in the country in the relatively short span of 20 years. We have

both large, multi-unit, and small, single-unit franchisees. Our franchises represent long-term agreements which require substantial investment by both parties. In that time span, our experience, policy, and practices with regard to terminations may be more instructive than the many general allusions and speculations regarding abuses which have been advanced during these hearings. Our original twenty year license agreements will be expiring in the next several years and we are facing the question of their renewals or reissuance. And, finally, we believe that we are an example of a large and successful business enterprise which has dealt fairly with its franchisees without governmental regulation and which has remained committed to the franchising concept.

We are aware that certain McDonald's franchisees have been aggressively promoting this legislation. To the best of our knowledge, the group that they speak for represents a maximum of 50 out of a total of approximately 1,100 McDonald's franchisees. We believe that they do not speak for anyone but themselves; that the majority of McDonald's franchisees do not share their goals and objectives; and that the majority of our franchisees do not believe that S.2335 is necessary or desirable to serve their interests. We have, in fact, had numerous McDonald's franchisees express to us an interest in communicating their opposition to this bill to Congress, and in fact, one of our franchisees testified before the House Subcommittee in opposition to H.R. 8349 during the hearings held last month.

In 1955, when Ray Kroc, Chairman of the Board of McDonald's Corporation, determined to go into the 15-cent hamburger business, he was told by his friends, business associates, and the bankers that he was crazy. The hamburger business was saturated. Competition was fierce. But Ray Kroc had something unique to offer in 1955. The formula was deceptively simple —serve the highest quality products in immaculately clean surroundings, with excellent and speedy service, and at an outstanding value. The rest is history. By maintaining an uncompromising attitude toward substantially higher standards than offered by our competitors, McDonald's gave the American public more than it expected, and certainly a lot more than it had been receiving in the 1950s. If any single ingredient for the success of McDonald's can be stated, it has been that the American Public has looked to McDonald's restaurants for consistent and uniformly high standards of quality, service, and cleanliness which we call "QSC." These "QSC" standards have substantially contributed to and upgraded the entire American foodservice industry since 1955 and have become the industry benchmark.

McDonald's careful selection of its franchisees and the mutual commitment tour unique high standards has been the success formula for both the company and our franchisees. Meeting our customers' expectations by providing the public with a uniformly high standard of quality, service and cleanliness at any McDonald's restaurant they visit is essential to the success of all McDonald's franchises. A substandard McDonald's harms not only that restaurant, it harms all other McDonald's locations by creating dissatisfied customers.

Indeed, it is our franchisees who are ever ready to call our attention to a substandard McDonald's, and to remind us of our obligation to maintain our "QSC" standards. Their businesses are most harmed by the substandard operation, and they have as great a stake in the company's ability to maintain its standards and protect the value and goodwill of its trademarks as does the company.

The "good cause" and "bad faith" definitions provided under this bill are neither comprehensible nor adequate to enable a franchisor to define, much less maintain, its high standards of operation. The proposed legislation would offer a federal judge the responsibility for determining what standards are "essential", as well as "reasonable". There is every likelihood that in making that determination, a judge would be inclined to adopt the lowest common denominator of acceptable community standards rather than the higher standards of performance established by McDonald's. This will obviously lead to a substantially increased cost, unpredictability, and additional risk to any performance and quality-oriented franchisor in maintaining its unique standards. In our opinion, this bill would lead to the gradual erosion of McDonald's unique standards and competitive position. It will lead to a proliferation of the marginal and substandard operation and to the benefit only of sub-

standard franchisees, and their lawyers. Performance-oriented companies such as McDonald's will suffer, as will the consuming public, by blunting the value of competitive upgrading.

Such difficulty in enforcing standards of performance could also lead to the granting of new franchises only to existing franchisees who have proven abilities and attitudes, thus foreclosing opportunities for new prospective franchisees, and particularly for minority applicants who have been turning to franchising in greater numbers in recent years.

We believe maintenance of high standards is in the best interests of franchisors, franchisees, and the consuming public, and that clear, objectively defined standards are essential to our ability to maintain the integrity of our nationwide restaurant operations. We therefore oppose any legislation which would make it more difficult to maintain those standards.

We would like to cite McDonald's record and views with regard to the two major areas in which proponents allege that legislation is needed, and specifically termination and renewal.

First, some observations about our licensing agreement and our franchising arrangements in general. The vast majority of our agreements are long-term agreements, for a twenty year term and, in fact, the capital investment by the company in a McDonald's restaurant exceeds that made by the franchisee by a ratio of approximately two-to-one. Our franchisees are carefully selected and are provided with extensive training and other management assistance and given proven operational and marketing procedures and programs. All of these factors combine to give us a great financial interest in the success of our franchisees. Good business judgment dictates that experienced and proven franchisees are a highly valued asset to the company and they are treated accordingly. Arbitrary terminations do not make good business sense. Nor would we be able to conduct our business through our licensees if we engaged in such conduct.

We believe that there is a substantial economic distinction between a long-term, high investment franchise such as ours and the type of arrangements possibly envisioned by proponents of S.2335.

With regard to terminations, we believe that our record shows that McDonald's has not abused our franchisor-franchisee relationships, and has, in fact, gone to great lengths to avoid termination of substandard franchisees by granting them ample assistance and opportunity to cure any deficiencies perceived. Even with our careful screening and proven record of success, we occasionally find an operator who encounters difficulty in managing his operation successfully. It has been McDonald's policy and practice to work with marginal franchisees to upgrade their restaurants to acceptable standards. We have devoted considerable time, expense and talent to analyzing and solving problem situations involving substandard operations through special marketing, operational and even financial assistance.

As the result of this problem-solving approach, the vast majority of franchisees who have had problems in meeting our standards have been upgraded and are still operating their McDonald's restaurants—and prospering. The others, relatively few in numbers, have discontinued their relationship through sale to a third party, or in extremely rare instances, to the company, at fair market value. One possible exception is Mr. Ralph Baker, whose circumstances are discussed below.

We view termination as an expensive, time-consuming and damaging last resort which is rarely used, or even mentioned. But we believe that it is absolutely necessary if we are to maintain the value of existing franchises, as well as the attractiveness and value of future franchises.

With regard to the issue of the possible misuse of the threat to terminate a franchise, we would like to respond at this time to testimony and information given to the Subcommittee by Ralph Baker, a former McDonald franchisee from Midland, Texas. During his testimony, Mr. Baker recited a series of alleged events which he claims occurred during his relationship with McDonald's. While we have not had the opportunity to review a transcript of Mr. Baker's testimony, it is our judgment that its substance follows complaints filed against McDonald's in the U.S. District Court, Western District of Texas, Midland-Odessa Division, by Mr. Baker.

While we do not, as you stated at the hearings, believe that lawsuits should be tried before a body of the Congress, we believe that it is important

that the record accurately reflect our denial of Mr. Baker's charges, and the existence of a counterclaim which the company subsequently filed against him.

In two separate actions before the court, Mr. Baker has sought damages from McDonald's alleging various breaches that he recited in his testimony. Included was the charge that the company harassed Mr. Baker by threatening to terminate his license agreement, and that this resulted in a miscarriage by Mrs. Baker.

In its response to these charges, McDonald's has denied all allegations in Mr. Baker's complaints, including but not limited to breach of contract, negligence and infliction of mental distress.

We have further filed a counterclaim seeking both punitive and exemplary damages from Mr. Baker.

McDonald's is specifically charging that Mr. Baker secured his franchise fraudulently when he entered into a limited partnership, without McDonald's knowledge, on terms which required 75% of the profits to go to his secret partners. McDonald's is further charging that Mr. Baker operated a substandard restaurant, despite extraordinary training and management support provided by McDonald's and that he made false and malicious statements concerning McDonald's to news media.

As evidence of our policy of working with substandard operators to help them resolve their problems, McDonald's went to great lengths to help Mr. Baker. During the year Mr. Baker operated the Midland restaurant, McDonald's attempted to stem the deterioration and upgrade the restaurant by providing extra training, management and marketing support; offering to install extra facilities at no cost to Mr. Baker; giving him a moratorium on rental and service fee payments; and finally offering to resolve his problems and terminate the business relationship by purchasing the restaurant for $230,000, while intending to then sell it to another franchisee for $195,000, its realistic fair market value. Mr. Baker, by the same inexplicable conduct that characterized his business operations, instead chose to tender the premises to McDonald's, only to change his mind on the turnover date by refusing to honor his tender, instead simply closing and abandoning the premises.

We believe that his inadequate and misrepresented financing was instrumental in his declining our offer. Had he owned the assets which he represented to the company at the time the original agreement was executed, Mr. Baker would have been able to accept our offer and convey title. The matter would have been resolved without litigation. We call your attention to the letters submitted by Mr. Baker in conjunction with his testimony as evidence of our recognition of the substandard nature of his operation and of our willingness to work with him to solve the problems involved.

While McDonald's sympathizes with Mr. and Mrs. Baker's personal and financial misfortunes, It does not believe that is either fair or accurate to make McDonald's or the franchise system the scapegoats for these events or to advance the proposition that this constitutes an example of arbitrary and unconscionable terminations.

Rather than help in problem cases, we believe that S.2335 would seriously impair the ability of franchisees and franchisors to work to solve difficulties. It would substitute an adversary legal relationship for the business relationship which now exists between companies such as McDonald's and its franchisees. Rather than adopting a businesslike approach and working together to solve problems and upgrading substandard operations, S.2335 would encourage each party to adopt a legal posture to protect its interests. Both franchisee and franchisor would be encouraged to involve legal counsel at the earliest stages. A franchisee may have little inducement to upgrade his operation if he is given the ample opportunities for legal action provided for by S.2335.

The second major activity to which the bill addresses itself is renewal. At McDonald's, franchises are not renewed. Instead, a new franchise may be offered at the expiration of the franchise. We call this new franchise a "rewrite", and it is issued upon expiration of the current agreement, at then prevailing terms and conditions. We believe that there is no need for the legislative restrictions with regard to failure to renew which are proposed by S.2335. A look at our policies, practices and record as a large franchisor whose initial agreements are beginning to expire, may be helpful in determining whether franchisees in our type of franchising arrangements need additional protection with regard to renewal.

As in the case of its policy with respect to terminations, McDonald's employs its rewrite policy as an additional means to maintain quality standards. Specifically, the policy provides that four years in advance of the expiration of the twenty year term, the franchisee's overall performance is evaluated. If it is satisfactory, a rewrite on the then prevailing terms for a new license will be committed. If this performance is found to be lacking in terms of satisfactory QSC standards and other detailed written criteria, specific steps are suggested to see that the situation is corrected. Inasmuch as the Company has a very substantial investment in each McDonald's restaurant, the Company's return on that investment is dependent on the success of the franchisees. There is an obvious desire to ensure that aggressive, progressive, competent and actively involved management will continue to be available. One of the most difficult problems created by the renewal provisions of S.2335 is that it would remove the needed flexibility to customize the business relationship to the complex economic and other business circumstances that exist at the end of a twenty year term.

If a franchisee cannot or will not upgrade his McDonald's restaurant, he is informed well in advance that he will not be issued a new franchise upon the expiration of his current term. He is then encouraged to sell his business at its going concern value to an approved third party. The company will typically issue a new twenty year license to such approved party on then prevailing terms. Therefore, in addition to the profitable return on investment typically realized during the duration of the franchise term, the franchisee may also realize a substantial increase in his investment upon the sale of the business to a third party. If the provisions of S.2335 regarding renewal were adopted, there would be little inducement for him to do anything but wait it out to the end—at the continuing level of substandard performance—secure in the knowledge that he is guaranteed a purchase price by the franchisor.

A few of our older franchisees who obtained franchise agreements nearly twenty years ago are openly supporting S.2335 for the purpose of forcing McDonald's, through Congressional action, to renew their expiring franchise agreements at the original terms at which they acquired those franchises twenty years ago. We believe that they are supporting the bill not because of fear of injury through arbitrary termination or renewal practices, but rather as a business endeavor to gain more favorable economic terms.

McDonald's does not feel that the reissue of a McDonald's license should be on terms and conditions in existence twenty years ago. First, our business and our company have changed considerably since that time, becoming far more complex and demanding, evidencing the substantial changes that have taken place in our economy, our society and in franchising. This is reflected in changes in our license agreement and in the nature and cost of a McDonald's franchise in the marketplace. The increased competition, regulation by governments at all levels, and most importantly, customer expectations, have resulted in demand for and provision of increased and specialized services to the franchisee. The cost of doing business to support a McDonald's franchise through a national network of field offices in today's environment obviously differs markedly from five years ago, ten years ago, and certainly twenty years ago.

Proponents of this bill have argued that it is necessary to protect franchisees from a franchisor's action when the franchisor becomes large enough to be financially able to finance its own expansion without needing franchisees. While we cannot speak for all franchisors, we would like to offer our observations from the vantage point of a successful franchisor which has reached that size.

It is clear to us that franchising as we know it today has been and will continue to be to the mutual business advantage of our company and its franchisees. The past and potential future contributions made by our franchisees constitute one of our outstanding resources. It would be foolish to abandon this essential resource—now or in the future. I am confident that McDonald's is not alone in this belief.

By any measure, McDonald's became large enough to be able to finance its own expansion over ten years ago. Yet, in the ensuing decade, 70–80% of all of our restaurants have been franchised, and in each of the past three years, the percentage of franchised restaurants in the United States has

increased. Our domestic company-operated stores have never exceeded 30% of the total. In the last three years, the percentage has dropped to approximately 27%. The percentage of newly constructed stores being franchised in 1975 was 74%. In 1975, 59% of all new McDonald's stores were licensed to existing owners, 15% to new franchisees, and 26% were assigned to company operation.

Evidence of the viability of our franchising system today is further provided by the fact that the vast majority of licenses currently granted by McDonald's are being acquired by existing McDonald's franchisees—on prevailing terms and conditions. An experienced, sophisticated investment decision is being made daily by existing McDonald's franchisees. We believe that their enthusiastic acquisitions of new McDonald's licenses clearly demonstrates that those most familiar with McDonald's believe that a McDonald's franchise will continue to be an excellent and safe business investment. Over the course of a twenty year period, there are few business investments available today which will offer as uniquely a high return as a McDonald's franchise. But the demand for and marketability of a McDonald's franchise is not just because it can make money. It is due to our record of maintenance of high quality standards and a confidence that the franchise need not fear unfair, arbitrary, and unconscionable terminations or refusals to rewrite the license upon its expiration in order to favor company stores.

In this regard, we would like to address ourselves to the portions of the statement in support of S.2335 made by Dr. Bradwell which attempted to indicate a trend away from franchising, using McDonald's as an example in several instances.

His statement, for example, that McDonald's Corporation received, as of 1970, two-thirds of its revenue from the company-owned units which comprised less than 30% of its stores, is somewhat like the proverbial comparison between apples and oranges. The corporation reports as revenues the total sales of its company-operated units, but only that percentage of the sales of franchised units which is paid to it as fees. A valid comparison, therefore, would be to compare the revenues from company-operated outlets with total systemwide revenues. Making this comparison for 1970, 30% of McDonald's systemwide revenues were derived from company-operated outlets, a figure has remained fairly constant to the present time.

Dr. Bradwell further referred to a "telephone survey" of San Francisco Bay Area McDonald's which allegedly suggested "considerable selectivity occuring in the choice of units for company ownership." He further embellished the results of this survey with the oral statement that franchisors were taking the plums while leaving less desirable sites to franchisees. We question both the accuracy of the percentages he uses and the relevance of median family income by counties as an indication of the desirability of one location over another for various types of businesses and would like to state for the record that there was no "selectivity" or "taking of plums" in the establishment of any of the company-operated units in these counties, or in any other areas where both types of McDonald's units are operated. We, in fact, go to great lengths to insure that the franchisee is favored when a decision whether to establish a franchised or company-operated unit it being made.

Although it did not specifically refer to McDonald's, we would like further to comment on the portion of Dr. Bradwell's statement which discussed "Franchising and Ethnic Minorities", wherein Dr. Bradwell referred to the declining opportunities for minority participation in franchising.

Contrary to Dr. Bradwell's statement, at McDonald's the opportunities for minorities in franchising have not decreased, but rather have grown. McDonald's has made a positive effort to recruit and grant expansion to qualified minority franchisees and has increased the scope of our operations in areas which can most effectively be served by minority franchisees. We at McDonald's are proud of our record with respect to minority franchisees and wish to speak for ourselves in this regard.

One hundred twenty-five McDonald's restaurants are licensed to minority operators, a figure which represents 9% of our licensed units. In addition, 22 of the 126 people on our registered applicant list to receive new franchises are members of minority groups, representing 18% of the current waiting list for the licenses which will be granted over the next few years. Also, many of our present minority operators will probably acquire new units in 1976 or 1977.

Proponents of S.2335 have claimed that its passage is needed to enable franchisees to amortize and recoup their investment in instances where agreements are terminated or not renewed. While there may be a problem in this regard to a few industries or types of agreements, we believe that there is a substantial distinction between the short duration franchise business relationships and long-term business format franchises such as McDonald's.

On the basis of our experience, we believe a McDonald's franchise offers one of the best returns on total investment in our country today. Experienced and more affluent franchisees are able to secure a higher ratio of financing on the initial franchise package. Therefore, the return on their equity investment is even higher.

The exceptionally high return on investment offered by a McDonald's franchise had made it so attractive that in no time in the past fifteen years has there been less than a one or two year waiting list to obtain a franchise. We believe that our ability to attract such a number of highly capable franchisees attests not only to the attractiveness of the investment, but to the reputation we have acquired in our dealings with our present franchisees.

In conclusion, we believe that our relationship with the overwhelming majority of our franchisees has been one of fairness and mutual benefit. From our perspective, we see no evidence of abuses which would warrant enactment of broad legislation such as S.2335. We believe that such legislation would harm the conscientious, hard-working franchisee through the possible erosion of the McDonald's System and therefore, the worth and marketability of his franchise. We further believe that the consumer, who is the ultimate recipient of the benefit of high systemwide standards, and the resulting competitive industry upgrading, would also be harmed by enactment of S.2335. We therefore respectfully urge the Subcommittee to reject this legislation.

We thank you, Mr. Chairman, for the opportunity to participate in the record of your deliberations.

Senator Moss. Mr. Earl Schmadel and Mr. Charles Kunkler.

Mr. Schmadel, will you proceed? We will then hear from Mr. Kunkler after that.

STATEMENTS OF EARL SCHMADEL, VANCO BEVERAGE CO.; AND CHARLES KUNKLER, PRESIDENT, MIDWEST BEVERAGE

Mr. SCHMADEL. Has my statement been put in the record?

Senator Moss. You statement in full will be placed in the record, yes, sir.

Mr. SCHMADEL. It is only two pages.

Senator Moss. I noticed it was brief.

Mr. SCHMADEL. I'm a franchisee on the wholesale level in the beer business. I live and have my business in Evansville, Ind.

It might be of interest to this committee to know that franchise legislation or protective legislation is not at all new. In 1965, the State of Indiana in its exercise of the police power to control the alcohol beverage business saw fit to protect the beer wholesalers in that State from unjust, arbitrary termination without cause.

I have been in the beer business since September of 1953. Until 1965, abrupt termination without notice were the order of the day. Since that time there have been five that I know of attempted. In three the distributor won his case. One lost on a technical point and the other one gave up. This has worked.

There are exceptions, however, to it. One of the exceptions is that the brewers, or suppliers on their level are free under Indiana law to charge anything they want to charge for their product. We in turn are free to either pay it or not buy it, promptly being out of business.

The committee should give some thought to the complete protection that is outlined in the second half of my statement.

I have a typographical error. I referred to a Supreme Court case. That should be Kestenbaum, e-n, Kestenbaum case.

Whoever suggested that arbitration might correct these evils for franchisees on either a retail or wholesale level; it is not the right way. In my personal opinion, I think the law should be simple and give the aggrieved parties access to the courts and let the question of whether there was or was not cause be determined by the courts.

Thank you, sir.

Senator Moss. Thank you very much. I may have a question or two, but I would like to hear from Mr. Kunkler before I do.

[The statement follows:]

STATEMENT OF EARL E. SCHMADEL

This hearing is being held to determine the need for legislation protecting the franchises in a franchisor-franchisee relationship.

May I begin by giving you an example of how this can work. In Indiana, the State in the exercise of its police power to regulate the alcoholic beverage industry, saw fit to enact legislation that recognized franchises between brewers and beer distributors. Both written and equitable franchises arising out of the course of business between the parties were recognized. The law then simply prohibited the termination of such a franchise without good cause. There were several specific reasons in the law that were given as not being good cause.

This law has worked. No longer can minor officials of brewer-suppliers force any action on a distributor by threat of abrupt termination. Good business relations have flourished, and good business practices with mutual cooperation have become the normal procedure. The exceptions, however, are important. There is at the present time a massive investigation going on before the Federal Trade Commission and the Department of Justice. This investigation will show some violations on the part of brewers. It will also show many violations on the part of the distributors who have been forced to engage in various illegal activities by breweries and brewery representatives, especially in those states not having any franchise protective legislation.

There is another exception that is occurring, especially in those states that have franchise legislation, and that is price discrimination.

The Supreme Court has recently upheld a U.S. Circuit Court of Appeals case (Kestenbaum v. Falstaff) which ruled that Falstaff could bump price automatically when wholesalers raised, that such an increase does not violate antitrust laws! Question of what percent okay not an issue, although the case arose when brewer took 50%. In cases that did not get into court there have been instances of brewers taking more than 100% of the wholesalers price increase. In short, when the franchisor can't control the franchisee absolutely and directly by threat of termination; the franchisor simply applies economic strangulation by control of not prices but profits.

Legislative relief and the right to resolve differences in court are desperately needed by all franchisees. A great deal has been said about the economic impact of franchisees, all this is true. However, the various states have not seen fit to correct this situation on any uniform basis, and the Congress can take affirmative action. The important question is, "Why Not"?

I have attached hereto a document entitled "Distributor Bill of Rights". It was written by a beer distributor for beer distributors, but every word of it applies also to all franchisor-franchisee relationships.

DISTRIBUTOR BILL OF RIGHTS

A beer distributor has the following rights with respect to a brewery for which it distributes brands of beer brewed by such brewery:

(a) To be designated and recognized by the brewery as the distributor for the brands of beer of such brewery in the geographical area where the distributor is distributing such beer and for no other distributors to be appointed for such brands of beer in said area, and for the franchise existing between the brewery and the distributor, whether written or equitable arising out of the course of business between them, to not be terminated without just cause.

(b) To receive in writing from the brewery detailed specifications of any minimum standards which such brewery desires to be maintained by the distributor in the distribution of its brands of beer.

(c) To purchase such brands of beer from the brewery at a price which does not exceed the net FOB dock price charged by such brewery for said brands of beer to other distributors in the state in which such distributor is doing business or in any adjoining state.

(d) To pay the brewery for purchases of beer in either case, in which event no financial statement need be furnished to the brewery, or upon credit by furnishing an appropriate financial statement.

(e) To sell its distributorship franchise to others subject only to approval of the purchaser by the brewery based upon reasonable standards of the brewery which are applicable to other distributors of such brewery in the same state in which the distributor is doing business.

Mr. KUNKLER. Have you received my letter.

Senator MOSS. I do have your letter and that will be placed in the record in full.

Mr. KUNKLER. There is one other item I wanted to ask. I sent a 17-page document to the FTC and to the Honorable Lionel Van Deerlin of the House to be entered into the record of their committee. I did not send a copy to you.

Would you like that material?

Senator MOSS. We would like to have a copy and if you will supply it, we will place it in our record.

Mr. KUNKLER. I was prepared to read from my letter to the Honorable Warren Magnuson, but I will just call attention to the fact that I mailed that to you.

The things that have taken place with our operation the State of Arkansas. We went into business 3 years ago in an area which nobody wanted, would not offer one nickel, one dollar to the holder of the franchise there.

We took it over. We became possibly one of the most successful from a sales standpoint in increasing the sales in the country on Miller.

The action that has been taken against us, has been since I have been in the brewing industry, which has been since 1948, probably the most flagrant violations of anything I have ever seen.

My feelings have been from the very beginning of my controversy and trouble, that somewhere I would have protection as all persons under the Constitution. I have found out in the last 2 or 3 months that I may have that protection, but it is only available if I have $25,000 or $50,000.

I have contacted every source of Government agency that I know of and turning over to them what I feel are the violations. In fact I have even written to the President.

To this date I have received no notice except from the State of Arkansas, the director of Alcoholic Beverage Control, that a supposed regulation, 216 that prohibited such action that took place in our case was now no longer a regulation and in effect, in the State of Arkansas.

Actually it shows that one of the reasons for the Miller action is the fact that the present active management of the company placed in business as a dual distributor of Midwest in 1975, is a close personal friend, a former coworker of the Miller regional manager responsible for setting up a plan to place Midwest in jeopardy.

With that I will end my statement and if you have questions I will try to answer them.

Senator Moss. Thank you very much for your statement which is set out in even more detail in your letter. We are pleased to have you before the committee.

I wonder because beer and wine and alcoholic beverages are regulated by the States in a manner unique in our commerce, is there not a need to treat these kinds of franchises differently from others? Do you think there is a difference that we ought to observe there?

Mr. KUNKLER. Absolutely not. We have two agencies that we refer to. I have on two occasions contacted these people. There are specific violations involving the issuance of a basic permit to the wholesaler that was placed in competition with us by Miller. I was told they did not check for state violations. I would like for the gentlemen to also tell this committee that they do not check into these violations. They only check into what you—put down on your application for the basic permit, if you're telling the truth or not and if your statement is true they don't look into any possible State violations.

So we have had absolutely no protection from our Federal agency that issues the permits. I previously noted my State problems with the State license. We need this bill.

Mr. SCHMADEL. May I answer, please?

We have found that the States where such legislation to protect franchisees have been effective are not uniform and they are far too few.

An example is in the State of Indiana. The distributors in the neighboring great State of Kentucky—Commonwealth, pardon me, Senator.

Senator FORD. I prefer that and I appreciate your understanding of a commonwealth.

Mr. SCHMADEL. Those distributors are treated differently. All either of them want is simply justice.

Senator Moss. Would the Indiana statute be useful to us in drafting Federal legislation?

Mr. SCHMADEL. Definitely, sir.

Senator Moss. Mr. Kunkler, are you the only Miller distributor in your market area?

Mr. KUNKLER. As far as we are concerned—we are the only legal one. However, Miller has not shipped us any beer since November 18, 1975. They have done so on a situation which I feel is the fraudulent use of the agreement. They used an agreement—that they had signed in 1970 with a Mr. Higgs who since that time had sold it to Mr. Paul Dean who is the nephew of Dizzy Dean and from whom I bought the company in 1973.

The reason they had not sent me beer is they notified Mr. Higgs who was no longer in business as of 1972, that his agreement would not be renewed in 1975.

Senator Moss. Do you sell other kinds—are you still in business with other brands?

Mr. KUNKLER. Yes, sir, we have almost every other brand in the market with the exception of Schlitz and Budweiser brand. Schlitz and Budweiser had 95 percent of the market potential when we took over. We showed increases basically on the sale of Miller's.

Not having Miller's shipped to us puts us in a position of jeopardy and we will either have to cut down to a one-man operation or close our doors.

Senator Moss. It makes that much difference by losing that brand?

Mr. KUNKLER. We had put everything into building it up and it was 80 percent of our business. The manner that they have tried to deprive us of Miller's and keep us out of beer has hurt the sale of everything we have to offer.

As I told you, our salesmen have been thrown out of many accounts on all others brands we handled because we did not have Miller which was in demand.

Senator Moss. You indicate it is being shipped to another distributor now and being denied to you?

Mr. KUNKLER. Yes, sir. We had orders in up through March. I did not turn in any more for April since they had not shipped to us for the first 3 months.

Senator Moss. Have you brought any kind of legal action against Miller's for their refusal to deliver?

Mr. KUNKLER. I have contacted—possibly about five attorneys. Due to the enormous expense involved, three attorneys have turned down the case on a contingency basis. Two of them are too busy and they are two of the best in the country. We are not in a position where we can come up with a $25,000 or $50,000 fee.

None of the attorneys we have contacted have agreed to take it on a contingency inasmuch as it is too long a court trial. We are looking for an attorney. Hopefully I will get one who is a good, honest Christian who will take it on a contingency basis.

Senator FORD. Mr. Chairman, I will have to leave to go to another meeting. As you said earlier, we are confronted with the disease of being in two or three places at one time.

Since I have not heard the testimony, I will refrain from asking any questions. But I do understand that you're not receiving Miller's but another dealer is receiving Miller's. I was hoping that the lack of Miller's beer in our area would improve the bourbon market some, being from the Commonwealth of Kentucky.

I yield, Mr. Chairman.

Senator Moss. Thank you.

Thank you, Mr. Kunkler and Mr. Schmadel.

We do appreciate your coming and you have presented real situations to us and that make our record more understandable as we deal with this problem.

[The material referred to follows:]

MIDWEST BEVERAGE OF PINE BLUFF, INC.,
Pine Bluff, Ark., April 9, 1976.

Hon. FRANK E. MOSS,
U.S. Senate,
Washington, D.C.

SIR: In regard to my statement given in support of the Fairness in Franchising Act, S. 2335, I am enclosing the letter sent to Mr. Tom Massie,

Federal Trade Commission, dated February 1, 1976, with all enclosures pertaining to this letter.

In addition I would like to note the latest comments received from the fourth attorney consulted, and I quote from his letter to me, dated March 29, 1976:

"I think that you might possibly have grounds for an antitrust suit or a violation of the Robinson-Patman Act, but that would not get you immediately back into business, although you might be able to recover a substantial amount of money. As I indicated to you, unfortunately we could not take such a case on a contingency basis. I am returning to you all of the material that you previously sent to me."

Thanking you for your consideration, I remain

Most respectfully yours,

CHARLES R. KUNKLER,
President.

Enclosure.

MIDWEST BEVERAGE OF PINE BLUFF, INC.,
Pine Bluff, Ark., March 31, 1976.

Hon. WARREN MAGNUSON,
U.S. Senate,
Washington, D.C.

SIR: There are vital issues that your committee must consider in the hearings concerning S. 2335.

For your information, I am presenting to you our experience encountered due to the action of Miller Brewing Company in refusing orders from Midwest, since our last shipment was received November 18, 1975.

The refusal or orders by Miller has placed this corporation in jeopardy, as $128,000 dollars had been invested, or committed the past three years. Over $32,000 dollars had been committed directly to further the sales of Miller's in the past 20 months, as all requests made by Miller's representatives had been completed and put into effect. In addition to our expenitures above, an approximate loss of $87,000 dollars, gross sales profits, can be added to the burdens imposed upon us, due to unlawful and malicious action of Miller's in discrimination of shipments.

The mental problems that confronted me with my employees, as to why we were not shipped Miller's products as ordered, made it very difficult to maintain normal operating procedures. Almost daily, my personnel were put into a position of complete frustration in trying to explain to our customers that we were doing our best to maintain a supply of Miller's product. The criticism leveled directly at my personnel has been extreme, and in many cases profane, due to the lack of product, particularly "Lite," as Miller's national $17 million dollar advertising campaign covered this market with the message, "If you have the time, we have the beer." They failed to tell our 400 retail accounts, that they had shipped only 126 cases of "Lite" to us during 1975!

One of the reasons for Miller's action is the fact that the present active management of the wholesale company, placed in business as a dual distributor with Midwest in August 1975, is a close personal friend, a former coworker, of the Miller Regional Manager, responsible for contriving a plan to place Midwest in jeopardy. Flagrant violations were carried out by those concerned due to the fact, that they feel they are above all laws, due to the financial strength of their companies, specifically Phillip Morris, the giant parent of Miller's.

In spite of all the acts of conspiracy, in the remarkable concurrence of events, that were continually imposed upon us to exhaust our finances, physical and mental strength, Midwest still showed an increase in sales far above the national average of Miller's. An increase of 115% was obtained in 1974, over 1973 sales. An increase of 59% was achieved in 1975, over 1974 sales. These increases were accomplished under the most difficult conditions existing in these United States.

One of our national leaders has stated previously, "The test of government is now how popular it is with the powerful and privileged few, but how honestly and fairly it deals with the many who depend on it."

The past six months, I have relied completely on the above, and have brought to the attention of all concerned, the flagrant violation that have been carried out against my corporation, its personnel, and myself.

Your interests and concern into these matters, are vital to all who still have faith that this is, "One Nation, Under God."

Most respectfully yours,

CHARLES R. KUNKLER,
President.

MIDWEST BEVERAGE OF PINE BLUFF, INC.,
Pine Bluff, Ark., February 1, 1976.

Mr. TOM MASSIE,
Federal Trade Commission,
Chicago, Ill.

DEAR MR. MASSIE: I am submitting to you evidence that I feel you may be interested in, concerning the use by Miller Brewing Company of their agreement, dated November 11, 1970, with Midwest Beverage.

You will note that this agreement was made with Mr. H. A. Higgs, President of Midwest, who on August 13, 1970, purchased the beer business operated formerly by Braswell Brothers. Note copy enclosed, marked FTC "A."

I wish to call to your attention to the fact that Mr. Higgs sold Midwest to Paul Dean, Jr. in 1972, Mr. Dean then sold to the writer in 1973. This is noted per enclosed copy marked FTC "B."

Mr. Dean had formerly expressed his concern to sell to all breweries representatives calling on him, due to the many problems confronting Midwest and the operating losses of the company. Except for myself, no other parties, no persons, expressed interests, and had an agreement not been worked out between Dean and myself, all brands handled by Midwest would have been without means to service retail accounts properly. Thus, all concerned breweries were receptive to our market plans, based on operating the market with two full time route trucks. All were aware that our plans called for market improvements as finances made these improvements more secure.

To the knowledge of all concerned, the writer had endured extreme personal problems concerning his family. It is in my opinion this fact, that a plan, conceived by Miller's representatives involved, came into action with the belief that I would not be able to cope with additional problems, insuring a simple change in the existing franchises of Midwest Beverage.

On January 24, 1975, the enclosed letter, marked FTC "C," was mailed to Midwest Beverage, Attention: Mr. H. A. Higgs, President. This letter is signed by the Executive Vice President, and also the Secretary of Miller Brewing Company, and is an intentional act used in a manner to misrepresent the material fact with the intent to induce Midwest to rely on it and to surrender their legal rights and property for reasons listed:

1. The agreement is dated November 11, 1970. It was executed due to the fact that the former Miller's distributor sold his business to Mr. H. A. Higgs.
2. Miller's management recognized and were aware of the fact that Mr. Higgs sold the business to Mr. Paul Dean, Jr., who then sold to the writer.
3. Miller's management is also aware that all their wholesalers must operate under the Federal Alcohol Administration Act, Department of the Treasury—Bureau of Alcohol, Tobacco and Firearms, Wholesaler's Basic Permit, which states "This permit is not transferable. Any change in name, address, ownership, management, or control of business covered by this permit must be reported to the Regional Director, Bureau of Alcohol, Tobacco and Firearms without delay." The permit further states that it is conditioned on compliance with the laws of all States in which you engage in business.
4. Miller's management is aware that by law, their records must show correct ownership and licenses.
5. Miller's management is aware that the State of Arkansas, Permit #W-176A, clearly shows the Permittee as Charles Roscoe Kunkler. This permit also states that it is not transferable.
6. Since all breweries do have a right to restrict the sale price on distributor franchises, Miller's were aware that Mr. Dean purchased Midwest from Mr. Higgs for an amount over $75,000.00, on a loan from his uncle, Jerome "Dizzy" Dean.

From the very beginning of our active management, Miller's District Managers have expressed their agreement in the manner we were oprating in order to obtain a greater share of the market. No criticism was ever given to this writer as far as market improvement in daily operation by either of the two persons who called on us. The two concerned, Calvin Croom and Marvin Winston, were aware that our plans called for the very best operation possible in order to have sound and ethical marketing efforts with a conscientious regard for customer service. They both realized that the most important need was product. Mr. Winston seemed to be always enthused due to the fact that we still had over 100% sales increase in 1974, and over 50% in 1975. If our shipments had not been so restricted during the critical months between June and October, 1975, there is no question that we would had obtained another 100% sales increase. This restriction was due directly to the action of Michael T. Walker, Miller's Regional Manager, who told the writer when I visited with him in August 1974, that he had no control over shipments to Midwest that we ordered through their distributor in Texarkana, Arkansas, per instructions given originally by District Manager Calvin Croom. However, when he was contacted directly by us in February, 1975, on the fact that we had received only 126 cases of Lite, he stated that he could care less, and would do his best to see that we didn't receive any additional shipment of Lite.

The records indicates that Mr. Walker initiated the plan to terminate the Miller's agreement by first documenting market deficiencies. This is the reason for George Suesser's letter of August 2, 1974. Please note enclosures marked FTC "D." Inasmuch as no other criticism was made following this initial letter, Mr. Walker then personally made a visit to Pine Bluff, with Mr. Winston, which is noted per his letter of January 15, 1975. See enclosures marked FTC "E."

The letter by Mr. M. T. Walker, dated January 15, 1975, addressed to Midwest, attention Charles R. Kunkler, is the first use of the Miller agreement involved as a direct threat. His personal attitude to my employees carried out his expression as he stated to my sales manager that no matter what we did, he would personally see that Miller's would be taken from Midwest. This was stated by him, after he asked our office secretary to leave, suggesting that she do some Christmas shopping.

I wish to call your attention enclosure marked FTC "F." This action documented our plans for 1975, and shows clearly that little could be requested of us as far as market efficiency is concerned. At this point, approximately $25,000 additional had been invested by Midwest to upgrade our operation. It was after these plans were submitted to Mr. Walker that plans were made to use the Miller's agreement issued to Mr. H. A. Higgs. During the next few months, phone calls were received by the writer and his personnel from Texas, Louisiana, and various points in Arkansas, stating that they heard we were selling our business and expressing a desire to talk to us. All, were told politely that we had no interests in selling, certainly not after working the past years with the effort and expenditures we had made.

These calls were made as an entrapment. You are aware that the Federal Courts have ruled that breweries have a right to restrict the sale price of one of its distributor franchises to the reasonable value. It is due to this reason, that Mr. Walker restricted shipments to Midwest particularly during the peak selling months, as every distributor knows that these months are your most critical ones in order to obtain a fair net profit.

The continued harassment of this corporation and its personnel is beyond description. The remarkable concurrence of events that besieged us were not by mere chance, an investigation by those concerned will certainly prove these events to be deliberate. Please note enclosure FTC "G."

It is apparent that those concerned, violated the laws with the full knowledge that financially we could not afford the long legal battles to have the Court enjoin them from terminating the Miller's agreement. In this regard, they are right for unless the court does issue a temporary injunction, this corporation can not survive.

There is far more at stake than our survival, and that is the understanding that this country is still a government "Of the people, by the people and for the people."

It is our hope that some action will be taken as quickly as possible by those concerned, so that a normal operating routine can be assured Midwest Beverage.

In this course, complete cooperation by all our personnel will be given to those interested.

Yours very truly,

CHARLES R. KUNKLER,
President.

TC "A"

MILLER
BREWING
COMPANY
INCORPORATED

MEADOWS BUILDING SUITE 284 5005 GREENVILLE AVENUE DALLAS, TEXAS 75206
TELEPHONE 363-9315 AREA 214

October 9, 1970

Midwest Beverage of Pine Bluff, Inc.
P. O. Box 6057
Pine Bluff, Arkansas 71601

Attention Mr. H. A. Higgs

Dear Mr. Higgs:

It is noted in your August 13, 1970 Sale and Purchase Agreement with Braswell Brothers that Miller is listed as an asset of the business and we wish to advise that distributors have no right to sell or assign their rights and obligations under their "Distributor Application" as accepted by Miller.

?) INTENTIONAL SREPRESENTATION : A FACT, WITH 6 INTENT TO INDUCE)U TO RELY ON THIS SENTENCE. (FRAUD!)

You cannot purchase a Miller Franchise. Distributor appointment is the sole prerogative of our Executive Officers. There are no exceptions to this rule.

In conjunction with voluntary termination by Braswell Brothers, we have screened the market and recommendation is being initiated by this office for appointment of Midwest Beverage of Pine Bluff Inc., contingent upon issuance of Wholesalers Basic Permit.

Please advise our Arkansas State Manager R. J. Spinosa when this requisite is received along with number and date issued.

ARK-P-2623
W-176A

Sincerely,

Bruce I. Ostermick
Regional Manager

BIO:vc
cc: R. J. Spinosa

The Champagne of Bottle Beer

FTC "B"

MILLER
BREWING
COMPANY

Phillip Morris
completed transaction
latter part of '72

MILWAUKEE, WISCONSIN 53201, U.S.A. • AREA CODE 414 • TELEPHONE 931-2000

March 19, 1974

FILE

Signed & Returned 3/22/74 CRK

Midwest Beverage of Pine Bluff, Inc.
P. O. Box 6057
Pine Bluff, Arkansas 71601

Attention: Mr. Charles R. Kunkler

Dear Mr. Kunkler:

Enclosed are three copies of Distributor Data Sheet which adjusts our records in connection with the change of ownership of your company.

We would appreciate it if you and Ronnie K. Clark would sign each copy on Page 10 and return them to us in the self-addressed stamped envelope enclosed for your convenience. Please do not date the document. It will be dated after approval by the Miller officers.

Thank you for your cooperation.

Very truly yours,

George Sempos tb

George Sempos
Distributor Services Coordinator

GS/tb

Enc.

The Champagne of Beers®

LTR SENT FOR PURPOSE OF HARRASSMENT - BRING FULLINING MONTHS, PHONE CALLS RECD FROM LA, TEX, OKLO, ARK ABOUT "OUR SELLING"!

FTC "C"

MILLER
BREWING
COMPANY

MILWAUKEE, WISCONSIN 53201, U.S.A. • AREA CODE 414 • TELEPHONE 931-2000

January 24, 1975

Midwest Beverage of Pine Bluff, Inc.
P.O. Box 6057
Pine Bluff, Arkansas 71601

Attention: Mr. H. A. Higgs
President

MR HIGGS SOLD TO DEAN IN 1972, DEAN SELLING TO CRK IN 1973, WITH FULL KNOWLEDGE BY MILLER. LTR OF MAR 19-74 SHOWS CHANGE IN OWNERSHIP.

Gentlemen:

In the last three years we have notified you on several occasions of certain deficiencies in your operation. In 1973 you were rated "Fair" as a Miller distributor and in 1974 you were rated "Unsatisfactory." In both 1973 and 1974 you were advised of the specific reasons for these ratings.

Under the circumstances we regretfully advise that, pursuant to the terms of paragraph 1(b) of our agreement dated November 11, 1970, we are electing not to renew such agreement, and, therefore, it will expire on November 10, 1975. However, Miller reserves the right to invoke its termination rights under paragraph 1(d) at an earlier date should it so desire due to circumstances that may arise between now and November 10, 1975.

NOW? REQUESTS MILLERS SIMPLIED WITH, AS KT PLANS TO WALKER SHOWS.

CRITICISM BY D.M. HAS EVER BEEN MADE.

ON "RATING" DIST MGR STATED THEY HAD TO SHOW AS SUCH, BUT BOTH REALIZED THAT LACK OF BEER WAS DUE TO MILLERS INABILITY TO SHIP FOR REASONS OF SALES DEMANDS GREATER THAN PRODUCTION. (CALVIN CROCH MARVIN WINSTON)

Very truly yours,

MILLER BREWING COMPANY

by [signature]
Executive Vice President

[signature]
Secretary

(WAIT FOR FURTHER ACTION! DO NOT ATTEMPT ANY ACTION THAT COULD BE TERMED "DETRIMENTAL" TO THE SALE OF MILLER, SUPPLY WITH REQUESTS, MAR D.M. ON EACH VISIT ON HIS SUGGESTIONS TO UPGRADE MKT OPERATION)

Via Certified Mail
Return Receipt Requested

The Champagne of Beers®

FTC "E"

MILLER
BREWING
COMPANY

SUITE 508 6060 N. CENTRAL EXPRESSWAY DALLAS, TEXAS 75206
TELEPHONE 363-9315 AREA 214

January 15, 1975

Midwest Beverage of Pine Bluff, Inc.
P. O. Box 6057
Pine Bluff, Arkansas 71601

ATTENTION: Charles R. Kunkler

Dear Mr. Kunkler:

I met with your Manager, Mr. Clark, on December 17, 1974, in Pine Bluff to discuss the deficiencies still existing in your operation. Present at the meeting was Area Manager, Marvin Winston.

During the meeting we discussed the following points:

1. INVENTORY: At the time of our meeting there was less than one weeks inventory. Mr. Clark stated that he received one truck a week and that had to suffice until a load was received the following week. This causes constant out-of-stock condition of various packages. MILLERS UNABLE TO FILL ORDERS CAUSES OUT-OF-STOCK CONDITIONS.
2. SERVICE: According to your Manager, all accounts are not serviced weekly.
3. DISTRIBUTION: Distribution is still poor, with an overall distribution of 65 percent.

'74 DEC Sales 6577
'73 " " 2311
25% '75 (70% '74)
17th A.M. 1618 Cu
18th A.M. 2622 Cu - (Beer Red) (40%) (113%) '74

P.O. Serviced 2 times weekly, except for small volume, which are weekly - Mag M are contacted 2/3 times weekly.
Stuttgart - once weekly
Cabin - twice weekly
All others - weekly except Chicot Country (250 Mi Route) every other week.

The Champagne of Beers®

Mr. Charles R. Kunkler
Page Two

4. NON BUYERS: Not called on regularly because of lack of manpower.

5. NO DRAFT BUSINESS: Not handled at present.

6. ABSENTEE OWNER: Owner not active in market.

7. KARDEX: Posted but apparently contains only accounts presently buying.

8. MAJOR ACCOUNTS IN PINE BLUFF: Two (2) Safeways not called on.

In view of the continuing problems still existing in this market, I am recommending to the Miller Brewing Company, Management that we do not renew your five (5) year distributor agreement which expires November 11, 1975.

Very truly yours,

M. T. Walker
Regional Manager

MTW/js

cc: L. M. Naveaux
E. Frantl
W. H. Dunn
G. Suesser
M. Winston

NEVER REQUESTED!

APPROX 40/50 ACCTS HAVE BEEN ADDED

2 FULL TIME R.S.
1 PART TIME (P.B.)
1 BLACK HELPER
1 SALES MGR

HAVE VERY LIMITED POTENTIAL - HAVE DEFINITELY HAVE STRIKED OUR DESIRED TO HANDLE BRAND

RON CLARK SECY/TREAS STOCKHOLDER - WORKS FULL TIME CHAS KUNKLER WORKS 12-15 DAYS MONTH HERE.

UNSOLD ACCTS LIST
SELECT ACCT LIST

BOTH DISCONTINUED NOT ONLY MILLER, BUT FALSTAFF & CC DUE TO CALL OF TOP - PLACED MILLER IN IMMEDIATELY ON T&T CONTRACT AUTHORIZATION.

M.W. IS AWARE THAT DUE TO FINANCIAL CONDITION THAT CRK HAS WORKED IN TOPEKA IN ORDER NOT TO PUT FURTHER FINANCIAL STRAIN ON MIDWEST BEV. HAD DISCUSSED COMING HERE FULL TIME IN '74, IF WE HAD ANY ASSURANCE THAT BEER WOULD BE AVAILABLE.

PERMIT NO. W-176A

STATE OF ARKANSAS
DEPARTMENT OF FINANCE AND ADMINISTRATION
ALCOHOLIC BEVERAGE CONTROL DIVISION
LITTLE ROCK, ARKANSAS

$250.00

WHOLESALE BEER

PERMITTEE

Name		Trade Name
CHARLES ROSCOE KUNKLER		MIDWEST BEVERAGE OF PINE BLUFF, INC.
Pine Bluff	311 State Street	Jefferson
City	Street	County

This Permit shall not be deemed a property or vested right, is NOT transferable or assignable, and may be revoked at any time pursuant to law. This Permit shall remain valid until suspended, cancelled or revoked so long as the Annual Permit Fee shall be paid as required by law.

STATEWIDE	July 1, 1975	June 30, 1976
Counties Covered	Date Issued	Expires
Counties Covered	Administrator	

Karen Jones
ACTING ADMINISTRATOR

58

THIS PERMIT MUST BE DISPLAYED IN A CONSPICUOUS PLACE

71302—11-8—A54812—9-24-74—100

Department of the Treasury - Bureau of Alcohol, Tobacco and Firearms

Wholesaler's Basic Permit

(Under The Federal Alcohol Administration Act)

1. PERMIT NUMBER: ARK-P-2623

2. DATE OF PERMIT: February 7, 1974

DATE OF APPLICATION: December 17, 1973

4. PERMIT GRANTED FOR PURCHASING FOR RESALE AT WHOLESALE THE FOLLOWING: Malt Beverages

NAME AND ADDRESS OF PERMITTEE *(Number and street, city or town, State, ZIP Code)*

Midwest Beverage of Pine Bluff, Inc.
311 State Street
Pine Bluff, Arkansas 71601

Pursuant to application of date indicated in item 3, you are hereby authorized and permitted to engage, at the above address, in the business of purchasing for resale at wholesale the alcoholic beverages indicated in item 4, and, while so engaged, to sell, offer and deliver for sale, contract to sell and ship, in interstate and foreign commerce, the alcoholic beverages so purchased.

This permit is conditioned on compliance by you with sections 5 and 6 of the Federal Alcohol Administration Act and all other provisions thereof; the Twenty-first Amendment and laws relating to the enforcement thereof; all laws of the United States relating to distilled spirits, wine, and beer, including taxes with respect thereto; the Federal Water Pollution Control Act; all applicable regulations made pursuant to law which are now, or may hereafter be, in force; and the laws of all States in which you engage in business.

This basic permit is effective from the date hereof and will remain in force until suspended, revoked, annulled, voluntarily surrendered, or automatically terminated, as provided by law and regulations.

This permit is not transferable. Any change in name, address, ownership, management, or control of business covered by this permit must be reported to the Regional Director, Bureau of Alcohol, Tobacco and Firearms without delay.

THIS IS AN [X] ORIGINAL [ ] AMENDED PERMIT.

REASON FOR AMENDMENT

DATE OF AMENDMENT

SIGNATURE OF REGIONAL DIRECTOR, BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Billy L. Gaunt by Earl P. Brainard

ATF Form 1633 (Rev. 8-72) *Dispose of all prior issues*

"G"

MIDWEST BEVERAGE OF PINE BLUFF, INC.

PINE BLUFF, ARKANSAS 71601

P. O. BOX 6057

TELEPHONE
535-0445

NOTES CONCERNING UNUSUAL EVENTS:

An invoice sent by Miller's to the State of Arkansas, showing that a rail car of beer was shipped to Midwest which took us 7 to 8 months to get Miller's to correct their invoice, showing we did not get this car.

A "supposed" notification by the state that our tax bond should be increased from $5,000 to $10,000, was made to the insurance company handling our bond. As a result our bond was cancelled, making necessary the withdrawing of $5,000 from our bank cash for a Certificate of Deposit, to cover our tax bond. The Revenue Dept stated to us, that there was never any notice to the insurance company that our bond had to be increased.?

The conversation the Geo. Suesser, M.T. Walker and T & T Dist had with the Pine Bluff National Bank official, shortly after our application for a loan to cover the expense of a car shipped to Midwest. The bank official was notified that we no longer would be the Miller distributor after Nov 10th, as our agreement expired. Mr. Suesser and Townsend personally talked to the bank loan officer, Mr. Townsend introducing himself as the new Miller distributor, and making application for opening an account. He had already been doing business for over a month elsewhere. Our loan request for $12,500 to cover the car was turned down, and only $4500 could be borrowed.

Final shipments in period covering Sept 23 to Oct 23, of 9264 cases of 7 ounce, costing approx $59,000, before bottles and can (12 ounces), were shipped, the cost here amounting to approx $20,000. We were out of the 12 ounce packages for almost six weeks, with T & T receiving them instead of Midwest..

The five month period between Dec 74 thru April, shows Midwest receiving 7.4% of the state total on Millers. The five month period between May 75 and Sep 75, shows Midwest receiving 5.0%.. The 2.4% difference represents 20,220 cases. With the appointment of T & T in Pine Bluff, shipments for Sep and Oct 75, shows Pine Bluff receiving 11.9% of the states total.

NOTES - MIDWEST BEVERAGE OF PINE BLUFF, INC.

CANCELLATIONS OF SHIPMENT REQUESTS 1975

MAY - 5 trucks from JJS
JUNE - 5 trucks from JJS, 1 rail car from Miller
JULY - 8 trucks from JJS, 2 rail cars from Miller
AUG - 7 trucks from JJS, 1 rail car from Miller
SEPT - 7 trucks from JJS, 2 rail cars from Miller
OCT - 4 trucks from JJS 1 rail car from Miller
NOV - 7 trucks from JJS 1 rail car from Miller

DAYS OUT OF PRODUCT FROM JUNE THROUGH OCTOBER 1975

MONTH	QUARTS	PONIES	4/6 12 RR	4/6 12 TR	4/6 16 TR
June	12	5	5	0	21
July	12	0	20	20	24
Aug	16	0	0	0	24
Sep	16	0	5	17	23
Oct	6	0	21	21	21

Below listed is analysis on beer shipments to JJS Dist, Texarkana, and the percentage sold by JJS to Midwest. This in accordance with instructions from Miller's representative in ordering beer through JJS, in order to get truck shipments to Pine Bluff, due to lack of commercial services.

MONTH	% 7 ounce	% 12 ounce	MONTH	% 7 ounce	% 12 ounce
Jan	71	36.5	June	63.7	33.7
Feb	47	21.5	July	28.2	0
Mar	71	39	Aug	30.2	18.9
Apr	94.5	38.5	Sept	33.8	.8
May	41.5	24.1	Oct	66	31.4 (*)

*Note Before 12 ounce bottles and cans were received, 9264 cases of 7 ounce were shipped from Sep 23 to Oct 23, approximately $59,000.00.

MIDWEST BEVERAGE OF PINE BLUFF, INC.

P. O. BOX 6057
PINE BLUFF, ARKANSAS 71601
TELEPHONE
535-0445

Miller Beer Orders Placed w/JJS and Received:

	Quarts	4/7 oz.	F-6 R.R.	4/6 12 Tray	4/6 16 Tray	Total Cases
Jun Ord	378	6336	3136	3640	210	13,700
Rcd	294	4224	784	910	70	6,282
Jul Ord	336	6528	3136	3458	140	13,598
Rcd	0	2304	0	0	0	2,304
Aug Ord	336	6528	3136	3458	140	13,598
Rcd	84	2208	784	910	0	3,986
Sep Ord	336	5376	3024	3458	280	12,474
Rcd	84	2112	112	0	0	2,308
Oct Ord	336	5367	3024	3458	280	12,474
Rcd	168	4224	840	455	280	5,967
Nov Ord	336	4224	3136	3276	280	11,252
Rcd	168	960	0	0	0	1,128
Dec Ord	None placed due to inventory and T&T sales					
	1260	18336	16072	18473	980	55,121

Total cases ordered and not received thru JJS June 1, thru Nov 30.

Due to remarks from M.T. Walker, that we should order Miller's by rail cars in a conversation about our shortages of shipments during 1974, the following cars were ordered for months indicated.

June - 2 Ord, 1 Rc'd	Sept - 3 Ord, 1 Rc'd
July - 4 Ord, 2 Rc'd	Oct - 3 Ord, 2 Rc'd
Aug - 4 Ord, 3 Rc'd	Nov - 2 Ord, 1 Rc'd

A total of 8 rail cars ordered, were not received.

Total cases ordered from June 1, 1975 thru November 30, 1975, amounted to 128,434 cases, not including "Lite", which Mr. Walker told Ronnie Clark that he would do his best to see that we never received any.

Of the amount of beer ordered, 51,662 cases were received, 76,772 cases were not shipped.

MIDWEST BEVERAGE'S NOTES

" Remarks and Conversation"

Nov 12 - 74 Ronnie Jarrett, SLT Representative, commented to Betty Pierce, Midwest's Office Sec'y, that when he was at Burford Dist in Ft. Smith, he heard that miller's might take their brands away from Midwest. She told him she didn't think there was anything to that. (Note signed by Betty Pierce, 11/12/74)

Jan - 75 Marvin Winston, miller's District Manager, used office phone to call Little Rock for dinner reservations, concerning the "Lite" campaign. All Miller's distributors in Arkansas were notified however Midwest was excluded from meeting. No reason given by miller's.

Feb 15 - 75 Ronnie Clark called M. T. Walker, Miller's Regional Manager, discussed the fact that our orders for "Lite" were not being shipped. Mr. Walker stated that he didn't care.

Feb 17 - 75 Ronnie Clark discussed with Marvin Winston, miller's District Manager, about the "Lite" shipping problem. Mr. Winston stated to Ronnie, he didn't know anything about it.

April 7 - 75 Don O'Quinn, Falstaff Sales Mgr., called asking Ronnie Clark if miller's had taken their brand away from us. Mr. Clark told him no, not to his knowledge. Mr O'Quinn asked Ronnie to let him know if he heard any more about it.

Apr 15 - 75 Ken Clark, Falstaff Dist Mgr, asked Ronnie about the miller's "deal", stating he had heard the rumor in New Orleans that Midwest would lose, or had lost Miller's.

Sep 8 - 75 Bill Baumgardt, miller Brewing Company, called stating we owed for two truck loads of miller's, that he couldn't release until they received payment.

Sep 9 - 75 Mr. Clark called "JJS", talked to Bob Pickett, and found that the two loads of beer being shipped to Pine Bluff, were in Midwest's name, but were being shipped to P & T Dist. Midwest at this time were out of 12 oz cans and had only a few days supply of 12 oz bottles. We did not receive any until Oct 27th.

Sep 7 - 75 Dan Fyre called Mr. Clark at 8:30 p.m., giving him a week's notice that he would quit in order to take a job offered him from T & T Dist.

Sep 22 - 75 T & T Dist started taking orders by phone ahead of Midwest Beverage, contacting the below listed:
Clowers Liq - accepted orders for 7 oz from T & T
Jessie's Liq - accepted orders for 12 oz bottles and cans from T & T, bought 7 oz from Midwest.
Taylor's Liq - refused order for 7 oz., but bought 12 oz bottles and cans from T & T.
Knick's Liq - bought 7 oz from Midwest, 12 oz bottles and cans from T & T.
Dottie's Liq - bought 7 oz from T & T

Sep 26 -75 Lloyd Meistler, Midwest's routesalesman, was informed by the owner of Tom's Grocery, that they had been serviced by T & T, and was give the impression that we were no longer the Miller's Distributor.

Sep 29 - 75 T & T sold Miller's "Lite", and the regular Miller's 12 oz bottle and cans to Safeway, who notified our driver that we (Midwest) were no longer authorized to sell Miller's to Safeway's Stores. Both Safeway Stores who had discontinued handling brands sold by Midwest, due to out-of-stock conditions that existed with the Miller's products, immediately placed Miller's back in stock from T & T.

Sep 29 -75 Pat Henry, Pabst Dist Mgr., was informed by T & T that they would not sell any bottles, cans, or 7 oz ponies, until after November 10th. Acme Liquor were told this day by T & T, that they had bought Midwest Beverage.

Sep 29 - 75 Dumas' retailers were serviced by T & T, most bought 7 oz ponies. Paul Paschall, of the Head Butcher's, stated that Dan Fyre told him T & T had bought Midwest Beverage.

Buck's Liq showed Mr. Clark an invoice # 1036, dated 9/24/75, where he purchased 20 cases of 7 oz ponies, and 15 cases of Miller's Lite.

STATEMENT FROM CHARLES R. KUNKLER,
ON M. T. WALKER'S LETTER DATED JANUARY 15, 1975.

1st Paragraph—Statement that deficiencies still existed. On every market call made by a Miller's representative, our personnel always asked them if there was anything we could do to improve our operation. No suggestion, or criticism was ever made, and I personally talked to Mr. Winston, and he felt things were moving great!

Item 1. Inventory: Statement that less than one week inventory was on hand is untrue, as verified by daily inventory and physical count. 1618 cases were on hand the day of the 17th, which was 25% sales for the month, 70% of Dec '73 sales. A shipment received the following day gave us a 40% total for Dec '75 sales, and 113% total in comparison to Dec '73 sales. Further, state shipments shows that we received, or ordered more Miller's, than seven other Miller's distributors in the state. The statement that our ordering causes constant out-of-stock conditions on various packages is almost too flagrant a lie to comment further, except to note analysis of "Days Out of Product."

Item 2. Service: This statement is made only to justify some cause. Mr. Walker was aware that the only accounts not called on weekly, were those accounts in the Chicot County marketing area, a route in excess of 250 miles, and not necessary to cover weekly, particularly in the winter months.

Item 3. Distribution: Considering the poor allocation of Millers to Midwest, our distribution has to be good. The only obstacle to obtaining greater distribution was the lack of product from Miller's.

Item 4. Non Buyers: A statement completely untrue. Mr. Winston and Mr. Walker were certainly aware that we had added almost 50 new accounts, with the availability of product in late fall. The shortage of beer was so severe, that it would have been useless to try to open new accounts during the summer months.

Item 5. No Draft Business: We had stated that we would handle, if and when available. Mr. Winston had never requested to the writer that draft beer be handled, knowing the production problem existing at Miller's.

Item 6. Absentee Owner: This statement is completely and totally untrue. Mr. Walker and Mr. Winston both knew that Ronnie Clark had an interest in the company, and was active full time. Charles Kunkler spends the time necessary for management functions, as any qualified person would verify. M. T. Walker was fully aware that due to our financial condition that the writer did work in Topeka, Kansas, in order not to put further financial strain on Midwest. I had discussed coming here full time in the early part of '74, if we could have received any assurance that beer would be available. This assurance Mr. Walker states he could not give!

Item 7. Kardex: Clearly a statement to mislead. No mention was made that an up-to-date list showing "unsold accounts," as well as "selected accounts" was used. Also that route books were in use, and up-to-date.

Item 8. Major Accounts in Pine Bluff: The reference that two Safeway Stores were not being called on, is somewhat of a shock! Both of these stores discontinued Miller's because of lack of product during the peak summer months, they also discontinued handling the other brands we carried, Falstaff, Pabst and Country Club. Frequent calls were made on both managers in order to place our products back into their respective stores.

Mr. Walker's statement that Miller's not renew the distributor agreement, shows clearly the reason for all problems existing in this market. His own statement to Ronnie Clark, that "He didn't give a damn if we were out of beer, and that he would do everything he could to see that Millers would be taken from us."

The letter by Mr. Walker is one of clear deceit, written only to harass Midwest Beverage in his attempt to force the sale of Midwest.

MIDWEST BEVERAGE OF PINE BLUFF, INC.
MARKET PLANS—1975

FLEET EQUIPMENT

A 10½ bay GMC, identified MHL, is to be delivered in March or April, 1975, by France Betten, Inc. This will be the second truck purchased from

France Betten, both identified "MHL." The purchase of these two trucks gives Midwest a satisfactory fleet.

OFFICE

The office is staffed from 8:30 a.m., till 5:00 p.m., by secretarial help. In addition we will continue to open on Saturday mornings, from 8:00 a.m. till 12:00 noon. This will give more opportunity to the black retail accounts to purchase beer for their Saturday business.

ADVERTISING

An advertising budget will be prepared to promote Miller's products throughout our marketing area. A recommendation will be made to Miller for co-op advertising with them to also cover the Lake Village-Eudora area. Radio spots will be given first consideration in order to emphasize the Miller's Reclamation Program.

DISTRIBUTION AND SALES

To gain more advantage from route books, names and addresses of key personnel will be listed, with their birthdays, so the route salesman can personally send cards to those concerned.

Rotation will continue to be stressed by management personnel. Route salesmen are to use their best efforts in keeping MHL rotated in retail accounts.

An incentive on new accounts will be continued through 1975. This will be for unsold accounts and additional new package placements.

To ensure the best efforts of all concerned, to maintain and improve the distribution and market penetration, in order for Midwest Beverage to obtain maximum sales on MHL, an additional incentive will be given to sales personnel in their obtaining monthly sales goals on all MHL packages.

Our policy, has been in the past, and will continue to be one, in which full co-operation is given to all brewery personnel and family brand distributors.

MILLER BREWING COMPANY,
Dallas, Tex., August 2, 1974.

MR. CHARLES KUNKLER,
Lawrence, Kans.

DEAR MR. KUNKLER: This is to confirm our meeting of July 31, 1974 with Ronnie Clark, Marvin Winston and the writer.

I am requesting an immediate plan of action regarding our discussion which is briefly mentioned below:

1. Since Miller has become the dominate brand in your operation and no Miller identified vehicles are delivering product, it is necessary to upgrade your fleet and identify your trucks with MHL.

2. Your Kardex file is deplorable and useless to determine active accounts and cases sold—this is a priority and should be instituted immediately.

3. It is a Miller Brewing Company policy to report your Sales and Inventory and Chain Report no later than the fifth working day following the month. This must be done.

4. Rotation Calendar was not in use—apparently because the week of May 26th had not been removed and this is a necessary part of Miller's Quality Awareness.

5. The reclamation sign and operation of a center is not in effect and February, 1974 was the starting date. The sign is still leaning against the fence inside of the warehouse and is doing nothing to serve this function.

6. P.O.S. materials stored above the office in flashing neons are still in wooden crates and are gathering dust—these must be strategically placed.

7. Distribution is atrocious with approximately 265 accounts, only 225 are being served. The Safeway stores of which Miller is in 2 of 4 must be served. I am instructing Mr. Frank DeFils, MHL ethnic representative, to survey the black market within 60 days. Little Rock and Hot Springs, which are in the same cluster, has distribution of over 93%. If manpower is the problem, then an additional route must be put on.

8. Draft beer, which comprises nearly 10% of the Brewery's business, is absent from your market. Nearly 750 half barrels are sold in your market and our fair share is nil.

9. It has become very necessary to contact the distributors at all times of the day. However, from noon until 8 o'clock the following day, it is almost impossible to contact anyone in your operation. Additional personnel or a full-time office manager is necessary. This also has a bearing on section 2 and 3 of this letter.

10. A Co-op Advertising Program as well as a Merchandising Program must be instituted to further both your business and our involvement in this marketing area.

11. As you are selling a companion brand on the Pine Bluff Arsenal, it is necessary to take steps to become competitive on the base with MHL.

As you can see, there are glaring pockets of marketing that are lacking in your area. If these areas are not corrected, other means of distribution must be obtained.

I am awaiting your Action Plan to eliminate these conditions, and a re-evaluation will be made in 90 days.

Very truly yours,

GEORGE SUESSER,
Regional Sales Manager.

NOTES—MIDWEST BEVERAGE OF PINE BLUFF, INC.

Re George Suesser letter, dated August 2, 1974.

This letter was mailed to me, after a meeting between George Suesser and Marvin Winston, with Ronnie Clark, Sales Manager of Midwest Beverage.

The letter was first initial form of criticism received by Charles Kunkler, concerning the operation of Midwest Beverage. I was not notified previously of meeting between Miller's representatives and Midwest.

Of importance, previous to this meeting, no criticism on operation had ever been made to Charles Kunkler, or Ronnie Clark, in fact, all previous remarks from Miller's sales representatives had been favorable over progress shown under the critical operating conditions we had encountered, particularly due to Miller's production problems.

Due to the method used by Miller's Regional Management to "put in writing," detrimental remarks showing "cause" to later cancel the Miller's franchise agreement, we complied with all requests. I also instructed my personnel that on every market call by a Miller's representative, that they ask for further suggestions to improve our operation. This was carried out by all concerned, not one suggestion was ever received, particularly by our people from the Miller's District Manager, Marvin Winston, who seemed satisfied on each visit.

MARKET PLANS
MIDWEST BEVERAGE OF PINE BLUFF, INC.

FLEET EQUIPMENT

Presently Midwest Beverage owns four (4) route trucks. One with Miller's I.D. is not licensed due to o y (closed van) and to high repair costs. Purchase of an additional truck is necessary and requests have been made to France Betten for two (2) ten (10) bay route trucks, which will be identified "Miller High Life." First truck to be delivered in December 1974, second truck to be delivered either in March or April, 1975.

OFFICE

Kardex file is active. Also route books have been placed in use. In addition, select account lists and an unsold account list are in use.

To my knowledge the sales and inventory reports had always been mailed on time. Responsibility for this has been emphasized to all concerned.

Rotation calendar is in use. The rotation of product has been my prime concern, as well as Ronnie Clark's.

Reclamation sign has been placed and bottles and cans are ready to be returned to brewery.

P.O.S. materials are being placed, particularly in new accounts. Since availability of product, distribution is being emphasized. An incentive for new accounts opened has been made to all sales personnel. The black market is a major problem. Cooperation with all black representatives on their recommendations to increase sales and distribution will be of priority. Manpower is not now, or has been a problem. The biggest problem is basically the lack of money by the black retail accounts to buy any product that does not turn over quickly. Pabst, Falstaff and Miller's representatives have all worked market—no new accounts have been added by them.

Draft beer accounts can be solicited and arrangements can be made to install a cooler in warehouse. The draft potential is limited.

The office is staffed from 8:30 a.m. till 5:00 p.m., Monday thru Friday by secretarial help.

An advertising program has been prepared. (Was prepared last summer, but cancelled due to lack of product by brewery).

Requests have been submitted to the Arsenal for the sale of Miller High Life. A 16 ounce promotion was given to them last year, which they accepted, however no authorization was issued after the sale promotion ran out.

All of the "glaring" pockets of marketing that are mentioned as lacking has been brought about by the tremendous financial losses that Midwest Beverage had incurred during the past two years—up to April 1974. Expenses had to be held in line this year. A letter that was sent to Miller High Life, February 14, 1974, was never acted upon or replied to. This letter clearly pointed out some of the difficulties that we were experiencing.

This is duplicate of plan sent to Mr. Walker 11/11/74, and discussed with Marvin Winston.

Mr. Hilton Peaster, executive director of the Recreational Vehicle Dealers of America, will be our next witness.

We have your statement here with a number of appendices to it. The entire statement and all of the attachments will be placed in the record and we will ask you to identify your companion and proceed.

STATEMENT OF HILTON PEASTER, EXECUTIVE DIRECTOR, RECREATIONAL VEHICLE DEALERS OF AMERICA, DEERFIELD, ILL.; ACCOMPANIED BY CROSBY FORREST, CHAIRMAN, LEGISLATIVE COMMITTEE

Mr. PEASTER. This is Crosby Forrest. He is a recreation vehicle dealer located in Newport News, Va. He serves on our national board of directors and is chairman of the legislative committee.

Senator MOSS. We welcome you, sir.

Mr. PEASTER. Mr. Chairman, members of the subcommittee, this opportunity to present our statement favoring passage of S. 2335, Fairness in Franchising Act, is deeply appreciated.

We have addressed ourselves to the need for this legislation from several standpoints.

Is the corrective legislation needed?

Do present State and Federal laws and regulations offer relief, and will this particular bill serve these needs?

I would like to say since you have agreed to put in the entire statement, I am going to paraphrase it so we can move on.

Senator MOSS. You may do—paraphrase, summarize, highlight—as you see fit.

Senator FORD. The definition of that is curtail it.

Mr. PEASTER. I have heard curtail.

I was thinking that drawing a parallel between a recreation vehicle dealer—and, incidentally, that is a dealer who sells camping trailers, truck trailers, motor homes.

I was thinking or drawing a parallel between the activity level of that dealer this time of year with what the activity level will be among those running for office the latter part of this year. They are very similar.

It is the busiest part of this year.

On February 25 and 26 we mailed out nationwide a one page letter, unannounced, never told anybody it was coming.

It was the first time it happened and we asked for information so that we could present it to you here on this franchise situation.

Is it prevalent? How do you feel about it? Et cetera.

Within 10 calendar days the mail had gone out nationwide and 41 percent of it had come back. That was election night for these people. They were in the middle of shows. They are small proprietors, understaffed. They are not administratively oriented people who read their mail because they do not probably have a secretary.

This legislation was so gripping to them that they took time on, so to speak, election night and 41 percent of them immediately answered.

It is a testimonial to the Postal Service if nothing else.

Senator Moss. That is one of the good things I have heard about it.

Senator Ford. It is obvious they didn't send it in a package, though.

Mr. Peaster. We made a point of putting no special delivery stamps on it.

Of the 41 percent who responded it was overwhelmingly the fact that they said we want this bill. We said, "well, now, should we as dealers rock the boat in our industry with the manufacturers and disturb smooth—working relationships?"—because our being here today could do that very thing, and will probably subject us to less than cordial dealings perhaps in the future.

They said considering that, "Get yourself in Washington and testify on our behalf, because we cannot afford to come."

We discovered three things from the survey.

Franchise abuses are widespread.

The franchisees not only desire corrective Federal regulation and legislation, but they are highly motivated and want to permanently become involved. This is their livelihood.

I would like to maybe in two sentences or less describe that our industry will sell $3 billion worth of products this year, increasing 16 percent over last year which was a 15-percent increase over the previous year.

There are hundreds of manufacturers of recreational vehicles.

In our industry the vast majority of the franchise relationships as defined in this bill, the vast majoirty of these relationships are not written. They are not written and to a great extent they are implied.

The wording of this bill would be most applicable to our situation and a temerity of somebody saying we should confine ourselves only to the express written franchise relationship would leave the thousands upon thousands of dealers in our industry, the ones who are

responsible for selling the existing 5 million recreational vehicles in the public's hands today, without any protection.

I would like to briefly allude to some case histories and one in particular.

We have carefully chosen these so that each one might illustrate a different point.

Actually I am going to read one and I think I can eliminate quite a number of others.

Let me say as background that this dealer happens to be one of the most outstanding dealers in the United States as judged by the awards that the franchisor gives him.

He says—talking to somebody in our office. "Ken, our problems are essentially the same with all of the makes that we have handled since 1968. The manufacturer gives us a franchise with a spelled-out sales area and later they come back—it might be a year or two—and they say 'you are doing such a great job, this must be a tremendous sales area. In fact, it is so good we ought to have more dealers in your area.' "

And so they put more dealers in the sales area.

Is the first dealer saying I want to restrain competition and not have competition?

This might be a natural inclination, but it is something that is not allowed and he is not saying that.

Is he saying, "I invested based on implied understanding that if I developed this area I could at least have the chance of gaining the customer that I sought to be getting?"

Is he saying if I am the one who built up a sales area, is it right or proper that the franchisor, to his benefit, can put additional dealers in, to the detriment of the original franchisee?

That is the crux of the termination noncancellation issue. That is the crux of it.

I would like to relate to you a couple more things and then try to move on.

I have in the written testimony shown you cases where a dealer said, "no, we never received a cancellation, it was just plain violated."

We have a case where the franchisee was overstocked, the franchisor said, "You must buy more," because he had to get rid of it, the dealer said, "I can't take anymore because the sales are depressed because of the gasoline situation," the franchisor went down the street and the franchisor dumped the merchandise at a discounted price.

We have case history, names, dates, places of people who said, "You will either modify your existing agreement now in effect or we will cancel you."

The dealer said, "I will not modify it and we will stick to our original agreement."

"Then, sir, you are canceled."

I have case histories here that are unbelievable.

A franchised dealer acting in good faith takes money from a consumer on the purchase of a good product and orders the vehicle from the factory. Nothing is heard. One month passes.

He calls up the factory and says, "Where is the merchandise for the customer? The customer is getting anxious."

"Sir, your franchise has been canceled." Past tense.

These are spelled out in writing in the written statement.

I would like at this time a chance to read over my notes, to ask Crosby Forrest to indicate an experience he has had that is illustrative of the practices in the industry.

Senator Moss. We are glad to hear from you, Mr. Forrest.

Mr. FORREST. I started in business about 12 years ago. During this time we came across a product which we thought was a good product. We knew it was a good product. So I sent my sales manager to the plant to obtain this. He obtained it and came back and we started selling this product, promoted it on television, radio, wherever we could.

Sales were good and things were looking up.

I think we bought in excess of $300,000 worth of product from this manufacturer the first year.

My sales manager became disgruntled with our organization. He wanted to leave, and he left. He went with another dealer in my area.

I was called a week later and told that my franchise was canceled or that my marketing area was gone, it would be given to somebody else.

I got in my automobile, drove to the plant with my new sales manager, and talked the plant manager and sales manager into not doing this.

They agreed to give me back my marketing area and franchising area, but I was constantly subjected to coercion.

I don't know exactly the word to use. Threatened.

Nothing written or anything. Just things like if we had a particular size product on our lot that we would like to sell they would make us stock a lot of them in the season that we didn't need them. Or if they had a particular size that we didn't want, they would tell us, "Either you put it on your lot or we will go down the street and put it on somebody else's lot."

So I had no alternative but to take the product they had sent us.

We have continued our relationship with this company. It has been mutually beneficial to both of us. But I am always subjected to this coercion from the plant and plant manager.

Senator Moss. Is your franchise an oral one or is it in writing?

Mr. FORREST. I have about six or seven franchises. Five of them are just oral. There is nothing in writing.

Senator Moss. Five out of the seven are an oral agreement? Nothing in writing?

Mr. FORREST. That's correct.

Senator Moss. Is that quite usual in the recreational vehicle business?

Mr. FORREST. We are an industry that has grown fast. It is nothing to experience a 100-percent increase in sales in some areas.

Because we have grown fast I guess this part of our business has been left out.

Senator Moss. Well, we appreciate your describing your particular experience in this matter.

Since your franchise was an oral—was this one an oral one, the one you have talked about?

Mr. FORREST. That was oral.

Senator Moss. By going to the plant and talking to the manager you did get part of it straightened out although you feel you are under pressure or threat now?

Mr. Forrest. That's correct.

Mr. Peaster. Mr. Chairman, one thing that is of interest here, this particular story Mr. Forrest is relating is about a franchisor who's sales volume is the largest in our industry. That is the largest manufacturer and I am not wishing to single them out or do damage to them, but it is an illustrative case. They will not give a written franchise.

Senator Ford. He will not give a written franchise?

Mr. Peaster. No.

I know of a dealer in New Jersey whose bank said "We will not loan you the money to buy the vehicles unless we have a letter in writing acknowledging you are the dealer."

They did receive a letter stating that, yes.

Also they will not issue a written notice of cancellation.

A dealer says, "I have received a threat that I was being canceled," and I say, "Ask them to put it in writing," and the dealer says "They won't."

Let me give you a couple of examples.

One of the problems of an oral agreement is that new people come on the job and different memories have to be dealt with.

We have a case of a dealer in New York State who, because of a personality conflict, had his franchise canceled.

In Colorado a dealer who had for 12 years developed a franchise area—a dealer who—the circumstances in this instance are most unusual. But the bottom line of this horror story is—he was forced to go out of the church ministry back into private business to rescue his company. He was told his franchise laws and common law laws in Colorado are not adequate.

In Michigan we have a case where a dealer was formerly with a franchisor. He had established and awarded 1,000 franchises or more. He knew both sides of the fence and on occasion he had to cancel franchises himself because the franchisees did not live up to their end of the bargain.

Knowing what was expected and after purchasing a company store from the company who he later left, and leaving on friendly terms, he found his franchise canceled.

His franchise was canceled during a conversation over dinner one evening.

Senator Ford. Is this one attached to your statement?

Mr. Peaster. Yes, sir.

As pointed out in the statement, when he was with the franchisor he had had the opportunity of dealing with the FTC quite intensively. After he became a franchisee and felt he had been aggrieved he went back to the gentlemen at the FTC and he says, "the FTC told me if I went out of business I might have a case. I did not want to die to make a point."

I wish I could say off the record, to force a person out of business to make a point would have to be most restrictive, restraining competition.

We need a cure, not a dead body.

In the State of Washington which recently had enacted some apparently modern State franchise legislation a dealer went to court whereupon the Judge says, "This law does not apply to you. You have been aggrieved but, I am sorry, we cannnot help."

His statement is in here in full.

We have a dealer in New Jersey. That State is supposed to have a modern franchising law. No help.

His legal counsel said, "I know the agreement has been broken, but I cannot find that I can do anything," literally.

Senator Moss. You favor, then, Federal law rather than leaving it to the States?

Mr. PEASTER. I do for two reasons.

Quite frankly, the ability of our association and the franchisees to testify effectively in 50 State capitals is not as great as it could be.

The State laws upon which we depend will end up not being protection.

I would request Federal legislation for one additional reason, and here I will take the interests of the broader industry scope, including the franchisor.

If I was, for a moment by way of illustration, the national sales manager of a corporation, if I had to be aware of and knowledgeable of and in comformance with 50 different kinds of licensing franchise laws, it would severely hamper my national marketing.

A patchwork quilt will not facilitate free enterprise. It will do the reverse.

I think for the good—and I say that from the standpoint of the franchisee and franchisor in our industry—if we as franchisees hamper the franchisor—well, we are part of the industry team.

The question was asked: won't this legislation tend to encourage vertical integration?

In our industry it would not.

The few manufacturers who have tried setting up retail stores have set wonderful examples of red ink, failure.

It does not work.

Senator Moss. We have to terminate. We have only 3 or 4 minutes of life left.

Mr. PEASTER. Let me say one thing. A dealer tried to bring suit under the Automobile Dealers' Day In Court Act and the court found that recreational dealers and RV manufacturers are not covered under that act.

Senator Moss. We appreciate your statements. We have your statement in full.

[The statement follows:]

STATEMENT OF CROSBY FORREST, DIXIE TRAILER SALES, LTD., MEMBER OF THE RVDA BOARD OF DIRECTORS, RVDA LEGISLATIVE COMMITTEE CHAIRMAN; AND HILTON PEASTER, RVDA EXECUTIVE DIRECTOR

Mr. Chairman, Members of the Subcommittee, this opportunity to present to you our statement favoring passage of S.2335, "Fairness in Franchising Act" is deeply appreciated.

We have addressed ourselves to the need for this legislation from several standpoints which are:

(1) Is corrective legislation needed?
(2) Do present state and federal laws and regulations offer relief?
(3) Will this particular bill serve these needs?

We have done considerable research and wish to make this available to you here today. This research is new; it has never been done before in our industry.

Our method deals entirely with actual case histories. It is primary research, dealing with the real world as it now exists.

First, a word about our industry. This year almost $3 billion of new recreation vehicles will be sold to the public, almost exclusively by franchised dealers. We define recreational vehicles to include: camping trailers, travel trailers, truck campers, and motor homes. These vehicles are manufactured by hundreds of franchisors. They are sold by thousands of dealers who are acting in a franchise relationship as defined by this bill. Unfortunately, to a considerable extent, these franchise relationships are not in writing, but are verbal, and their essence is many times implied, not expressed in writing. Virtually all of the more than four million recreational vehicles now in use by the citizens of this country have been sold by these franchised dealers.

Now, let us look at the evidence we collected.

First, we mailed a questionnaire to all our regular members throughout the United States. This was done on February 25th and 26th of this year. Three weeks later, we had received a 45.9% return. The results of this survey overwhelmingly show three things:

(1) Franchise abuses are widespread

(2) Franchises not only desire corrective legislation; but

(3) Franchises most urgently called for corrective legislation and are extremely willing themselves to become personally involved.

Earlier today, we submitted a written statement to this subcommittee. This written testimony is necessarily an integral part of our verbal testimony here.

The results of our aforementioned questionnaire survey are contained in our written statement.

We would like to briefly illustrate for you now, the results of our research of actual franchise case histories.

We first have a case of a franchisee who represented the franchised brand since 1969, won their top dealer award for four years in a row, and then had his franchise cancelled. He had made suggestions regarding product quality to the franchisor, which type of suggestions had been welcomed in the past. Apparently company policy had changed and suggestions were no longer welcomed. Upon abrupt notice of termination, he went to the franchisors president but could get nowhere. He found that his franchise had been given to a competitor. In talking to the competitor, who now exclusively holds the franchise in that market area, the new franchisee said, in effect, that he took the line purely because he knew the original franchisee had advertised, and as a new franchisee he was going to ride on the shirt tail of this advertising as long as customers were looking for that brand.

Next, we have a case where a dealer indicates that after building up the acceptance of the franchise brand in his area, the franchisor, capitalizing on the franchisee's efforts, places other franchisees in that same geographical area, to the benefit of the franchisor, and to the detriment of the original franchisee.

From a dealer in Missouri, we are told how franchises are not technically cancelled, just blatently violated.

Then, a dealer in California relates how his franchise was cancelled because he refused to purchase additional merchandise when at the time he was already overstocked and sales were depressed. As a result, the franchisor sold the merchandise to a competitive dealer nearby the original franchisee, at a greatly reduced price, in violation of the original agreement's attempt.

From Alabama comes the story of a franchisee who, after fifteen years of successfully representing the franchise brand, is first threatened with cancellation because he refuses to modify the agreement to the advantage of the franchisor, and subsequent to his refusal, finds himself cancelled.

A dealer in Virginia relates the all too common practice of being under pressure to conform to a franchisors whims, or face termination, because the franchise is unwritten. He relates how he once lost his franchise merely because his sales manager left and took the franchise with him.

A dealer on Long Island indicates the need for a written franchise and how, without one, they are continually pressured to purchase unwanted merchandise because their oral franchise arrangements are subject to personal reinterpretation upon change of franchisor personnel.

From another dealer in New York comes the story of how, after five years, a franchise was apparently cancelled because of a personality conflict between the franchisee and a salesman for the franchisor.

From a Colorado franchisee who was for twelve years, the one solely responsible for the franchise in that state, plus in portions of neighboring states, and for three additional years exclusively represented the franchise in Denver and Colorado Springs, who named his company after the franchised brand, who dealt with the franchisor for ten years prior to bringing his brother into the management of the franchised dealership, found that when his brother left, so did his franchise. The only renumeration rewarded to the franchisee was that the franchisor repurchased the remaining inventory at terms favorable to the franchisor. The original franchisee has, with his lawyer, investigated bringing an action, but is advised that present statutory and common law remedies are not adequate.

Another dealer in Michigan indicates that he has been a unique position to see both sides of the relationship. For a number of years he worked as the franchisors vice president in charge of sales, awarding over one hundred franchises to franchisees. He had, on occasion, cancelled franchises because franchisees had not lived up to their agreements. In short, he knew both sides of the fence. In 1969 he purchased a factory-owned store from the franchisor and left the franchisor with their blessings. Three years later, after achieving outstanding sales records, he was informed over dinner one night that his franchise was cancelled, effective immediately. Knowing what is expected of a franchisee by the franchisor, this franchisee believes he did not violate his franchise in any way. The franchisee sought assistance from the Federal Trade Commission, but was told that if he went out of business, he might have a case. Naturally, he did not want to die proving a point. He retained several legal counsels, asking them to research law applicable to the situation. After investing several thousand dollars in legal fees, a basis was not found to successfully prove the suit they filed in Federal Court.

A dealer in the state of Washington attempted to utilize state courts to adjudicate his franchise grievance, but was surprised to find out that the law on contracts was not applicable to his franchise situation and offered him no help.

A franchisee in New Jersey placed an order with his franchisor for merchandise after having, in good faith, taken a deposit on such merchandise by a customer who wished to purchase it. One month later, the franchisee inquired where the merchandise was, whereupon he was informed, over the phone, that his franchise had been cancelled without notice. Even though there was a written franchise agreement, the legal counsel of the franchisee advised that nothing could be done even though the agreement had been broken.

From California comes the case of a franchisee who relates how, on two separate occasions, franchisors cancelled their franchise agreement with them after pressure was brought by competitors who wished to have the franchised line of business for themselves. He further relates that upon one occasion the reason for the cancellation was due to his low sales volume, but states that these conditions were known by the franchisor when the franchise was awarded initially.

A Texas dealer, whose reward for winning an outstanding sales award, was a cancellation notice. A competitor of his was able to interest the franchisor in cancelling the first dealer's franchise, because the second dealer offered to purchase a great deal more merchandise on the initial order. While the original franchisee was willing to accept increased competition, the ability of the franchisor to unfairly terminate the original agreement, effectively restrained competition in that market.

Another dealer in New York, at the request of the franchisor, and not of his own desire, exhibited a piece of merchandise at a public show. A competitor didn't like the display of this merchandise at the show, phoned the franchisor: whereupon the franchisor called the first franchisee to the phone and cancelled the franchise as of that exact moment.

From a dealer in Illinois, we have a copy of a written franchise agreement stating that it can be terminated by either party with a thirty day written notice in advance of termination. Only two years later, the franchisor terminates the agreement effective immediately with a letter.

In Florida, a franchisee is notified by telephone of immediate cancellation of his franchise. He states that his consumers depend on him for parts and service peculiar to that franchise brand. He feels the establishment of that franchised brand in the area is due to his efforts and asks, "did we not (be able to) continue with the franchise for . . . company if we so elect?"

And last, a dealer in Texas finds that the franchisee will no longer honor his agreement because the franchisor has later decided to change its method of awarding franchises. The franchisee cannot find a suitable replacement.

These franchise abuse "horror stories" are representative of the more than three times this number which we have on file in our office. We have not presented all the case histories in our verbal or written statement to you here, today, because the situations they describe are highly repetitive.

In the appendix to our written statement you will find each of these case histories which we will briefly describe to you already. These case histories give the individual names of franchisees and franchisors, dates, details, and in many cases, a complete description of the financial loss unfairly suffered by the franchisees.

Mr. Chairman, will you accept our written statement containing these case histories and containing the questionnaire-survey summary results into your subcommittee's official record of these hearings?

After studying this bill, we feel its enactment will effectively insure greater fairness in franchising. This bill, for example, would do more to correct unfairness in franchising than measures such as pre-disclosure of franchise terms, for example.

On behalf of the franchised small business men and women, we urgently call upon you to pass this corrective legislation this year.

We will be happy to answer any questions you have or supply data within our grasp. Thank you again for the opportunity of presenting this statement to you.

APPENDIX A

The following is a compilation of the questions asked on the reverse side of RVDA President Lougheed's letter of February 26, 1976 addressed "To All RVDA Regular Members in the U.S.". The members were asked to fill out the questionnaire on the reverse of this letter and return to RVDA in the stamped reply envelope enclosed. Percents are of total. (Returned) Updated as of 3/22/76 using the 514 questionnaires returned. (514 returned = 45.9% of those surveyed)

APPENDIX B

These case histories came to us in response to our questionnaire of February 26, 1976 wherein we asked our members, "would you be willing to give your own case history of the time(s) you have had your franchise(s) cancelled, naming names, etc., for presentation to Congress?"

After franchisees dictated their case histories to us over the phone and recorded on tape (with their permission), we sent the transcriptions to them asking them to reverify their case history, sign their names, and suggested their legal counsel should review it.

The case histories which follow are told in their own words. We have not attempted to edit their testimony, nor to verify or disprove their signed statements.

We first have a case of a franchisee who represented the franchised brand since 1969, won their top dealer award for four years in a row, and then had his franchise cancelled. He had made suggestions regarding product quality to the franchisor, which type of suggestions had been welcomed in the past. Apparently company policy had changed and suggestions were no longer welcomed. Upon abrupt notice of termination, he went to the franchisors president but could get nowhere. He found that his franchise had been given to a competitor. In talking to the competitor, who now exclusively holds the franchise in that market area, the new franchisee said, in effect, that he took the line purely because he knew the original franchisee had advertised, and as a new franchisee he was going to ride on the shirt tail of this advertising as long as customers were looking for that brand.

STATEMENT OF HERM NIEWIEK, NIEWIEK TRAVEL TRAILERS, INC., GRAND RAPIDS, MICH.

My name is Herm Niewiek and our company is Niewiek Travel Trailers, Inc. We were dealers for Fan Coach Company since 1969. We had an agreement with them to cover our territory and just really as far as distance, it wasn't too specific but we did agree to stock merchandise. Last year in July we were

having a lot of trouble with their coaches and we started to ask them, for answers, or feed back the information which in the past they welcomed so they could make corrections in their product or watch their men who were giving them problems. Their attitude kind of shocked me last year. All of a sudden they acted as if I just was just nothing but a "bitcher" and complainer. I did have '76 merchandise on order. Fortunately, I had just sold my last '75 models and I was to pick out my new '76 models at the South Bend show which was in August. On the Monday before the South Bend show I received a telegram that seeing as though I did not at that time have a full line of merchandise that they decided they should terminate my franchise. At the South Bend show I went to their president to see if I could discuss anything with them and it was kind of a shocker after dealing with them since '69 and I have all the trophies for being their top dealer for four years in a row. But there was no talking about it. It seemed very strange to me until three weeks later, a man two and a half blocks away from me, across the street, had the franchise. And that's what happened. I did go back to them and ask them if I hurt somebody's feelings, If I could make an apology, if they misunderstood me maybe I could explain myself but there was no talking at all. It was done, they had a new dealer, they didn't need me . . . since then if I need parts to repair the products that I sold in the past, I get a C.O.D. for anything as little as $2 for a part.

Through the six years that I handled their product, I had an advertisement budget of $7,000 a year. That's a good question . . . I'm glad you asked that. I went down to this man who got the franchise and I said I was kind of hurt, I was trying to find out what his feelings were and if he realized my problems and he said he didn't care what my problems were, he took the line purely because he knew I advertised and he was going to ride on my shirt tail as long as the customers were looking for the brand.

Next, we have a case where a dealer indicates that after building up the acceptance of the franchise brand in his area, the franchisor, capitalizing on the franchisee's efforts, places other franchisees in that same geographical area, to the benefit of the franchisor, and to the detriment of the original franchisee.

TELEPHONE TAPED CONVERSATION FROM MR. MARTIN DYKSTRA, HOLLAND MOTOR HOMES, HOLLAND, MICH. 49423

Ken, our problems are essentially the same with all the makes that we have handled since 1968. The manufacturer gives us a franchise with a spelled out sales area and later they come back, might be a year or two, and they say, "you're doing such a great job, this must be a tremendous sales area, in fact, it's so good that we ought to have more dealers in your area." We have never been cancelled by a manufacturer. We have cancelled two manufacturers ourselves for imposing on our sales area in this manner. The first one was Sightseer Corporation out of Newburg, Ohio. The second one was Pace Arrow, a division of Fleetwood Enterprises. We do have the same problem with Tioga of Fleetwood but we decided to live with that and we are presently going through this exact problem with Travco Corporation. In fact we're rather upset about it with Travco. We are the largest Travco dealer in the United States and we have been since 1970 and suddenly due to change of management personnel, they have decided this very thing that our area is so good, we're doing such a great job they ought to have more dealers in it. Frankly, we're ready to go to court with them on this particular score. Giving us a franchise with a sales area exceeding every sales objective ever set, and then coming by and saying we ought to slice up your area and give you a smaller franchise area, we think it's legally and morally wrong. That pretty much tells the story, Ken.

From a dealer in Missouri, we are told how franchises are not technically cancelled, just blatently violated.

STATEMENT OF LESS LANGE, LANGE CAMPER CO., ST. LOUIS, MO.

I was former Campers Distributing Company, St. Louis, Mo. Approximately seven or eight years ago I had a franchise cancelled by Spacecraft of Kansas City, Missouri. They put in another dealer because they wanted to put in another dealer although I was selling a lot of merchandise, in fact, I was their largest dealer by far. They wanted to put other franchises in the area and they cancelled my franchise.

Did they give you any notification of it?

No, they just said they wanted to put another dealer in the area and that was all it amounted to.

Any problems with sales?

No, sales were great. In fact, they were my leading one. Well, you know this is a common thing. This franchise agreement, they're not very strong. These companies don't honor them too much. What happens is, instead of cancelling you, they put in another one across the street, which is the same as cancelling you.

One other question. Did you spend any money like for advertising or promoting there?

Well, certainly, that was my main line.

You were just left holding the bag there.

Totally. It did teach me a lesson. Now I don't put too much faith in the manufacturers. I handle more lines.

Then, a dealer in California relates how his franchise was cancelled because he refused to purchase additional merchandise when at the time he was already overstocked and sales were depressed. As a result, the franchisor sold the merchandise to a competitive dealer nearby the original franchisee, at a greatly reduced price, in violation of the original agreement's attempt.

STATEMENT OF BEN SMITH, BOB'S CAMPER CORRAL, HAYWARD, CALIF.

In 1966 when Bill Shelton first started building Vacationeer tops, I became a Vacationeer dealer. As time went on he built campers, mini homes, chassis mounts, and then trailers.

I stocked his complete line and never had any trouble.

In 1973, his new sales manager, Jack Smith, came to my lot, about August, and wanted an order. I had in stock the complete line of shells, non-cabover campers, cabover campers, mini homes, chassis mounts, 20' - 23' and 25' trailers. I was actually overstocked as I had duplicates of some units. I told him what I really needed was some customers. Also, I had purchased more Vacationeers by the end of July 1973 than the entire year of 1972.

Please remember 1973 was the gas scare and recession. The recreation business was at a standstill. People were not buying.

Next thing I knew, someone told me Tony Farr was the new Vacationeer Dealer. This did not come from the factory until later. I seem to have been the last to know.

Tony Farr is just across and down the street from my lot—actually in sight less than a block away.

Then the factory dumped units at hundreds of dollars below the price I had paid so I took a good beating trying to sell off the units that I had in stock at the high costs and with no way to compete. Tony could make a good profit at my actual cost.

From Alabama comes the story of a franchisee who, after fifteen years of successfully representing the franchise brand, is first threatened with cancellation because he refuses to modify the agreement to the advantage of the franchisor, and subsequent to his refusal, finds himself cancelled.

STATEMENT OF DON WILLIAMS, PARTNER, MADISON TRAVEL TRAILER, HUNTSVILLE, ALA.

Part of our story on franchise agreement down here. We've been with a manufacturer since 1964. Regardless of what you have in inventory, they insist upon our buying so much merchandise per quarter in a dollar amount even down to specifying which series that you must have in stock to round out the line. If you're real heavy in merchandise, they could care less. I think a lot of the manufacturers of recreational vehicles are this way.

Did the manufacturer at all cancel you?

No, they didn't cancel. They sent us letters threatening to cancel the franchise agreement. At one point I told them to bring their checkbook down and buy me out. Buy their merchandise back. I was doing all that I could do. In advertising and trying to sell the merchandise.

This happened last year, the manufacturer we've been doing business with for 14 or 15 years. I was handling just mini homes and that's all I agreed to handle. One day they called me and wanted to know if I would buy four mini homes and Travel Trailers, I told them "no." I agreed not to stock the

travel trailers. That was our mutual agreement. The next morning [I had one of their mini homes in stock at that time], I found one of their mini homes sitting on my competitor's lot. They had opened him up as a franchise dealer. He had promise to buy their merchandise. He didn't fulfill his promise to them. So, in turn, I lost the franchise to a competitor, before the whole thing was decided and settled they had put a piece of merchandise on my competitor's lot.

They really didn't give you a whole lot of warning on that. Did you expend any money advertising, promoting their product.

We have throughout the years. My normal promotion, letterheads, and stuff of this nature. After they pulled this trick, I understand by the grapevine they want to come back with me. I won't take their merchandise back. No way. I'm not going to do it.

A dealer in Virginia relates the all too common practice of being under pressure to conform to a franchisors whims, or face termination, because the franchise is unwritten. He relates how he once lost his franchise merely because his sales manager left and took the franchise with him.

TAPED TELEPHONE CONVERSATION WITH CROSBY FORREST, DIXIE TRAILER SALES, LTD., NEWPORT NEWS, VA.

My name is Crosby Forrest. I am President of Dixie Trailer Sales, Ltd. located at Justin Avenue and Mueller Lane in Newport News, Virginia. Approximately, I had been in business approximately 12 years—we were at one time, in 1970 promoting a Fleetwood product, home office in California. The name of this Fleetwood product was Terry Travel Trailers. To my knowledge we were doing an excellent job for this company.

There was a lot of pressure put on us to take merchandise that we really didn't need. There was also a lot of pressure put on us to buy merchandise at specific times of the year when we knew we would not sell it. We actively promoted this product in our marketing area. We sold in the neighborhood of around 75 to 100 units. Always we were suggested to the fact that the sales manager at the Winchester plant in Virginia would call us up at any time and tell us that we were no longer a dealer or no longer had a franchise area with him but needless to say we did do a fairly good job with this company.

They had a very good product and we actively promoted it in the newspapers, on television and also on the radio. Also there were many trade shows that we put on locally. About 1969 or 1970, Dixie Trailer Sales lost its sales manager. He was the predominant driving force in getting us this Terry franchise made by Fleetwood Enterprises out of California. So he left and went with another dealer located in my marketing area. Several weeks later I was informed by the sales manager of the Winchester plant that my franchise had been terminated.

I immediately drove to Winchester the following morning with my new sales manager to try to find out if we could resolve our differences and keep our franchise. We were successful in doing this. We stopped a loaded truck going to the other dealer in Newport News and diverted it to my lot the next day. This is just an example of how loosely our franchise was with this company. They put other pressures on me and I did exactly what they wanted me to do but one thing, my sales manager, my franchise went with him. This seems to me like its a very poor way of doing business.

A dealer on Long Island indicates the need for a written franchise and how, without one, they are continually pressured to purchase unwanted merchandise because their oral franchise arrangements are subject to personal reinterpretation upon change of franchisor personnel.

STATEMENT OF DOLORES LENHARD, OZZIE'S CAMPING CENTER, INC., SAYVILLE, N.Y.

Prowler Industries does not grant a written franchise to their dealers, and an oral franchise agreement is good only as long as the representative who made it is still at the same factory.

This results in a dealer spending a great deal of time and money to promote a trailer that he feels he will have an exclusive right to sell, and then a year later finds a new factory representative feels entirely different about the original oral agreement.

For example, Prowler Industries makes 10 travel trailer models, but since one is a reverse of another, they actually make nine. Prowler insists that we carry all nine, or they will place those we don't stock with another dealer.

We have been in the camping business since 1959, selling trailers since 1962, and we know that not all models sell equally well. We are willing to stock a representative number of trailers; we are willing to agree that we must sell a certain number of trailers, but we disagree with the logic that we must sell some of every model they make.

Last year, our first with Prowler, we stocked one of each model to see which would be the most popular, and feel qualified to state that certain models have certain features that limit them to too narrow a market. We feel the 24.5 is one of these, as is the 23M. However, because of unrelenting pressure from Prowler, we have both models in stock. (Last year, we had a 23M on our lot for one week short of a year.)

With seven of the nine models now on our lot, Prowler requested that we take a 27.5 and a 31. Our answer was that the 27.5 is the same floor plan as the 24.5, and we don't want it for the same reason. We offered to take a 31, but were told unless we took both, they would place both trailers with another dealer.

For years manufacturers have been telling us to service the trailers we sell so their customers will be happy, and so we have one of the largest indoor service areas on Long Island, We have been told to carry accessories to be a "complete" dealer, and so we have a complete retail store. Now, however, when we wish to draw on our own knowledge and experience, we are told "do it our way, or we will place another dealer in your area."

Prowler, of course, has the right to place as many dealers as they chose in an area, just as we have the right to state we will not represent a company whose policy it is to do this.

The problem is, without a written franchise agreement, there is no recourse when corporate policy is changed, or when a sales manager is transferred elsewhere.

We hope that RVDA will be instrumental in getting all manufacturers to give a written franchise.

From another dealer in New York comes the story of how, after five years, a franchise was apparently cancelled because of a personality conflict between the franchisee and a salesman for the franchisor.

MARATHON, N.Y., *February 28, 1976.*

DEAR SIRS: I was an Apeco dealer for (Chateau and Roadcruiser) RVS for about 5 yrs. and done quite well with them.

At the end of the 1974 model year, I was asked by salesman Ed. Dinsmore from Christiana, Pa. plant what I wanted in 1975 trailers? I told him I wasn't sure what and I wasn't in any hurry till I decided what I wanted. A week later he called to get my order and I told him the same thing I did before. He then informed me I would have to order soon.

I didn't like the salesman Mr. Dinsmore so the following day I called another salesman and gave him an order for a 5th wheel. (Roadcruiser)

Within the week I received a letter from Dinsmore informing me my franchise was cancelled with no reason whatsoever.

I then called to see if I would get the 5th wheel and was told they couldn't sell it to me.

To this day I don't know why I was dropped as they have never told me, and they still have no dealer in this area.

WARD S. PUBLES.

From a Colorado franchisee who was for twelve years, the one solely responsible for the franchise in that state, plus in portions of neighboring states, and for three additional years exclusively represented the franchise in Denver and Colorado Springs, who named his company after the franchised brand, who dealt with the franchisor for ten years prior to bringing his brother into the management of the franchised dealership, found that when his brother left, so did his franchise. The only renumeration rewarded to the franchisee was that the franchisor repurchased the remaining inventory at terms favorable to the franchisor. The original franchisee has, with his lawyer, investigated bringing an action, but is advised that present statutory and common law remedies are not adequate.

STATEMENT SUBMITTED IN BEHALF OF WILLIS B. BERGAN AND APACHE CAMPING AND SPORTS CENTERS, INC., COLORADO

The following sets forth briefly the background of the franchise problems which Willis B. Bergan and Apache Camping and Sports Centers, Inc. have with the Vesely Company of Lapeer, Michigan. Mr. Bergan obtained a Vesely franchise in the early 1960's and continued thereafter to sell Vesely products on an exclusive basis in the state of Colorado and portions of neighboring states for approximately twelve years. Mr. Bergan eventually incorporated his sole proprietorship business as Apache Camping and Sport Centers, Inc. ("Apache") which continued to operate as a franchisee with outlets in Denver and Colorado Springs.

In approximately 1972, Willis Bergan brought his brother, Dick Bergan, into the business and sold a nominal number of Apache shares to Dick Bergan. Thereafter, Willis Bergan decided to attend a Lutheran seminary with a view toward possibly becoming a Lutheran minister and, although he retained the vast majority of the shares of Apache, he caused Dick Bergan to be elected as president of the company and gave Dick direct responsibility for the continued management of the franchise.

Thereafter, for approximately three years, Willis Bergan attended the seminary and continued to have only part-time participation in the operation of the Vesely franchise. However, Apache encountered severe financial problems and Willis Bergan determined that his brother simply was not running the company on a day-to-day basis in a satisfactory manner. Therefore, Willis Bergan returned to full time participation in the business. Disagreements arose between Dick and Willis and in June, 1975, Dick walked out of the Apache offices and took all of the Apache employees with him. Despite this serious disruption of business, Willis, his wife and children and friends took over operation of Apache and actually increased sales of Vesely merchandise during the period July through September, 1975 over the comparable period of 1974.

Soon after the walkout by Dick and the other employees, it became clear that Vesely was seriously considering transferring its franchise to Dick. Willis Bergan had been under the impression that he had a written franchise agreement between Apache and Vesely, but upon review of his files, he found a form agreement which had never been signed. In addition, the form agreement gave Vesely very broad powers of termination.

After a number of conferences with various Vesely executives, Willis Bergan was advised that the franchise to Apache would be terminated. The only explanation that he ever received was that Vesely regarded the franchise as being basically a personal relationship and that Vesely had come to regard Dick Bergan, during his period of approximately three years as president of Apache, as its representative in the state of Colorado. Both the fact that Willis Bergan had loyally dealt with Vesely for approximately ten years prior to Dick's participation in the business and the fact that the Vesely franchise was the principal asset of Apache were apparently immaterial in the Vesely determination. In approximately October, 1975, Vesely terminated the Apache franchise, repurchased the Apache inventory of Vesely products at a price favorable to Vesely and immediately granted a new franchise to Dick Bergan and apparently sold the Apache inventory to Dick Bergan. Since that time, Dick Bergan has entered into active competition with both Willis Bergan and Apache by forming a new corporation known as Apache Village, Inc. It appears that the new corporation is contacting customers of Apache using advertising materials very similar to those of Apache, that it has employed many of the former employees of Apache and that it is otherwise engaging in activities which may constitute unfair competition. All of these activities have apparently been carried out with the knowledge and perhaps the cooperation of the Vesely company.

Apache has undertaken to commence a new line of business with a franchise from a different manufacturer. Although Willis Bergan has been reasonably successful in reorganizing the business, he has incurred substantial problems in retaining old customers and has otherwise undoubtedly suffered severe economic losses as a result of the abrupt termination of the Vesely franchise.

Willis Bergan and Apache are now investigating the possibility of possible legal action based on various common law and statutory bases, including a Colorado statute which appears to offer some protection to a franchisee for unjust termination of a franchise. C.R.S. 12-6-120(d).

However, it is the feeling of Willis Bergan and Apache that they have been unjustly treated by the Vesely Company and that the present statutory and common law remedies are not totally adequate.

Another dealer in Michigan indicates that he has been in a unique position to see both sides of the relationship. For a number of years he worked as the franchisors vice president in charge of sales, awarding over one hundred franchises to franchisees. He had, on occasion, cancelled franchises because franchisees had not lived up to their agreements. In short, he knew both sides of the fence. In 1969 he purchased a factory-owned store from the franchisor and left the franchisor with their blessings. Three years later, after achieving outstanding sales records, he was informed over dinner one night that his franchise was cancelled, effective immediately. Knowing what is expected of a franchisee by the franchisor, this franchisee believes he did not violate his franchise in any way. The franchisee sought assistance from the Federal Trade Commission, but was told that if he went out of business, he might have a case. Naturally, he did not want to die proving a point. He retained several legal counsels, asking them to research law applicable to the situation. After investing several thousand dollars in legal fees, a basis was not found to successfully prove the suit they filed in Federal Court.

STATEMENT OF BILL PIFER, DEALER, FLINT AND DETROIT, MICH.

My name is Bill Pifer. I live in Warren, Michigan which is a suburb of Detroit. I have been in the Recreational Vehicle business since 1957. Since 1969 I've been a retail dealer with operations in Flint, Michigan and another in Detroit. Prior to that, from 1957 to 1969, I was Vice-President In Charge of Sales for Vesley Company, manufacturers and franchisors of the Apache Camping Trailer. During that time I was instrumental in establishing perhaps 1,000 dealers. I was also instrumental in cancelling several hundred of them. Now I'm seeing this thing from both sides of the fence, so I realize that sometimes there are very good reasons for cancelling a dealer; possibly he didn't do enough advertising, maybe he's not doing the volume of business the territory is entitled to, perhaps he doesn't pay his bills or service the product properly either, so there are good reasons for cancelling a dealer.

I am now looking at it from the other side. I opened an operation called Flint Apache which was in Flint . . . this was in 1969 and within six months I was one of the top fifteen dealers in the United States for Vesley. I would guess that Vesley Company had around 450 or 500 dealers at that time. We continued to maintain a standing in that category right through to the end of 1971.

In January of 1972, we were invited to a dinner . . . when I say "we" I had by that time taken on a partner who had been a road man for the Vesley Company in previous years. We were invited to dinner by the Sales Representative of the Vesley Company and during the course of the dinner we were informed that we were cancelled, effective immediately. We were given no reason whatsoever and at that time, being a little thunderstruck, we started trying to determine what reason or problem existed for the company to take this action. I mean, were we not advertising enough? Did we not pay our bills? What was the reason? We could get no answer whatsoever from the company. They refused our orders, they refused to discuss the situation with us over the phone, they would not notify us in writing as to why we were cancelled and going back over the records we knew for a fact that our bills were paid, always promptly. In fact, the first year I was in business I got stuck with a lot of merchandise at the end of the season and had to mortgage my house for $45,000 so I could walk into the Vesley Company one minute before the deadline that my bill was due just to present them with a check for all the merchandise that I still had on the lot. So my bills were always paid promptly, the service we rendered the product was always good, good enough, in fact, that the company oft times sent in people who were traveling who had problems on the road . . . they would send them over to our place to be taken care of. Our advertising budget . . . well, I have a scrapbook just filled with Apache advertisements and although I did later have other franchises on the lot, certainly the thrust of the advertising was geared to Apache. In fact, what we spent on advertising out of our little operation was many, many times per unit what Vesley Company themselves spends nationally. Certainly, the amount of

volume we did put us in the top fifteen and so that certainly couldn't have been the problem. At any rate, in the matter of ten minutes conversation over dinner we were deprived of our major line.

Now that line meant to us somewhere between $40,000 and $50,000 worth of gross profits a year and they took it away from us at the beginning of the selling season without even the four or five months before the selling season in September to get ready for this sort of blow. We were pretty shook and I went to the FTC immediately because I had the feeling that perhaps I was cancelled because I had other competing lines. At that time Vesley Company was operating under a consent order from the FTC and in talking to the lawyer from the FTC who had done the investigation of the Vesley Company, I was told that I would have to prove that I was damaged and the only way I could prove I was damaged was to first go out of business, become bankrupt and then come back and see the FTC. Then perhaps, something could be done about it.

Well, needless to say, I didn't go out of business. We sweated our way through a catastrophic upheaval as far as my partner and I were concerned. We tried to get recompense, we filed a suit in Federal Court, I've been through a series of three lawyers and we haven't gotten to the first deposition, but I am $5,000 poorer for my efforts. If this bill under consideration has a retroactive clause, I will very probably not even be able to take advantage of it because it has been quite some time. However, if I can prevent this sort of thing from happening to some other dealer it will be worthwhile for us and the industry. It certainly has been very painful to me.

A dealer in the state of Washington attempted to utilize state courts to adjudicate his franchise grievance, but was surprised to find out that the law on contracts was not applicable to his franchise situation and offered him no help.

STATEMENT OF BOB EICHLER, MOTOR HOMES NORTHWEST, SEATTLE, WASH.

Hilton, you asked me to make some comments about any problems that I've had with my franchises and manufacturers concerning franchises. I've had plenty of problems and I list four different manufacturers that I've had problems with, and basically, the same problems.

1. Happened back in about 1972 with Revcon Motor Homes. We entered into a verbal franchise agreement for the territory of Western Washington. I always tried to negotiate with them a reasonable franchise agreement that was worthwhile for both parties; their franchise agreement was not reasonable and I refused to sign it and tried many times to negotiate a new franchise with them but they refused to do so. I operated for about two years as a "franchise" dealer when one day I got a cancellation from them, giving me 30 days notice of cancellation. Within two days after I received the letter, Revcon put their units on one of my competitor's lots. They should have of course waited at least 30 days to put the units on my competitor's lots and brought back my units if they were going to cancel me. We sold Revcon Motor Homes that month which was quite a few and there was no apparent reason why they should cancel me, at least at that time there was no apparent reason. My attorney thought we had a good case against them, there was an applied franchise, I had been their dealer and they recognized this for almost two years. We started a lawsuit against Revcon for damages and for cancelling the franchise. However, we lost the lawsuit because the judge said we never had entered into a written franchise, therefore, it was only verbal and they really didn't need to give me 30 days notice of cancellation. But one key reason we lost was the fact that even in any written correspondence there had been no bargaining on my part that I was guaranteed to buy so many units from the manufacturer, so the judge said, "why should you be able to sue the manufacturer if they can't sue you in some way or another" . . . So I lost that one. I later found out from the former sales manager of Revcon the reason we were cancelled and if you can believe this, he said "the reason you were cancelled was because all you people could talk about was how beautiful the executive motor home was". When I went back and reported that to the president of Revcon he merely said, "cancel them". That takes care of one franchise.

2. Second was the Explorer Motor Home Company, a Portland operation, and again probably in about 1972—we were the exclusive dealer for the area, but did not have a franchise agreement. We tried to get one but never could but it was obvious that we had been their dealer for about a year and sold 40 to 50

Explorers in that year, but they merely came to us and said, "we want you to become an exclusive Explorer dealer. You are doing a good job and we want you to sell only Explorers". We said, "there is no way we can sell only Explorers it doesn't make sense, whereby, plain and simply, they cancelled us and set up a new dealer down the street and again refused to repurchase units from us. We were also cancelled in Portland by Sports Coach Corporation. Same type of thing—when we took over the dealership we purchased the units from the dealer that they had cancelled and why they cancelled the other dealer I have no idea—I believe it was for non-performance. Again we tried to get a franchise agreement from them and they refused. After a year or two, again we did an excellent job for Sports Coach but then the politics, as far as we can find out, had something to do with the factory getting a part of the ownership of the new Portland dealers they set up and they cancelled us in Portland and left us cold and didn't do us the courtesy of buying back the units from us as we had done with the dealers they had cancelled previously.

Another case in Portland was Fleetwood Industry Products, Tioga, which does not have a franchising program and absolutely refuses to give any kind of written agreement of territory. We told them that we would take on Tioga if we could have the whole city of Portland—no question about that—they agreed to it, they said however, if we wanted the whole city of Portland and to keep them to setting up a dealer on the other side of town, we would need to stock more units and several vans which I was always opposed to. However, in order to go along with their request, we stocked more units than we normally would, including several van conversions, did an excellent job for them and four or five months later, one day in the paper we read that there was a new Tioga dealer on the other side of Portland. I might add that Tioga had just done the same thing—put another dealer here in Seattle, Travel Trailer Exchange, was Tioga's largest dealer in the country and an RVDA member just north of my Seattle location. They did an excellent job for Tioga and Fleetwood Industries came in and set up another dealer within 25 miles of Travel Trailer Exchange. They even allowed the new dealer to show units in a show that was definitely in Travel Trailer Exchange's area, right in competition with Travel Trailer Exchange.

Lastly, the Diplomat franchise—the Diplomat which is made by Executive—I had an excellent franchise agreement or as good as I've seen so far, and during the middle of my franchise year with Diplomat, Executive Industries I gather, decided to change their policy and separate Diplomat and Executive dealers, so they sent me a letter of cancellation based on ridiculous details in the contract, saying I was not keeping my units clean or promoting them, which was very untrue because we sold lots of units and did an excellent job for Diplomat but they subsequently cancelled me anyway and suffered a loss because of the incident recently, and I believe this is the first franchise where we will have an opportunity to collect something for the damages from Executive. We were definitely damaged and it was definitely an unreasonable cancellation.

In all cases, we were never cancelled for non-performance or for anything other than political reasons. However, even in the Diplomat case, although it will be sometime before it comes to court, we will have a difficult time. I'm afraid, proving exactly what damages we sustained and what we will get out of it I'm not sure, but any legislation that will give the franchisee more rights than helter-skelter cancellations of dealers for no good cause. That has got to stop.

If you wish further information about any of these or did not understand anything I said in this recording, please do not hesitate to call me.

A franchisee in New Jersey placed an order with his franchisor for merchandise after having, in good faith, taken a deposit on such merchandise by a customer who wished to purchase it. One month later, the franchisee inquired where the merchandise was, whereupon he was informed, over the phone, that his franchise had been cancelled without notice. Even though there was a written franchise agreement, the legal counsel of the franchisee advised that nothing could be done even though the agreement had been broken.

TAPED CONVERSATION WITH TRAILERAMA, ANDOVER, N.J.

About February of 1975 we had been a Globestar dealer and had no problems with them and we placed an order for a trailer, a 35 footer. The order was

taken and I guess we hadn't been in the habit of pressing for confirmations. On 3/21/75 we placed the order. About the end of April we wanted to find out where the trailer was . . . the customer wanted it, he had given a large deposit and we were told by Globestar that we didn't have a franchise anymore, that they had given it to another dealer. Now we had nothing written at all from them and the other dealer was not in our area but we also we had another lot in Pennsylvania which was in the area and for no reason at all, except that the other dealer was a much more powerful dealer than us and much larger and I guess he committed so many units to them, we were basically just dropped and never told about it. This cost quite a bit of hardship and bad representation and the customer was kind of mad at us and eventually we did get his unit through the other dealer. We were happy with the product and all of a sudden they just cancelled us and we had a written agreement.

Ken: They broke the agreement?

They say they didn't but we did have a written agreement and I had gotten . . . I have a copy of the written agreement here. They broke the agreement between us and I had gone to my lawyer about it and basically he felt there was nothing could be done about it, trade laws and so forth. This is why you're going to Washington, right?

From California comes the case of a franchisee who relates how, on two separate occasions, franchisors cancelled their franchise agreement with them after pressure was brought by competitors who wished to have the franchised line of business for themselves. He further relates that upon one occasion the reason for the cancellation was due to his low sales volume, but states that these conditions were known by the franchisor when the franchise was awarded initially.

STATEMENT OF LOUIS MARCELLIN, WALNUT VALLEY TRAILERS, ROWLAND HEIGHTS, CALIF.

We had Fireball products for about five years. A year ago last April or May, Fireball sent us a letter telling us that we were terminated as a dealer. After checking on it we found that they had another dealer in Baldwin Park who started up and wanted the line and didn't want any competition close to him so they cut us off right at the beginning of the spring season. Within six months that dealer went out.

Fireball came back to us and asked us if we wanted the product again . . . we did take the product back on. About a month ago we got another letter from Fireball stating that we were being terminated as a dealer again. The reason, I found out was that they had another dealer in El Monte that they sold a group of products to so this is two times in a year and a half and I doubt that I'd ever handle Fireball again, even if they built a gold plated product but to me it's just a short-sighted effort on the manufacturer that every time they find a new dealer that'll buy twice the quantity that you have and they request that they have an exclusive territory then they write you a letter terminating your franchise.

We have always advertised the Fireball products using their name in our ads in both the Times and local paper such as the Tribune and in our classified ads so of course we'll continue to get calls on them and we've promoted the product in various shopping centers, shows and in the Los Angeles Pomona Fair a year ago and again, we'll continue to get follow up from that. We lost sales last time we lost the product and this time it has cost us approximately 4 sales with a gross profit loss of approximately $8,000.

Overland Industries was one of our Motor Home lines, we never carried very many in stock but it was because of our sales lot size. The factory knew this when the products was taken on. After 2 years of promoting these units in October 1975 we called the factory to place a customer sold order, and they indicated they would not take the order (or) sell any further units to me. The reason was another dealer was complaining about a sale they lost. After some heated conversation they agreed to take the one order that I had the deposit on, but no further sales were to be made.

This was one of the worst ways I have ever experienced to have a product terminated. Actually in the process of placing a customer sold order to be told I could not order the unit.

A Texas dealer, whose reward for winning an outstanding sales award, was a cancellation notice. A competitor of his was able to interest the franchisor in cancelling the first dealer's franchise, because the second dealer offered to purchase a great deal more merchandise on the initial order. While the original franchisee was willing to accept increased competition, the ability of the franchisor to unfairly terminate the original agreement, effectively restrained competition in that market.

PHONE CONVERSATION WITH MRS. PHILLIP BEAVER, FUN CENTER USA, HOUSTON, TEX.

In 1972 we received a plaque from Newmar Industries in Indiana as the top Kountry Air Fifth Wheel dealer. We sold approximately 46 [5th] wheels * manufactured by the same factory and of course in the year's time and were awarded in December as one of their outstanding dealers in that particular segment of the industry. In January another dealer in our area offered to purchase three times our present inventory in order to obtain the franchise and Newmar Industries sent a representative down here to interview that dealer and ourselves and see how we felt about it. We were violently opposed and the man gave a fair hearing to us and a fair hearing to the other dealer and went back to Indiana and said I can't make a decision, do whatever you want to do. So we moved into a retail show in March and in the middle of the show we received notice that we were no longer the Kountry Air dealer that the franchise had been moved to the other man and he had already the units on his lot. We had taken the stand all along that we would be most willing to share the franchise . . . we did not demand a monopoly, however the other dealer did demand a monopoly and whereas we were holding up our end, we were selling our share of the market we were doing more with fifth wheels than any other dealer they had and any other dealer in the Houston area, nevertheless we simply got bought out by a bigger initial purchase. We objected by letter, telephone and every other way possible but we never got any recourse out of this.

Another dealer in New York, at the request of the franchisor, and not of his own desire, exhibited a piece of merchandise at a public show. A competitor didn't like the display of this merchandise at the show, phoned the franchisor; whereupon the franchisor called the first franchisee to the phone and cancelled the franchise as of that exact moment.

STATEMENT OF JOSEPH W. RECCLIO, SOUTH CAMP RV CENTER, HAMBURG, N.Y.

I started the RV business four years ago, today or tomorrow, and I never had a franchise. I never intended to be an RV dealer. I was just going to sell a few used cars and take it easy. I own a bowling alley. I've owned it for thirty years and I've made a successful living at it.

But through contacts with people I got into the rental four years ago. I went out to a dealer in the local area and bought a couple of motor homes and I rented them out and found out there were a lot of problems to them. The people are starving for help. Service, that's the word. So I built me a quarter of a million dollar service center. I blacktopped my whole lot, built me a nice office and went to the Toronto Fair and I saw some motor homes there which were named "Swinger". I took the name off one of the units and wrote the company a letter. Two days later they had a man in my office by the name of Ron Holland. He worked for Swinger. From that day to a year ago, I sold over 100 motor homes for him which they had a heck of a hard time being represented in this area.

So a year ago I had taken on the franchise called "The King's Highway" and one of my salesmen, when I got the first unit in, sold it after it was here for about three days and I bought it for the show. Our show was at the Niagara Falls Convention Center. So due to the fact that my man had sold this King's Highway, I had a vacancy at the show. So Swinger had a monitor motor home, a 31 ft. monitor motor home and I wasn't interested in it at all. I had their 31 ft. swinger in the show plus all their trailers, plus their 5th wheels because I was at that time 90% Swinger and 10% Tyton. So they asked me if I would put their monitor in the show. We did. We put the monitor in the show and not knowing that they got a Monitor dealer in the island, he does not sell motor homes. He's only a monitor travel trailer dealer.

So when we were setting up at the show, this dealer got a little sore at me for putting this coach in the show. So I told him, well, take it. You can have it.

I don't want it. I'm just doing Swinger a favor. He said I don't want it and you can't have it. Well, I'll tell you what I'm going to do. I'm going to stay here until the show is over with and when the show is over with, I'm going to resign from your local organization.

So, in the meantime, he went to the telephone and he called Swniger. Then he called me to the phone that they wanted to talk to me. So when I went to the phone, the representative from Swinger which was not Ron Holland. He wasn't there anymore. He's with Coachman. A real nice fellow. At this time this representative said to me I've got 200 ft. in the show which a lot of money cause I dress it up. I got 200 ft. of Swingers vehicles. 5th wheel, travel trailers, mini homes and motor homes plus their one monitor. When I went to the telephone, he told me right over the phone as of that moment, I was not to have any more mini homes, no more 5th wheels, no more truck campers and no more trailers. And I said to them. Don't make a mistake. And I hung up on them. Now, I never told them that I quit but they told me that I couldn't have any more trailers. Now, this man on the island never bought a Swinger trailer. never bought a mini home, I'm talking Swinger and I couldn't have any.

So I liquidated all my Swinger motor homes and now Swinger don't have any representation in this area. They don't know why they lost me because they're passing the buck. They want me to be back with them as a dealer. I got a little hurt because of the fact that I had $2,500 worth of rental space plus all the carpeting that I had put in there and the decorations. I felt kind of hurt that I had spent all that money and gain nothing out of it. It takes time to build up a name in a local area.

Any franchise anybody takes on in a local area, if he's any kind of dealer, a service dealer, he doesn't build it up over night. When you take on a franchise like Swinger, and I don't know how much money you spend, I spent a lot of money in advertising, I got a name with Swinger. I'm known as Swinger. Now everybody who comes in here to this day asks me what happened to Swinger. So I just tell them they priced themselves out of the market. I'm not going to sit down to tell them a love story. So this is what happened to a franchise. Let me say this to you people. Franchises are only good for dealers that service motor homes.

I believe that they should have protection. Also, I believe that manufacturers should have representation from a dealer to protect the coach that the manufacturer builds. I'm 100% in favor of that. But your main issue is franchises. But to me it's not a main issue because it didn't bother me because I'm a service dealer and I know that any coach that I handled I could sell. Because what sells the coach is the company with the service. Now I don't know of anything else to say to you people that would help you in any way because I've never had any other problems with franchises outside of Swinger. But I will say that there's going to be some more trouble coming up in the near future. Got to be.

From a dealer in Illinois, we have a copy of a written franchise agreement stating that it can be terminated by either party with a thirty day written notice in advance of termination. Only two years later, the franchisor terminates the agreement effective immediately with a letter.

PLEASURE MATE INDUSTRIES,
South Haven, Mich., March 15, 1971.

Mr. DAVE O'CONNELL,
Go Camping Sales, Inc.,
Alsip, Ill.

DEAR MR. O'CONNELL: We Pleasure Mate Industries have agreed to sell to Go Camping Sales, Inc. of 12851 South Cicero, Alsip, Illinois, Pleasure Mate camping trailers for the year 1971. Pleasure Mate Industries also agrees to give a protected territory in the following counties: Cook County, Illinois; DuPage County, Illinois; Well County, Illinois; Lake County, Indiana.

This agreement may be terminated by either party with a thirty day written notice in advance of the termination.

Hoping this will meet with your approval, and if I can be of any help to you in the future please feel free to contact me.

Sincerely,

RODGER L. WHALEY,
Vice President of Sales.

PLEASURE MATE INDUSTRIES,
South Haven, Mich., April 24, 1973.

GO CAMPING SALES,
Alsip, Ill.
Attention: Dave Connell.

DEAR DAVE: In the interest of both yourself and Pleasure Mate Industries, on this date, we are cancelling the franchise agreement between Go Camping Sales and Pleasure Mate Industries.

We would like to take this opportunity to thank you for the cordial business dealings we have had in the past, and we hope that Go Camping Sales will have a very successful and profitable year of 1973.

Sincerely yours,

RODGER WHALEY,
Vice President of Sales.

In Florida, a franchisee is notified by telephone of immediate cancellation of his franchise. He states that his consumers depend on him for parts and service peculiar to that franchise brand. He feels the establishment of that franchised brand in the area is due to his efforts and asks, "did we not (be able to) continue with the franchise for . . . company if we so elect?"

MERRELL CAMPING CENTER, INC.,
West Palm Beach, Fla.

Merrell Camping Center, Inc., was the first camping center established in Palm Beach County. We have been in business for sixteen years and have held a franchise with Bethany Fellowship, Inc. for fifteen years. During this time we have also held franchises with Wheelcamper, Scamper, Keystone, Globe Star, Dunhill, Terry, and Nimrod.

Since 1971, we have held a franchise with Vesely Company for Apache Trailers. October 22, 1975, we ordered from Vesely Company a load of Apache trailers for delivery January 31, 1976. Our order was cancelled by the company in January. Furthermore, the Vesely Company which handles the Apache Trailers cancelled via telephone conversation our franchise with them without any prior written notification.

Prior to the telephone notification by Vesely of our franchise cancellation, we heard through "the grapevine" that another local dealer had been awarded the franchise.

Vesely Company has already advertised the name of the new dealer in the February issue of Camp-A-Rama which was released in January.

However, to our knowledge the new dealer as mentioned in the magazine has not as yet been awarded the franchise; in fact, no one holds the franchise at this time in this area. Moreover, the only other Apache dealer in the area is in Broward County, Fort Lauderdale.

Since 1971, we have expended money on the advertising and promoting of the Apache product. We have various types of brochures and the like which we distributed by mail to area people. We presently stock parts for the Apache trailers, and many customers rely on us for continued quality service, repairs, and maintenance. Our clientele of Apache owners has been two fold: One because of the trademark Apache and secondly because of our company reputation and trust worthiness.

Overall, we have promoted the Apache product and have established the trade name of "Apache" in the area.

Should we not continue with the franchise for Vesely Company if we so elect?

And last, a dealer in Texas finds that the franchisee will no longer honor his agreement because the franchisor has later decided to change its method of awarding franchises. The franchisee cannot find a suitable replacement.

STATEMENT OF WALLACE A. PRATT, PRESIDENT, TEXAS CAMPER CORRAL, INC., AUSTIN, TEX.

My name is Wallace A. Pratt, Pres. of Texas Camper Corrall Inc., 2010 So. Lamar Blvd., Austin, Tex. 78704. I have been carrying a pick-up camper made by Rigid Form, Inc., P.O. Box 8, Richmond, Kansas 66080.

Aug. 6, 1975, Rigid Form gave us an exclusive dealership. This was reassured when Mr. Ronald L. Webster, Pres. of Rigid Form, Inc. came to see us in the

week of Dec. 8th, 1975. At this time he suggested that we order larger quantities and his company would give us a larger discount. We planned to do this when we finished our lot expansion. We finished expanding in early Jan. 1976. He also suggested that we might contact several truck dealers in and around Austin, which we did. Campers Covers were ordered in Dec. to help Rigid Form fill out a load going to Corpus Christi.

Based on his promises, his pick-up campers were showed in the Austin Boat and Travel Show—Jan. 22–25th, 1976 and advertised in a special edition of the local newspaper. More campers were reordered Jan. 22, some of which we had already sold. These campers were never delivered!

Sometime before the Travel Show (Jan. 1976) Rigid Form went to a distributor type set-up and this distributor set up another dealer just a short distance from us here in Austin.

We were informed of this change Jan. 27, 1976 and Rigid Form, Inc. has refused to deliver campers at any price.

We went to a lot of expense and effort to establish this camper in Austin, we were not able to deliver the campers we had sold and consequently have lost a lot of business. We not only don't have his campers but to this date are unable to find a pick-up camper such as his to fill out our once much rounded line of pick-up campers.

Senator Moss. I think we have a good, full hearing this morning.

We have kept under the wire. We become illegal when that clock hits 1 o'clock. So we have to terminate at this point.

We will continue the hearings tomorrow morning. It will be in S–407 of the Capitol tomorrow.

[Whereupon, hearing in the above entitled matter was adjourned, to reconvene at 10 a.m., Thursday, April 7, 1976.]

FAIRNESS IN FRANCHISING ACT

THURSDAY, APRIL 8, 1976

U.S. SENATE,
COMMITTEE ON COMMERCE,
Washington, D.C.

The committee met at 10 a.m. in room S–407, the Capitol, Hon. Frank E. Moss, presiding.

Senator Moss. The hearing will come to order.

This is the second day of hearings on S. 2335, the Fairness in Franchising Act.

Today we have a number of very important witnesses to hear.

And we will proceed with those witnesses.

I would like to announce in advance that our time is limited. We will ask our witnesses to wherever they can summarize and shorten the statements and make a general order at this time that all of the printed material will appear in the record and in fact if for any reason someone want to put something in later, that they have forgotten, and if it's germane and on the subject we will include it up to a week after we conclude the hearing. We will keep the record open that long.

Our first panel is Mr. Jerry Opack, president of the International Franchise Association, accompanied by Mr. Zeidman, counsel for the IFA; Mr. Rosenberg, president of Dunkin Donuts; Mr. Donelson Lake of Holiday Inns; and Mr. Gerald T. Aaron, general counsel for Pizza Hut.

Senator Moss. You may proceed in whatever order you wish.

Mr. OPACK. I am Jerry Opack. In Mr. Lake's place we have Mr. Burrow, who is counsel for Holiday Inns.

STATEMENT OF JERRY H. OPACK, PRESIDENT, INTERNATIONAL FRANCHISE ASSOCIATION; ACCOMPANIED BY PHILIP ZEIDMAN; ROBERT ROSENBERG, DUNKIN DONUTS; CHARLES BURROW, HOLIDAY INNS; AND GERALD T. AARON, PIZZA HUT, INC.

Mr. OPACK. Thank you, Mr. Chairman.

First of all, I would like to make some generalized remarks and then Mr. Zeidman will analyze the bill. With your permission, then, Mr. Rosenberg will testify, followed by Mr. Burrow and Mr. Aaron.

Senator Moss. Thank you; we will proceed in that order.

Mr. OPACK. I certainly do appreciate the opportunity to appear before you today in connection with your consideration of S. 2335.

The International Franchise Association is a trade association consisting of more than 220 firms, large and small, representing nearly

three dozen industries which utilize the franchising method of distribution.

Among our membership we do not have any companies involved in the auto, oil, newspaper, or beer industries.

We welcome these hearings because we are proud of the franchising system and the positive contribution it has made to the economic well-being of hundreds and thousands of people, and to the satisfaction of consumer preferences to millions of people. We take pride in discussing it.

We welcome these hearings, also, because they present a public opportunity to clear the air of misunderstanding and lack of knowledge about this distribution method that accounts for nearly a third of all annual retail sales in the United States. The very existence of these hearings and those recently conducted by the House Subcommittee on Consumer Protection and Finance show us that franchising is a matter of widespread interest but is little understood.

We welcome these hearings in the expectation that they will help clear the air of misconceptions, of misinformation, of lack of information, of distortions, of undocumented myths, and of fallacious generalities drawn and derived from unusual, novel, and isolated experiences.

Above all, we are pleased to have the opportunity to discuss and to analyze the substance of the bill, S. 2335, itself. This was not done yesterday. What does the bill really say? Does it do what it purports to do? What about the vague language? These are points we'd like to discuss with you.

Franchising is both a distinctive form of business organization and a method of distributing goods and services from their sources and suppliers to the ultimate consumer. It is a social as well as a commercial endeavor because it is a long-term interdependent relationship which brings into play human behavior dynamics which are unusual if not unique.

A great many changes of significant consequence have happened to franchising over the past 5 years. By its overall growth and relatively good performance during these economically turbulent and depressed years, franchising has established itself as, to quote the U.S. Department of Commerce in "Franchising in the Economy 1974–76": "a significant factor in the distribution of America's goods and services." It shows a record of strong, efficient, and socially desirable performance. Of course it is not a total success. Franchising, like any entrepreneurial business, is subject to both risks of loss as well as gain. In some instances franchising has been a phenomenal success in which all participants have enjoyed fantastic gains.

Twenty-three years ago Arthur Burns coauthored an economics textbook which included a segment on the dilemma between small business and economies of size. In that textbook, which was entitled "Modern Economics," he listed the advantages open to large-scale operations and those included specialization and division of labor, long-range planning, and raising capital. Large businesses could afford to attract managers of greater ability. Larger firms could engage in experimentation and research leading to product improvement and better and cheaper ways of making the product and marketing it.

Professor Burns said,

Theoretically it should be possible for a number of small firms, acting in cooperation, to achieve many of these advantages, but in practice, the necessary cooperation is seldom realized, if only because of the high degree of individualism that characterizes most small-scale entrepreneurs.

Mr. Burns and his coauthors hit on some key points. They posed the survival issue facing small businessmen. How could they be expected to compete with large firms that could afford to take the advantages of companies of size? He suggested a theoretical solution which was through cooperation among themselves. But, he was pessimistic that this would ever be realized because of his observations that there were strong personality characteristics prevalent among small, independent businessmen. It was his view they were not likely to act and work together for their own mutual good.

In light of the actual experience of that time, he was probably right. What he did not, and reasonably could not, foresee was an alternative means of organizing small business cooperation to achieve the advantages of large-scale operations.

He did not foresee franchising as a means of organizing small firms into a cohesive, cooperative enterprise under centralized management leadership. The term "franchising" does not even appear in the index to the book. Probably 95 percent of all franchising firms today did not exist in 1953, when his book was published.

The substantial growth and contribution of franchise distribution in our economy is now well documented. We see, of course, that the Commerce Department predicts $195 billion in sales approximately in 1976. We also would like to point out that this has been through organization, organization by central leadership, the franchisor. To an incredibly high degree franchising has been able to accommodate individualistic entrepreneurial drive with the discipline and cooperation that is required for effective and efficient team effort.

But it has not been and cannot be expected to be 100 percent successful in adjusting and reconciling the entrepreneurial individualism of every franchised businessman to the legitimate business needs of the entire cooperative system. Neither can it be a guarantor of 100 percent success. I make this point, Mr. Chairman, because of what I suspect is perhaps the underlying force behind this broadly based and what we believe is a one-sided legislative proposal.

The personality or the human behavior motivations were revealed by proponent witnesses in the hearings held on H.R. 4349. Moreover, they were recently the subject of extensive comment by the U.S. Court of Appeals in the Third Circuit in the *Dunkin Donuts* case, a landmark decision.

We suggest that vague and far-reaching legislation of this kind would not be appropriate or justified under any realistically conceivable circumstance and clearly it should not be entertained if based on contract renunciation and over-reaching by successful businessmen whose entrepreneurial appetites are unsatisfiable.

For example, one witness who appeared at the hearings held in the other body was a franchisee of the McDonald's Corp. In 1959 he made a $25,000 investment with a partner. Today he has 24 McDonald's units with a net worth in excess of $2½ million.

This witness was not concerned about termination of his franchise. He was never threatened with termination. He was a good operator. The company wanted to retain him. He was not concerned with the issuance of a new franchise following the expiration of the 20-year term. What he was concerned about was that when he got his new franchise, following the expiration of the 20-year term, that he might have to pay or might have to live up to terms that were somewhat different than what he was able to obtain 20 years ago in 1959.

He was asking that committee and this Congress to pass a law to guarantee that his prices would be frozen at the 1959 levels. I bring this to your attention to point out that there are reasons and nuances of this bill that may not seem obvious on its surface.

The wide variety of firms making up the IFA membership can be seen from our membership classified directory which has been provided to you with other materials that indicate the kind of activities and informational services the association provides.

Included in that membership are manufacturers and product distribution franchises such as Schwinn Bicycle, Radio Shack, Bresler's 33, which manufactures ice cream. Professionals are using the system. Century 21 is a network of real estate brokers. Comprehensive Accounting Service has brought together accountants. There are tax services such as H. & R. Block. Retailers such as Western Auto. Wrangler Ranches. There are rental services, employment agencies, food service companies, major hotel chains and many small companies, which are just embarking on a franchise program or are considering franchising as a way of getting their product or service to the marketplace and to the consumer.

The franchisee's investment can range from nothing to the price of a truck or van to multimillions of dollars. The industries, the systems, the investments and return on investment, the programs, terms and philosophies of organization and management are different for the dozens of industries and for companies within the same industry.

They are not standardized units of enterprise. Nor are they now subject to Government a mandate or under some type of central Government master plan to conform.

They represent a rich variety of choice to the prospective franchise owner and the economic system. They adjust and change and respond to the social and economic and competitive environment.

Up to now they have been free to innovate and to have the freedom of choice to adjust and to be different. But this bill would restrict that freedom and withhold those rights and attempt to pigeonhole in one tight compartment vast segments of the country's industrial products and service enterprises if, but only if they franchise. Vertically integrated firms are left free. If you have concern about vertical integration this proposal would hasten it.

I might point out that Mr. Bradwell produced a study for this committee yesterday and although there are many, many features of it that we think are erroneous and disagree with, I would like to point out one in particular dealing with vertical integration because such a great point was made of that.

The results and conclusions of that study do not square at all with the economic study that was released by the U.S. Department of

Commerce this January entitled "Franchising and the Economy." There, in the majority of industrial categories that were surveyed, the increase in the number of establishments of franchisees surpassed the increase in the number of establishments by franchisors.

In some industries there was a parity. In other industries a slight increase in company-owned operations. I suggest and hope that we can refer to the committee and for the committee files a copy of this economic study by the U.S. Department of Commerce.

Senator Moss. We'll be glad to have that in our files.

Mr. OPACK. I point out in connection with the economics report of Dr. Bradwell there is a definition of franchising which states that franchisee is provided with the obligation to sell the product or service of the franchisor within a specified territory or to specified clientele. Since the *Schwinn* decision and I believe that was some 15 years ago or so, that this type of restriction on franchisees has been outlawed.

It is a violation of the antitrust laws. So the definition of franchise in this study is certainly not what occurs today and is certainly not what is permissible by law today.

There are other aspects of it. I think in the chart dealing with the McDonald's situation, the allegation was made that they take the lucrative areas in certain cities and marketing areas for company operations and leave the marginal or poor operations to their franchisee.

I checked on that because I couldn't believe that myself. Here's the information I came up with. It's the policy of McDonald's to put company operations on the basis of their proximity to the regional office.

Now, the regional office that would be applicable to the San Francisco Bay area is located in Palo Alto. The number of company stores in that Palo Alto region was reduced from 26 to 22 percent since October 1973. In San Mateo, which is the county in which the office is located, 50 percent of the stores are company-owned. In Marin County, which is the highest income group, 50 percent is shown on the chart as being company-owned. The fact is that only one unit out of four is company-owned. That is 25 percent. The fact is that this store, this unit was first offered to franchisees who did not agree to accept it. In fact, it was offered to eight licensees who refused it. Out of 35 in the entire region, under 22 percent are company-owned.

Mr. Chairman, it certainly puzzles us and defies logic as we understand it to say as we heard yesterday that free enterprise will benefit from a legislative prescription calling for loss of freedom, administered in wholesale doses indiscriminately to all patients, whether sick or well, and without careful individualized diagnosis.

Franchising embraces a great variety of industries and businesses and people, and that is the bitter pill that the proponents of this measure are asking us to swallow. The identical therapy that may be considered necessary or appropriate for the sick can damage or injure the healthy. That is why IFA members are concerned.

The legislative advocate for the newspaper distributors said this bill would have no impact on competent franchisors, but it would have a severe impact on responsible business. If franchisors are not free to responsibly protect the quality and integrity of their opera-

tions, they will not survive and their franchised dealers and consumers will share the injury. If the integrity of contracting and freedom of will is not upheld and preserved, everyone will suffer. This proposal would have that effect.

The same witness told this committee that it should not demand production of evidence of abuses from him that would justify this drastic repression of contract rights because the record of government agencies' files (SBA and FTC) and the record of Congressional hearings dating back 20 years ago are "replete" with examples, he says. He invited us to research the record and read voluminous files along with searching the law books for reported cases.

This may be "legislative advocacy" of a sort, but this committee deserves a good deal more. The fact is that in April 1974, in response to an inquiry from the House Select Committee on Small Business, the Administrator of the SBA said that "So few complaints are received by SBA that no statistical data is maintained."

The SEC said in a letter from its Chairman that it would not be worthwhile searching its records because "complaints of this nature constitute a very small percentage of all complaints received by the Commission." The SEC regional offices also reported there were only a "very small number of inquiries regarding franchises."

The Office of Minority Business Enterprise of the Commerce Department reported in November 1973 as follows: "The number of complaints regarding franchising received by OMBE to date are so few and so infrequent that no table of statistics has yet been developed."

The kind of inquiries they had received related to the difficulty in obtaining equity financing, and to the difficulty in comparing the advantages of one franchising company in an industry to another franchise in the same industry.

Now, the FTC also responded in a letter that was signed by the then Chairman of the FTC, Lewis Engman. I believe a copy of that letter to the Committee is appended as an attachment to my statement.

He outlined the kind of complaints that the FTC received with respect to franchising. None of those complaints involved unfair termination, unreasonable termination, unfair failure to review, none. And the Chairman stated in that letter, and this is after the FTC spent 5 or 6 years studying franchising in connection with the proposed trade regulation it had under consideration, he said that the Commission continues to believe that the best way to deal with the abuses such as they may be in franchising is through full disclosure requirements.

Now, in 1972, when the FTC had this trade regulation rule under consideration, this was one dealing with disclosure—we made our own search of the FTC files.

We went through 2,100 pages of documents that were in a disjointed, unorganized order. We went through each of these 2,100 pages. And we found that of 246 documents in those files there were only 55 complaints remotely associated with franchising. Others dealt with multilevel distribution units, pyramid schemes, vending machine frauds, and product distribution misrepresentation. But the 55 complaints that we could categorize as being associated with franchising, none of these complaints concerned unfair terminations or failures to review.

Mr. Chairman, I hope I don't startle you by holding up this large document which is the result of that study. We have a three or four page summary that we would like to submit for the record to indicate what that search showed, if anyone on the committee would like to have a copy of this to look at or examine or keep, we would be delighted to reproduce it.

Senator Moss. We would be glad to have the summary in the record and access to the document so we can look at it if we would like to.

[The letter follows:]

INTERNATIONAL FRANCHISE ASSOCIATION,
Washington, D.C., April 20, 1972.

Re Analysis of "Franchise Complaints" in FTC Public Record regarding Proposed Trade Regulation Rule on Franchising.

Mr. WILLIAM D. DIXON
Assistant Director, Division of Rules and Guides, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C.

DEAR MR. DIXON: This report is submitted on behalf of the International Franchise Association to assist the Commission's study of franchising in three ways:

1. To more accurately identify and classify the specific kinds of business opportunity abuses now occurring in the marketplace, as evidenced by actual case histories taken from "complaints" in the public record of the Commission's proceeding on the proposed franchise rule.

2. To distinguish between: (*a*) Alleged abuses, including fraud, by non-franchisors masquerading as franchisors; and (*b*) Alleged abuses by franchisors—particularly those abuses which would be reached by the proposed rule; and (*c*) Ordinary business problems and disputes between franchisors and franchisees which are beyond the scope of the proposed rule.

3. To recommend remedies which will directly apply to the most prevalent abuses now occurring without burdening the Commission and responsible franchisors with depressing regulations and a mass of administrative detail which would very likely be evaded by the "fringe element", in any case.

CONTENTS

This report contains a one-page summary sheet for each of the 246 sets of documents (over 2100 pages) filed in Category (4) from January 26 through March 3, 1972. (Category (4) contains letters and documents solicited and obtained from, or in behalf of, purported franchises and other persons who claim to have been the victims of abuses associated with a variety of business opportunities.) These summary sheets have been grouped in four classifications as shown on the index tabs ("Miscellaneous", "Comments", "55 Franchise Complaints" and "116 Non-Franchise Complaints"). More detailed breakdowns of two of these categories "55 Franchise Complaints" and "116 Non-Franchise Complaints", are listed on their respective tab dividers.

These summary sheets, and the documents they describe, to our knowledge provide the most comprehensive collection and analysis of case history data ever assembled detailing specific "franchise complaints." They have been collected from regional FTC offices, Better Business Bureau offices, Justice Department, state agencies, chambers of commerce, members of Congress and various other sources, including attorneys and individuals known to have been involved in franchise litigation. Only a relatively small number of complaints were received by FTC in Washington with solicitation, and some documents relate to cases in which civil or criminal complaints have already been filed. Sixty-six of the 246 documents relate primarily to comments and opinions about the Proposed Rule rather than detailing specific complaints, as did the vast majority of the 1747 pages of testimony taken during twelve days of hearings.

116 NON-FRANCHISE COMPLAINTS

The most significant result of this study is the discovery that over two-thirds of the so-called "franchise complaints" in this FTC file do not relate to "franchising" at all—or to any variation of franchising. Instead, the records are

bulging with a long list of fraud and other abuses committed by hit-and-run swindlers who use—and continue to use—deceptive blind ads to peddle vending machines, rack jobber deals, phoney "distributorships", pyramid schemes and other nefarious offerings.

While some of these "come-on" ads appears under the "Franchises" heading in the classified sections of leading Sunday newspapers everywhere, most are found under "Business Opportunities." It is shocking to find that some of the same advertisers identified in this FTC file as alleged swindlers are still running the same kind of "come-on" ads. It is also discouraging to see the great number of blind ads accepted by leading newspapers where potential investors are invited to write to a box number, or to "call a Mr. X" at a phone number, or at a hotel. Although some such offers are no doubt legitimate, the FTC files contain numerous complaints alleging that deposits or "front money" were paid in hotel meetings to representatives who "disappeared", or that money was paid for machines, racks or merchandise never delivered. Such ads continue to appear in newspapers every Sunday—see "Business Opportunity Ads" tab.

FRANCHISE OR NON-FRANCHISE?

It is understandable that many people may be deceived or confused about what is franchising, and what is *not* franchising—especially when the already complex nature of franchising is further complicated by non-franchisors masquerading as "franchisors." (See speech by M. A. Caliandro of the Better Business Bureau in Appendix.) The opening paragraphs of the FTC's Background Paper on the Proposed Franchise Rule discuss the problems of defining "franchising" and reach the conclusion that:

"Basically, franchising should be viewed as a method of distribution in which the franchisor *licenses his trademark* to a licensee, i.e., a franchisee who conducts his business in accordance with the franchisor's uniform business format." (Emphasis added.)

It is the use of a trademark which almost invariably distinguishes true franchising from spurious "franchising." Granting the use of a trademark or service mark for a fee or royalty is indeed the essence of the franchise relationship. This is recognized by the definition of "franchise" in the California Investment Law, the International Francise Associations "Model Bill" and by most other state laws to regulate franchising. (Granting the use of a trademark without a fee or royalty for merchandising purposes also may be called a "franchise", although such arrangements usually are more accurately identified as "authorized" dealerships or distributorships, and do not possess the inherent risk of loss or injury to the investing public.)

It is clear that few if any of these "116 Non-Franchise Complaints" relate to true franchise relationships for several reasons. First, no trademark or service mark is involved—and indeed, based on the FTC complaint files, it is common practice for shady operators to change company names as often as they change hats. Second, the complaints show there is no "series of . . . transactions", no "continuing commercial relationship," nor does the "franchisor continue to exert any control. . . ." On the contrary, the typical swindler collects the deposit or "front money" and either disappears or refuses to respond to investor inquiries—this situation is illustrated over and over again in the file of complaints.

While it may appear to be a simple remedy to broaden the definition of "franchise" to cover sellers of vending machines, rack jobber routes, "distributorships", pyramid deals and other schemes described in this file of complaints, such a solution would suffer from at least two defects. First, the rule would have to be so broad as to encompass virtually every kind of distributor arrangement and would therefore be virtually unmanageable and, second, the fraudulent recruiters would no doubt switch to "Help Wanted" ads or other evasions, and would continue to violate laws, regulations, and business ethics by one means or another just as they are doing today.

55 FRANCHISE COMPLAINTS

With respect to the "55 Franchise Complaints," it is suggested that the Commission staff may find it worthwhile to investigate each of these cases in more depth. For the most part, the records available indicate that the majority of these involve ordinary business problems and disputes, a good many of

which are being litigated to determine whether the franchisee is justified in his complaint. Some complaints have been included in this category simply because they claim to be "franchise complaints" and there is insufficient information to classify them otherwise. Most of the charges made in all of these complaints are entirely unverified, being only "one side of the story."

This is not to say they should be dismissed as unimportant, but only that in their present state, and without more thorough investigation, they do not constitute reliable evidence of widespread wrong-doing or unfair practices by true franchisors. Even assuming one third of them may prove to be both justified and also covered by the Proposed Rule, which probably is a generous estimate, they would make up less than twenty actual franchise complaints—a modest number indeed in relation to some 500,000 franchisees now estimated to be in business. Such a figure provides scant support for the assertion made at the opening of the hearings that "The records of this Commission show that there have been a substantial number of complaints . . . These abuses are too many in number to go unheeded." (Transcript, pages 8 and 9)

REMEDIES THAT "ZERO IN"

As counsel and witnesses for the International Franchise Association testified during the hearings, IFA supports remedies designed to stop abuses by the "fringe element of promoters" which not only defraud the public but also damage the reputation of ethical franchisors. But at the same time, the Commission was urged to be selective and to propose remedies which would "zero in" on actual abuses, rather than to use a "shot-gun" approach. During the hearings, however, few if any witnesses had any clear understanding of what kinds of abuses were represented "in the files of this Commission". Indeed, the second witness, a lawyer, was frank to say,

"In other words, I simply don't know what is the problem on misrepresentation or fraud which is what I assume these disclosure requirements are aimed at, that prompts them to be such a sweeping type of regulation." (Transcript, page 34.)

Now that "the problem of misrepresentation or fraud" has been more clearly identified in the Commission's files, appropriate remedies might include the following:

1. A crack-down on the flood of blind Business Opportunity or similar "come-on" ads to stop those that are found to be deceptive or have the capacity to deceive.

2. A request from FTC to States' Attorneys General to conduct local investigations of such ads and to press for enactment of legislation to prohibit blind or deceptive ads, and to provide adequate penalties if not already in effect.

3. More vigorous enforcement of anti-fraud statutes at both federal and local levels, including mail fraud, with criminal prosecutions where warranted.

4. A systematic exchange of information about suspect offerings and investigations between all local enforcement agencies, Better Business Bureau offices, FTC regional offices and FTC headquarters.

5. If sufficient need can be shown on the basis of true franchise abuses, promulgation of a disclosure rule similar to the IFA, model bill and the California Franchise Investment Law, perhaps with appropriate exemptions (such as those adopted elsewhere, for established responsible franchise companies and for "authorized dealership" arrangements not involving a franchise fee).

6. If there appears to be sufficient need for a special trade regulation rule for gasoline service stations, as suggested by various witnesses during the hearings, representatives of the petroleum industry should be consulted to develop a reasonable, workable rule for that industry. This is far more reasonable and sensible than blanketing all no-franchise-fee marketers by having an overly broad definition of "franchise" merely for the purpose of bringing service stations under the rule.

7. In general, existing laws against deceptive advertising, misrepresentation and fraud by non-franchisors should be vigorously enforced—rather than attempting to eliminate these practices by imposing upon franchisors added burdensome regulations using a contrived definition broad enough to cover non-franchise offerings.

CONCLUSION

Based on the evidence of record in the trade regulation rule proceeding, it is apparent that unfair and deceptive practices do occur in the promotion and sale of a variety of business opportunities. It is also apparent that only a small percentage of recorded complaints and alleged abuses relate to true franchising. And, even these are unverified.

The Commission has authority under existing law to take enforcement action against the kind of promotional and sales practices which have been demonstrated to exist, and we urge that such action be taken. On the other hand, the proposed rule will be ineffective to a large extent in eliminating present abuses, while casting an enormous burden on ethical and fair-dealing business. The proposed approach to abusive practices should be changed and directed to squarely meet the real problems of the market place.

It is respectfully requested that the foregoing, with attachments, be included in the record of proceedings for the proposed trade regulation rule concerning franchising. We would be pleased to discuss this submission with you and to provide the Commission with any further information it may deem useful and desirable.

Sincerely yours,

JERRY H. OPACK,
Executive Vice President.

Mr. OPACK. We have searched, and Government agencies have searched without avail for the claimed "replete" record of abuses that this bill purports to cure. If we know what they are and their nature and their effect, then and only then can we deal with the problems.

But now and here we are talking about proposed revolutionary changes to franchise business based on what appears to be a fantasy, or somebody's idealistic "master plan" which would throw into a chaos a recognized successful and beneficial system of business.

The time has come, Mr. Chairman, to stop the rhetoric and to produce some real documented facts and to convert legislative advocacy into legislative education. If widespread abuses throughout franchising in the area of unreasonable and arbitrary termination and refusals to renew exist beyond peradventure, as claimed, then I urge those making the claim to "venture" out and bring them in. They failed to do so in prior hearings and they failed to do so yesterday before this committee.

I have described what IFA is and whom it represents. We are not clear whom the National Franchisee Association, which Mr. Waldie described as "loosely formed," represents. This question was raised by Senator Ford yesterday. Certainly its membership is not representative of anywhere near the score of industries and distribution arrangements that would be directly and adversely affected by this proposal.

Just from my partial inquiries following yesterday's hearings, it appears there may be more than one mistake in the listing placed in the record. For instance, I am advised that the Kentucky Fried Chicken National Association is not a member of the coalition although it did have observers in attendance at one or more meetings. With respect to McDonald's, the McDonald's Operators Association represents only 20 to 50 percent of the 1,100 McDonald's franchisees.

With respect to Dairy Queen, its association represents and includes only 10 percent of the 4,100 company franchisees. It appears clear to us that the NAFC represents not only a small minority of

franchisees but, at best only a small number of the Franchisees Coalition's own members.

We know that most franchisees are not malcontent. On the average 80 percent and more of all franchisees would do it all over again. I believe the proponent franchisees are not unhappy with the business. They in fact, based on this legislation, want to continue. They want to be renewed at the expiration of the first term or second or whatever it may be. They want a Government guarantee that their agreements freely and voluntarily entered into will be first rewritten to their advantage and then will be perpetuated indefinitely without modification of costs or terms.

I would like to touch on a couple of other mistatements made yesterday which I feel must be corrected.

IFA's position in favor of full advanced disclosure was publicly announced more than 7 years ago. Contrary to the opinion expressed, disclosure rules are not limited in effectiveness to just the inception of the relationship because if at any time during the relationship, which can be 20 years or more, if at any time during the relationship a disclosure requirement made at the outset is found to have been false, found to have been misleading, incomplete, or left undisclosed, the injured party has an effective remedy.

It lasts throughout the relationship. This gives individuals the opportunity to know about their relationship and all material facts about the franchise. If they are not true, then at any time during that franchise relationship and thereafter an action for damages and other remedies will lie.

Disclosure allows individuals the opportunity to exercise their own good judgment and intelligence. This bill's dictating of onerous contract terms is an insult to intelligence.

Mr. Chairman, I won't go over all that the International Franchise Association has done in connection with advocating uniform full disclosure of all material franchise terms and contract terms in advance. But they have been formidable. We have worked with State administrators, in the absence of a Federal uniform law, to get a single uniform disclosure document for all of the States that have a franchise disclosure law that would be acceptable to all States. It's highly detailed and is an appendix to Mr. Zeidman's statement.

In general terms, sir, we feel that one of the great dangers of this bill which isn't particularly obvious on the surface is that it takes away property rights, valuable trade mark property rights, from their rightful owners. It would attempt to take them from one group of businessmen and divide them among another group of businessmen who have no equitable claim to them.

The provisions of this bill go way beyond any real problems in the contemporary franchising relationship.

Senator, no one has been more concerned about the consumer than you have. We think that this proposed legislation provides nothing to the consumer other than the prospect of reduced standards of quality, service, and choice at a higher cost. If it's difficult for a franchisor to police and enforce quality standards, the consumer will suffer.

It does nothing to further competition or the fair and efficient functioning of the free marketing economy. The bill would put a straightjacket on natural marketing influences and personal freedom of choice. It forecloses business opportunities for the franchisor and franchisee, particularly the small individuals, small investors, and minority candidates.

It would make it so onerous to take a risk with an untried or proven franchisee that most franchisors would not do it on the basis of their own survival. It would add tremendous costs and burdens on business organizations that market their products and services through various channels of distribution, not to mention the clogging of the courts and the litigation that would ensue.

The fact that the proponents say this bill is written in constitutional terms and breadth and broad language necessarily would require that it would be interpreted throughout many years as the court put it through the judicial mill.

That is what they say they don't want—to require the franchisee to go through more litigation. But with that broad, generalized, theoretical, constitutional type language imposed and attached to day-to-day practical business, the impact is clear. It's going to continue and litigation will grow. There is no other way to look at it.

There is no real advantage, no theoretical advantage or practical advantage for franchisors not to renew good, satisfactory franchise owners. And this was borne out in practice by the study that was conducted by the Department of Commerce. The changes in ownership are nominal. Some 800, perhaps, out of thousands of new stores and new franchisees being added. But most of those were, if they were taken over by the company, for the temporary purpose of managing it until they could find another franchisee to take it over.

The fact is there does not exist any trend toward companies' taking over franchised operations. That simply does not exist.

Vertical integration which was characterized as being on a rampage simply does not exist. If someone claims it does, let us see where the figures and data come from.

The fact is that franchisees' agreements do not permit arbitrary terminations, at least not most of them. The results of a survey conducted by an objective, independent professor listed in our statement indicate that in 70 percent of all agreements franchisees were even given a grace period to correct serious deficiencies.

It has been stated in a study by the Conference Board that the evidence does suggest that most franchisors could not afford to unreasonably terminate their franchisees' contracts. When termination occurs it comes as a culmination of serious attempts by the franchisor to get the franchisees to operate in conformance with the franchisees' contract.

I will close with this observation, franchisor and francisees cannot be antagonists. They cannot be and remain competitive. But if real inequities do in fact exist and if legislation for improvement is needed, we want to deal with them and we will be anxious to give this committee all of the assistance we can and we would welcome the opportunity to do so.

Mr. Chairman, thank you very much for your attention.

With your permission, I would now like to turn the presentation to Mr. Zeidman and I think perhaps he will fill in a lot of questions you may have running through your mind and subsequent to his statement we would be delighted to entertain any question you may have.

[The statement follows:]

STATEMENT OF JERRY H. OPACK, PRESIDENT, INTERNATIONAL FRANCHISE ASSOCIATION, WASHINGTON, D.C.

Mr. Chairman and Members of the Committee, my name is Jerry H. Opack. I am President of the International Franchise Association (IFA), I appreciate the opportunity to appear before you today in connection with your consideration of S. 2335, a bill entitled the "Fairness in Franchising Act."

The International Franchise Association is a trade association consisting of more than 220 firms, large and small, representing nearly three dozen industries (not including the auto, oil and beer industries) which engage in whole or in part in the franchise method of distribution.

With me today is Philip F. Zeidman, IFA Washington Counsel, who principally will be presenting the Association's position on this bill.

The remaining members of the panel, while representing firms which are members of IFA, will be speaking on behalf of their individual companies. The entire panel welcomes the opportunity to answer any questions you have.

We welcome these hearings because we are proud of the franchising system and the positive contribution it has made to the economic well being of hundreds of thousands of people, and to the satisfaction of consumer preferences to millions of people. We take pride in discussing it.

We welcome these hearings, also, because they present a public opportunity to clear the air of misunderstanding and lack of knowledge about this distribution method that accounts for nearly a third of all annual retail sales in the U.S. The very existence of these hearings and those recently conducted by the House Subcommittee on Consumer Protection and Finance shows us that franchising is a matter of widespread interest but is little understood.

We welcome these hearings in the expectation that they will help clear the air of misconceptions, of misinformation, of lack of information, of distortions, of undocumented myths, and of fallacious generalities drawn and derived from unusual, novel, and isolated experiences.

Franchising is both a distinctive form of business organization and a method of distributing goods and services from their sources and suppliers to the ultimate consumer. It is a social as well as a commercial endeavor because it is a long term interdependent relationship which brings into play human behavior dynamics which are unique.

A great many changes of significant consequence have happened to franchising over the past five years. By its overall growth and relatively good performance during these economically turbulent and depressed years, franchising has established itself as, to quote the U.S. Department of Commerce in "Franchising In The Economy 1974–76": "a significant factor in the distribution of America's goods and services." It shows a record of strong, efficient, and socially desirable performance. Of course it is not a total success. (Franchising, like any entrepreneurial business, is subject to both risks of loss as well as gain.) In some instances franchising has been a phenomenal success in which all participants have enjoyed fantastic gains.

I see this bill (S. 2335) as a reflection and recognition of the success, growth, and economic importance of franchising, because rather than being simply "reform" legislation its unprecedented impact extends way beyond the adjustment or correction of alleged abuses or inequitable practices which exist between businessmen.

Portions of this bill are simply window dressing in that the situations it purports to "correct" are already justly governed by existing law. These window dressing features should not be allowed to disguise the over-reaching imbalances or the wrongful essence of this proposed legislation which includes the involuntary confiscation and forced, uncompensated appropriation of property rights.

The so-called "reform" bill asks this Committee and the Congress to take away valuable trademark property rights from its rightful owners and to redistribute them among others who have no just or equitable claim to them.

Contrary to the preamble of the bill, a close analysis will show that this broad ranging bill goes far afield from its purported purpose. It goes way beyond real problems generally prevailing within contemporary franchising relationships.

This proposed legislation provides nothing to the consumer other than the prospect of reduced standards of quality, service, and choice at a higher cost. It does nothing to further competition or the fair and efficient functioning of a free market economy. How can it? By its terms it stifles competition by severely restricting agreements permissible for franchised, but no other form of distribution, and it forces businessmen to make unnatural economic business decisions. This bill would put a strait jacket on natural market influences and personal freedom of choice. It would restrain and prevent efficiency of competitive market forces.

It would foreclose small business opportunities for both the potential franchisor and franchisee. And, it would seriously disrupt and add wasteful costs to an enormous number of business organizations that market their product and services through different channels of distribution.

Franchisors and franchisees must not be antagonists. They cannot be if the system is to be maintained and competitive. We urge this Committee to guard against attempts by others to foment discontent between franchisors and their dealers; to not be a party to devisiveness or the encouragement of antagonism and polarity in a relationship that requires a spirit of extraordinary cooperation and mutual confidence.

You have it within your power to ask for proof and evidence and to act upon that basis. We invite you to hold us to high standards and urge that you not be satisfied with any less from the proponents of this proposed legislation.

We are asking this Committee only for open-minded consideration and careful and complete collection and analysis of facts. We urge you to guard against allowing misuse of the federal legislative process for the purpose of providing an unearned and unwarranted windfall to some businessmen at the expense of others.

If real inequities do in fact exist, if legislation for improvement is needed, we want to deal with them, and to be given the opportunity to suggest means to better the system for all parties involved without unnecessarily hurting and wrecking a system of distribution that contributes so much to the well being of so many.

We trust in fairness for all, and would accept with grateful appreciation the judgments that would flow from fair conclusions, derived from a fair appraisal, of the evidence generated from a fair investigation.

With member companies located in Canada, England, Australia, Brazil, Japan, Puerto Rico, and the United States, the International Franchise Association is recognized as the spokesman for responsible franchising. A copy of our Classified Directory of Members is attached. Most member companies were created less than 20 years ago and most are small business firms.

The Association was founded in 1960 by franchising executives who saw the need for an organization that would speak on behalf of franchising before government bodies and the general public, provide services to member companies and those interested in franchising, set standards of business practice, serve as a central point for franchise data and information, provide a medium for the exchange of information and experience, and offer educational programs for top executives and managers.

IFA has high standards of membership. Not all companies applying for membership are accepted. A full member must have a net worth of at least $200,000, have been in business for at least two years, have a satisfactory financial condition, have at least ten franchisees of individual units or three area franchisors, if that is its method of operation, one of which shall have been in business for at least two years, have complied with all applicable state and federal full disclosure requirements, and have satisfactory business and personal references. Full members are granted the use of the Association's seal, which IFA proudly terms "Franchising's Seal of Excellence."

The associate membership category is reserved for those companies who are new in franchising, considering franchising, or who cannot meet the financial requirements of full membership. Associate members may not use the IFA seal. They are admitted so that they can be guided by experienced companies,

and have access to the programs and services which many companies find essential to the operation of their business. Like full members, their membership is contingent upon continuing adherence to the IFA Code of Ethics, a copy of which it attached.

As an example of the esteem in which the IFA Code of Ethics and Ethical Advertising Code is held, the Small Business Administration, in its booklet, "Franchise Index/Profile," reprints the codes and the IFA's membership requirements and suggests:

"It is worth a letter to the IFA requesting a copy of the International Franchise Association membership roster to determine whether or not the franchise you are interested in is a member. The codes themselves are reassuring."

IFA also offers affiliated memberships on an information exchange basis to franchising organization in other countries. The Canadian and Japanese franchise association, for example, are affiliate members. Educational memberships are offered at a very low cost to colleges and universities.

The International Franchise Association is unique in its status as the foremost medium for information about franchising. A monthly newsletter, "Franchising World", is distributed to members and contains the most recent information about developing trends in franchising. Also circulated to IFA members is the "Current Legal Digest", which contains updated information on the status of franchise legislation as well as summaries and analyses of the most recent decisions from the courts and administrative agencies relating to franchising. In addition to those monthly newsletters, the IFA has just published "Franchise Laws, Regulations and Rulings", the only existing compilation of franchise laws and regulations of general application. Other publications of the association provide information about other aspects of franchising. A list of IFA publications is attached.

The most notable of all IFA's publications is "Investigate Before Investing: Guidance for Prospective Franchisees." More than 200,000 copies of this pamphlet have been distributed by IFA and its members to prospective franchisees. IFA has made this publication available for distribution by the states, two of which are currently publishing the book under their own name. "Investigate Before Investing" has also been distributed by the Better Business Bureau. A copy is attached.

The Association's educational programs are unique. For example, this coming May 11–12, the Association will conduct its 9th Annual Legal and Government Affairs Symposium. This is the only annual program which addresses the legal problems and challenges of franchising. A significant portion of this year's program will deal with the subject under consideration today, franchise terminations and renewals. A transcript of the May legal conference will be published. Transcripts of earlier legal conferences are available through the IFA.

Another significant contribution of the IFA to franchising is its annual series of franchise management workshops. These workshops are conducted by top executives of franchise companies and are designed to educate the middle management of franchise companies. During the last year, these programs were expanded to provide direction for individuals and companies which were considering becoming franchisors. These programs met with overwhelming enthusiasm and will be continued in the future. We have attached a program from our most recent workshop to indicate the various business problems which confront franchisors.

IFA'S POLICY ON FRANCHISE LEGISLATION

The International Franchise Association has long advocated full and fair disclosure of all information which is material to the purchase and continuing operation of the franchise. The Association has supported in Congress, in the states, and before the federal Trade Commission legislation and regulation which require uniform pre-sale disclosure to all prospective franchisees. Full disclosure is required by the IFA Code of Ethics. We believe that this is the effective and fair way to deal with and to prevent abuses in franchising. This also is the position of the Federal Trade Commission as expressed in a letter dated April 4, 1974, from then Chairman, Lewis A. Engman, to Congressman Addabbo, Chairman of the Subcommittee on Minority Small Business Enterprise and Franchising, Select Committee on Small Business, House of Representatives.

This letter (copy attached) was in response to a Committee inquiry made in connection with franchise hearings held in June and July of 1973; IFA testified at those hearings, as did some witnesses who now support H.R. 8349.

The FTC has had more experience and exposure to complaints alleged against franchising than any other government agency. It has studied franchising for seven years in connection with its pending proposed trade regulation rule concerning franchising.

Mr. Engman's letter reveals that the FTC has received on complaints relating to arbitrary terminations or failure to renew franchises. He did not suggest that remedial action of any kind was needed or desirable in this area. To the contrary, his letter to the Subcommittee states:

"The Commission continues to believe that the problems and abuses occurring in the area of franchising can best be remedied through full disclosure requirements. Its proposed Trade Regulation Rule on Franchising endeavors to provide the prospective franchisee with the kind and the degree of information necessary in order to properly assess the advisability of a proposed franchise agreement. Public hearing on the proposed Rule have been held and Commission staff is in the process of formulating its recommended revisions."

The Subcommittee report (House Report No. 93–640, 93d Congress, 1st Session, The Role of Small Business In Franchising, November 1973), did not recommend legislation relating to terminations or renewals, but did recommend that Congress "Consider legislation which would establish uniform provisions for full disclosure by franchisors to prospective franchisees."

Congress has not acted on uniform disclosure requirements. The FTC proposed rule is still pending. In the meantime, the Association has worked with an association of the administrators of state franchise laws, The Midwest Securities Administrators Association, (MSAA) to develop a uniform disclosure document which can be used to comply with the divergent statutory disclosure requirements of all states having franchise disclosure laws. Most recently, IFA has worked with the MSAA to revise the offering circular to minimize anticipated conflicts between the proposed Federal Trade Commission Trade Regulation Rule on Franchising and the existing Uniform Franchise Offering Circular and Registration Application.

The significance of pre-sale disclosure as a remedy to franchise abuses becomes quite apparent after a review of the most recent statistics published by the U.S. Department of Commerce in "Franchising in the Economy 1974–76." The Commerce Department surveyed 1,051 franchising firms, estimated to be 99 percent of all franchisors. Its definition of "franchising" is far more restricted than the broad definition used in S. 2335.

The surveyed firms offer business opportunities in 39 broad industrial categories, which can be further broken down. (The IFA membership represents more than three dozen industries.) Franchising companies differ as significantly in size as do the investments made by the businessmen and women who purchase franchises. Where fees are charged, the investments range from $1,000 to $2,100,000.

Of the more than 1000 franchising companies, 45 (4.5%) of them account for 58.5% of all franchised establishments and 50.1% of all franchise sales. The remaining 950 franchising companies (95.5%) share the remaining 50% of franchise sales and the 41.5% of franchise establishments.

Accordingly, it is clear: that most franchising companies are themselves small business firms, that strong competition exists between franchisors in attracting new franchise owners to their system, that efficient franchise owners are the most valuable investment and asset to these developing as well as to established firms, and that it makes no economic or business sense to lose these productive people. There is no evidence that companies "boot out" successful franchisees for the purpose of "taking over" their operations. (See Franchising in the Economy 1974–76, U.S. Department of Commerce, at page 17.) There is no theoretical or imaginable incentive or motivation for arbitrary termination or failure to renew. To the contrary, it is illogical and poor business judgment to do so.

This theoretical conclusion is borne out in practice, as confirmed by recent studies and surveys.

(1) A 1971 survey of 172 franchise agreements undertaken by Gerald G. Udell [The Franchise Agreement Handbook: An Analysis of the Contractual Elements of Franchising, Purdue University Agricultural Experiment Station, Research Bulletin No. 889, May 1973], shows that franchise agreements are not

written to permit franchisors to arbitrarily terminate their agreements with franchisees. In fact, nearly all agreements describe the reasons for termination, and in nearly 70% (69.3%) of the agreements surveyed, franchisees were given the benefit of a grace period during which they could cure the default which was the basis for the termination notice. Since 1971, the trend toward specifying reasons and including grace periods has grown significantly.

(2) A 1971 study by the Conference Board ("Franchise Distribution", Conference Board Report, No. 523) states, "the evidence does suggest that most franchisers could not afford to unreasonably terminate very many of their franchise contracts. When a termination does occur, it usually comes as the culmination of a series of attempts by the franchiser to get the franchisee to operate in conformance with a contract stipulation."

(3) The Ozanne and Hunt study, "The Economic Effects of Franchising" (Committee Print, Senate Select Committee on Small Business, 1971) states: "Renewal Privileges." Many franchise agreements provide for automatic renewal privileges for franchisees who are in compliance with the agreement. In response to a question asking the franchisor whether the agreement is "renewable at the franchisee's option," 82.5% (94 of 114) of the franchisors replied in the affirmative. The median length of the renewal period was five years.

CONCLUSION

For the reasons herein, and as more fully set forth in the statement of IFA Washington Counsel, Philip F. Zeidman, S. 2335 is an unwise, unfair and unneeded legislative proposal. It is selfish, special interest legislation which is contrary to the best interests of the free and efficient flow of commerce, the growth of small business, and the needs of the consumer.

This bill is overwhelmingly against the public interest and should, we urge, be disapproved.

FEDERAL TRADE COMMISSION,
Washington, D.C., April 4, 1974.

Hon. JOSEPH P. ADDABBO,
Chairman, Subcommittee on Minority Small Business Enterprise and Franchising, Select Committee on Small Business, House of Representatives, U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for providing the Federal Trade Commission with a copy of House Report No. 93–640 entitled "The Role of Small Business and Franchising" which issued as a result of hearings held by your Subcommittee in June and July of 1973.

Your letter specifically directed the Commission's attention to Recommendations B and C of the report which call for particular actions by the Commission.

With respect to Recommendation B, the Commission is continuing its rulemaking proceeding in the franchising area; presently the Commission's proposed Trade Regulation Rule on Franchising is undergoing revision at the staff level. The question of enlarging the distribution of the FTC publication entitled "Franchise Business Risks" is being considered as part of this rulemaking proceeding.

Recommendation C requested that the Commission provide the Subcommittee with information concerning the nature and frequency of complaints received by the Commission involving franchising and pyramid sales, as well as the Commission's views and proposals for corrective action in the franchising and pyramid sales areas.

During the first eight months of Fiscal 1974, the Commission received 838 communications regarding franchise business relationships and pyramid sales practices. Two hundred and fifty-eight of these communications came to the Commission's headquarter operations and the remaining 580 were received by the Commission's eleven regional offices. Commission staff examined the 258 headquarter communications and found that 172 of these involved pyramid sales practices, while the other 86 communications concerned franchises.

Of the 172 headquarter communications involving pyramid sales, 134, or 78% were that 172 headquarter communications involving pyramid sales, 134, or 78% were complaints or inquiries in which assistance was sought in securing a refund of investments made in various pyramid programs. Thirty-four com-

munications complained about alleged misrepresentations and fraud in connection with the sale of distributorships. Eleven of these 34 complaints made specific reference to misrepresentations of income expectancy and potential profitability. The remaining 23 communications complained of misrepresentations and fraud of a general or unspecified nature.

Seventy-eight of the 86 headquarter communications covering franchise relationships fell into the following categories: (*a*) complaints and inquiries in which assistance was sought in obtaining a refund (21); (*b*) complaints alleging fraud and misrepresentation concerning potential profitability (14); (*c*) complaints alleging misrepresentation and fraud with respect to the failure of franchisors to provide equipment contracted for (12); (*d*) complaints alleging misrepresentation and fraud with respect to the failure of franchisors to provide services and assistance contracted for (11); and (*e*) complaints alleging misrepresentation and fraud of a general or unspecified nature (20).

Of the 580 communications received in the regional offices during the first eight months of Fiscal 1974, 305 pertained to pyramid operations and 275 concerned franchising. The substance of the regional office communications was substantially the same as the substance of those received by headquarters. Additionally, the percentage of communications falling into the various categories was also the same—for example, approximately 17% of the franchise communications complained of failure to receive services and assistance promised by the franchisor.

The Commission continues to believe that the problems and abuses occurring in the area of franchising can best be remedied through full disclosure requirements. Its proposed Trade Regulation Rule on Franchising endeavors to provide the prospective franchisee with the kind and the degree of information necessary in order to properly assess the advisability of a proposed franchise agreement. Public hearings on the proposed Rule have been held and Commission staff is in the process of formulating its recommended revisions.

The Commission is presently involved in various stages of litigation with four companies who have allegedly employed pyramid sales practices. Although the Commission is presently pursuing alleged violations of law in the pyramid sales practices filed on a case-by-case basis, this does not foreclose the possibility of promulgating a trade regulation rule covering pyramid sales in the future.

Sincerely,

LEWIS A. ENGMAN,
Chairman.

Senator Moss. Thank you very much.

Mr. Zeidman, we are glad to have you before the committee again. We look forward to your presentation.

I must indicate again we have to conserve some time or we won't get it in in the time we can sit. We no longer have authority to sit after the Senate goes in and completes the morning business.

Mr. ZEIDMAN. Thank you, Mr. chairman. It, as always, is a pleasure to appear before your committee.

Mr. chairman, members of the committee, I would like with your permission to submit for the record the comments of the International Franchise Association on S. 2335 together with attachments.

It is a somewhat extensive statement and I shall attempt today to summarize its principal points.

At the same time, I should like to respond to certain of the statements made by proponents of this legislation during the hearing conducted by this subcommittee yesterday afternoon.

Obviously it will not be possible to deal with the eight changes suggested yesterday by the proponents of the legislation; we have not seen the precise language—nor, we assume, has the committee—but they appear to be major and perhaps complex, and will require study . . . when we are provided with them.

The proposed legislation would, as you know:

(1) Severely limit the right of a franchisor to terminate a franchise agreement based upon the actions or inactions of the franchisee pursuant to that contract;

(2) Force the franchisor, except in certain specified circumstances, to enter into a new agreement with the franchisee, following the expiration of the previous contract;

(3) Impose quite stringent requirements upon the franchisor as to the manner in which, and the time within which, notice of either termination or nonrenewal must be provided;

(4) Provide for a number of other extraordinary steps, including the shifting of the traditional burden of proof from the plaintiff-franchisee to the defendant-franchisor; and

(5) Provide for $1 million, 3-year study of the FTC to determine if it necessary to pass the legislation which the earlier part of the bill has already determined to be necessary.

The bill would apply to a broad range of commercial contracts which fall under the general rubric, "franchising."

It would do so without recognition of the substantial differences among those forms of agreement; would apply to a broad range of American industries without regard to the substantial differences in the method of distribution and other relevant factors characterizing those industries; and would apparently seek to be applied retroactively to hundreds of thousands of franchise agreements now in existence.

We submit that this legislation is unfair; it is unjustified; and it is anticompetitive.

Our position rests upon the following considerations:

The States have ample power to legislate in this area. Some have elected to do so while others have rejected such proposals. Federal intervention under such circumstances is both unnecessary and inappropriate.

Many States have passed legislation dealing with termination or nonrenewal in the field of franchising, most dealing with specific industries, and 10 dealing with franchising generally.

A number of States, however, have considered this matter and have rejected the need for legislation.

In 1973, 1974, and 1975 alone, 10 States have done so.

There seems to be no justification for the Federal Government to act in a field which is wholly within the power of States, and well within their expertise.

With respect to the relationship between State and Federal law:

The very existence of these State statutes dictates that there will, in all likelihood, be discrepancies between the Federal statute and those in existence in the States.

Moreover, there is no need for such legislation based upon any requirement of uniformity or symmetry because, quite unlike disclosure legislation or legislation dealing with national advertising of franchises, the issues here are far more individual and ad hoc, and less demanding of uniform treatment.

The IFA position is, quite the contrary to the testimony you heard yesterday, not at all inconsistent.

As I shall not later, this association has consistently supported Federal disclosure legislation or regulation, as an objective which is

desirable on its own merits and as an alternative far preferable to a disparate hodgepodge of State laws rendering the national advertising and marketing of franchise programs virtually impossible.

No such considerations apply to legislation dealing with the factual circumstances under which a franchisor may lawfully terminate or refuse to renew a franchisee.

For here, almost by definition, the individual factual circumstances of each case will determine the result and, indeed, as the attorney for the newspaper dealers testified yesterday, "naturally the courts are going to have to deal with such language so as to effectuate the bill's purposes, and in light of changing conditions."

No cogent reason has been advanced, and we believe none exists, why that individual, case-by-case analysis can or should more effectively be conducted by hundreds of Federal courts than by hundreds of State courts.

The conditions under which Federal action is appropriate are absent.

The first such requirement for Federal action is that there be a sufficiently pervasive and widespread abuse that Federal action is manifestly warranted. That is not the case here.

Franchisors rarely if ever terminate franchisees for failure to comply except where the violation of the franchise agreement is of an integral nature or where there is a chronic history of such violations.

Similarly, as our attachments reflect, there is simply no evidence to suggest a widespread pattern of refusals to renew.

Indeed, with respect to refusals to renewal—perhaps the single most radical feature of the proposed legislation—yesterday's testimony is notable for the curious lack of testimony on this subject.

In 3 hours of testimony nine witnesses were virtually silent on this subject.

Mr. Waldie, for example, spoke of "terminal powers" in the context of termination, not of refusal to renew.

Surely so dramatic a departure from normal commercial practice should not be based upon a record so devoid of indication of need for it.

This paucity of evidence of need for the proposed legislation is, at bottom, the soundest reason to reject it.

We support the suggestion of Senator Tunney at yesterday's hearing: if there are indeed examples of abuses beyond those testified to yesterday, they certainly should be placed in the record and, hopefully, in such a fashion that the franchisors involved will have an opportunity to respond to the allegations made.

Yesterday's hearing featured a number of loose references to the records of Government agencies being "replete" with evidence of abuses specifically in the field of terminations and failures to renew, and of congressional hearings "filled" with similar such evidence.

I have reviewed those records. I have reviewed the transcript of those hearings. I have examined the positions of Government agencies on this and similar legislation in the Senate 6 years ago, and on the House counterpart to this bill 1 month ago.

Those hearings are not "replete" with such evidence. Indeed, they are virtually barren of such examples.

And the records of those Government agencies are similarly notable for their lack of any support for the proposed legislation.

As we note in our testimony, there is simply no support for this bill in the Government agencies.

If we are correct, and if there is in fact no substantial evidence of a widespread need—a need, not for a general "cure" for a range of assorted, illegal "abuses," but rather for the specific remedy proposed here—then, we submit, legislative priority requires that this harsh and punitive measure be rejected.

The second criterion for Federal action is that the problem which is asserted to exist should be one which exists, not merely in certain industries, but in all industries to which the legislation would be application.

That is not the case here.

The Congress has in the past dealt with this matter in those industries where problems were found to exist—in the automobile industry, and in the petroleum industry.

So have the States, as our attachments demonstrate.

Some examples of the excessive coverage of the legislation which we believe to be unwarranted:

Disparity of bargaining power between franchisors and franchisees: in which industries does it exist?

Short-term versus long-term franchises.

Large investment versus small or no initial investment.

Product distributorships versus business format franchises.

Period of time required to obtain a return on investment: how does it differ from one industry to another?

Surely it is not an adequate response to the excessively broad and indiscriminating lumping together of different types of commercial relationships to say, as did the representative of the newspaper dealers yesterday, that the statute needs to be broad, "like the Constitution and the Sherman Antitrust Act."

The precise and rather limited acts with which this statute purports to deal can hardly be compared to such broad charters of economic and social liberty as those other two, and somewhat more encompassing, documents.

The final criterion is not met here, that is, existing Federal law already covers what appears to be the gravamen of the attacks made by the proponents of this legislation.

Existing Federal law, principally the antitrust laws, already protect franchisees from a wide range of potential abuses, including price fixing, territorial or customer restrictions, tying arrangements, unreasonable restrictive covenants, and monopolization and attempts to monopolize.

Specifically, a franchisee cannot be terminated, nor can renewal be refused, for refusing to comply with franchisor demands which violate the antitrust laws.

If the franchisor attempts to terminate for these reasons, the franchisee can enjoin the franchisor's attempted action or can recover treble damages, including lost future profits.

The suggestions at yesterday's hearing that recourse to the courts is a "futile" remedy and that a legislative alternative must therefore

be fashioned is, of course, an argument against the proposed legislation, not for it.

Far from reducing the need for litigation, this legislation will almost certainly increase that need, straining the already overburdened judicial machinery of the Federal court system.

At yesterday's hearing Mr. Waldie testified in response to Senator Ford's question that "we are not getting into the antitrust arena."

He was followed by Mr. Fine who testified—on behalf of the same client—precisely the contrary, that the committee is in fact being asked to do just that, precisely because "the antitrust laws are inadequate."

For those who believe that those laws are quite adequate, even before their broadening by recent Senate action, his statement may be somewhat surprising.

And, for those who believe that the broadening of the antitrust laws is properly the function of other congressional committees, his statement may be, at the least, provocative.

He suggests that the antitrust laws do not provide adequate protection from unlawful termination. He is plainly wrong.

The cases are clear that a termination for antitrust reasons is a violation of law for which a franchisee may recover treble damages, costs and attorney's fees and in appropriate cases may obtain a preliminary injunction preventing the termination.

I do not understand him to dispute that proposition.

It is equally clear, of course, that not every franchise termination is an antitrust offense.

Mr. Fine's real objective is to prohibit, by Draconian legislation, even those terminations which the courts have found were not a result of antitrust violations at all.

In one of the cases cited by Mr. Fine—*Cartrade, Inc.* v. *Ford Dealers Advertising Association*, 446 F. 289, 295—9th Cir. 1971—*cert. denied*, 405 U.S. 997 (1972), the ninth circuit, approving a refusal to deal, stated that to impose liability "would be to saddle the dealers with Cartrade's services forever."

That result is evidently what Mr. Fine seeks to achieve, and that purpose should not be obscured by groundless claims that the antitrust laws are "inadequate."

Indeed, there can hardly be a better example of the impropriety of legislation of the sort proposed here than precisely the cause which is cited and referred to at length in Mr. Fine's testimony.

In that case, which apparently dealt with a contract providing that either party could terminate a relationship on 30 days' notice, the terminated distributors alleged violations of the Sherman Act growing out of the terminations.

They sought a temporary restraining order enjoining their termination, which was denied by the courts.

The further disposition of this case is, as it should be, in the hands of the parties rather than of this committee. But it seems clear that the principal thrust of their objection is that it should be illegal for the newspaper to make the decision which it did. I think that proposition should give serious pause to this committee. For you are

being asked to approve legislation to make such a decision impossible.

The order of the court states:

> The paper is trying to make a substantial savings in distribution. This might well further competition with other newspapers by keeping the cost of the paper down, enabling better distribution to customers which will lead to an increase in newsstand or vending machine purchases, thus competing more favorably with home delivery subscriptions of the Bee itself. . . . There is no anticompetitive result or motive apparent in the present case which show that the termination of city newsstand accounts raise any serious or substantial question.

Thus, the Court found, the newspaper was doing nothing more than making a business decision which might result in lower prices to the consumer and more efficient operations.

If, as the newspaper distributors' attorney yesterday testified, S. 2335 would make such decisions illegal, I can think of no better reason why that bill should not be enacted into law.

THE PROPOSED LEGISLATION IS ANTICOMPETITIVE

It is critical to understand the substantial contributions which franchising has made in our economy. The most recent report by the U.S. Department of Commerce, the just-published "Franchising in the Economy, 1974–76," estimates that of the total retail sales in the United States in 1975, $166 billion, or 28 percent, were made through a franchise system of distribution.

And, despite a flat or down-turning economy, the Department projected those sales to increase by 18 percent over the 2-year period covered by the study.

The enormous impact of franchising upon our economy can perhaps best be judged in the light of the statistics as to the total work force employed in the industry; 3.5 million Americans were employed by franchising concerns in 1974 with estimates of substantial increases to occur over the long- and short-term future.

Perhaps those benefits were summarized best by a case decided only a month ago.

In *Ungar* v. *Dunkin' Donuts*, one of the more important cases in the field of franchising decided in recent years, the court of appeals for the third circuit has just refused to permit a class action to proceed on the basis of a legal theory which, in the words of the court, "in our view would threaten the viability of the franchise system in our economy."

The court summarized the "significant advantages—both economic and social—which, are perceived to flow from the franchise system of distribution":

One: Provide oportunity for individuals, including persons of modest means, to go into business for themselves;

Two: Decrease the risk of failure of individual businesses;

Three: Decrease economic concentration by providing an alternative to vertical integration of business; and

Four: Benefit consumers by providing standardized products to an increasingly mobile public.

As the court noted:

> We are conscious of a general Congressional approbation of the franchising system, particularly in light of the opportunity it provides for small businesses.

The anticompetitive effects of the bill must be viewed against that backdrop.

The bill itself contains one of the most directly anticompetitive provisions contained in any legislation proposed in the U.S. Congress in recent years, the marketing area withdrawal provision which requires that a franchisor, in order to escape the harsh remedies of the bill, agree not to return to a particular market area which it has left, in any fashion, for a period of 5 years.

The ill effects of legislation of this nature apply not only in the case of the marketing withdrawal provision, but more generally with respect to the onerous provisions of the legislation as a whole.

Its effects are to confront a franchisor with one or more of the following courses of action, if legislation of this nature were to pass:

One: The retention of incompetent dealers.

Two: Vertical integration.

Three: The repurchases of franchises from franchisees.

Four: The franchising, if at all, of only large, established companies as franchisees.

The damage to competition thus plainly arises not from franchising, but from the impediments to franchising which this bill would create.

And the ultimate victims of that diminution of franchising will be small businessmen who are or desire to be franchisees, and the American consumer who will be deprived of the range of choice which franchising has fostered.

THE PROPOSED LEGISLATION IS INAPPROPRIATE

The most appropriate form of protection which should be afforded to a prospective franchisee against overreaching on the part of the franchisor is legislation prescribing the disclosure which must be made to the franchisee prior to and at the time of the sale of the franchise, with adequate legal remedies provided in the event of failures of omission or misstatement.

This is the approach taken by the FTC in its proposed Trade Regulation Rule.

This is the approach taken by the 12 States which have enacted such legislation.

And this is the approach taken by the new Uniform Franchise Offering Circular, all as indicated in our attachments.

Certainly that approach should be attempted first, particularly in light of the substantial evidence that it is the proper approach... evidence arising both from the Federal Trade Commission itself and from congressional committees.

To do otherwise, we submit, would be to place franchising in a peculiarly disadvantaged position competitively, to the detriment of franchisees and the American public.

THE PROPOSED LEGISLATION IS UNCONSTITUTIONAL

The legislation raises questions, not only under the provisions of the Constitution dealing with due process and equal protection, but

more specifically those provisions of the Constitution dealing with impairment of obligation of contracts.

If the law were held to have retroactive application, we believe it is clear that it would be constitutionally impermissible.

The proposed legislation is fundamentally unfair.

There is no "evenhandedness," contrary to the Declaration of Policy. Instead, the bill creates a second class citizenship for franchisors, and a uniquely privileged position for franchisees.

The bill permits franchisees to make a determination of those provisions to which one party to a contract shall adhere; makes the administration of the franchised system by the franchisor a matter beyond franchisor control; permits a franchisee an extensive period of time during which he may continue with impunity to engage in violations of his agreement; permits a franchisee to share in the goodwill of the business created by the franchisor; and shifts the burden of proof from the franchisee who accuses to the franchisor who is accused.

If there is one unifying thread which runs throughout the hearing yesterday, it is the desire for "equality" expressed by franchisees.

When one pursues the matter more thoughtfully, however, one becomes aware that what is meant is not some generalized notion that all men are created equal, or that all men are entitled to equal treatment under the law, but rather that the Congress should legislate "equality" in commercial relationships—by abrogating existing contracts; by removing advantages, however legally acquired; and by indulging in the fiction that if all parties to a contract are not "equal" that contract should be subject to invalidation.

In fact, all men are not equal, nor does anything in our law or our history require that they be so.

What our law does require is that those differences which do exist among men not be exploited or abused in a fashion which law and policy will not permit.

Surely, it must by now be clear that what the proponents of this legislation seek is a restructuring of commercial relationships—a restructuring which is far more radical than any which has yet been contemplated by the Congress. They seek a "guarantee of equality."

The Congress probably cannot do that. And even if it could, most assuredly it should not.

As the third circuit said in the *Dunkin' Donuts* case last month:

> The very nature of the franchise institution contemplates the presence of a comparatively strong financial entity—the franchisor—that makes available to a relatively weaker financial entity—the franchise—an attractive business opportunity at a relatively modest initial investment.

Faced with the argument that the law should operate contrary to its normal course "where there is an unequal relationship between buyer and seller," the court bluntly rejected that notion:

> It is difficult to conceptualize a more damning denunciation of the private free enterprise system.

Yet that is precisely what proponents of this legislation seek—based, incredibly, upon the notion that there is something fundamentally evil about the preparation of a printed, rather than typed or handwritten, contract; a contract which is offered to, not forced upon, those who desire it.

And, as you will hear, there are thousands of sound informed businessmen, including most of those who have already executed one or more such contracts, who very much wish to sign more of them in identical form.

The proponents of this legislation cite the form of such contracts as the basis for congressional action to permit them to be retroactively rewritten.

We urge the Congress to reject such a proposal.

What we appear to be seeing in this legislation is the reaction of businessmen who find that the bargain which they struck—which once seemed very attractive to them, and from which they have, indeed, reaped great profits—could perhaps be sweetened by a compliant Congress.

Again, in the words of the *Dunkin' Donuts* case:

> We do not imagine that many persons are, in any meaningful sense, forced to enter into franchise agreements. It may be that some do because they have been deceived as to the terms, or it may be that others do so because they lack sophistication and do not understand or appreciate the details of the bargain.
>
> Realistically, we would expect to find that an arrangement, apparently reasonable at its inception, begins to seem burdensome to the franchisee as the business is successfully established.

We respectfully submit that, as the courts have determined that they have neither authority nor good reason for rewriting contracts in that fashion, neither is there justification for the Congress to do so.

THE PROPOSED LEGISLATION IS IMPERMISSIBLY VAGUE

At yesterday's hearing Mr. Waldie testified that the bill seeks to "circumscribe the terminal powers of the franchisor in a fashion which is reasonable and specific."

With all due respect to that evaluation by the bill's proponents, we suggest that it is neither reasonable nor specific. Nor, in some cases, is it even comprehensible.

Examples of vagueness include:

Definition of "franchise."

Definition of "more than nominal assistance to the franchisee."

Definition of "good cause."

Definition of "substantially comply."

Definition of "reasonable excuse or justification."

Definition of "essential" requirement.

Definition of "reasonable" requirement.

Definition of "marketing area withdrawal."

Definition of "legitimate business reason."

We respectfully submit that it would be irresponsible to enact so ill-conceived and poorly executed a piece of legislation.

THE PROPOSED LEGISLATION IS UNWORKABLE

Examples of unworkability:

The "imminent danger to public health or safety" will not allow termination, but requires a 48-hour delay.

Three months is excessive time for notice under normal conditions.

No assurance of capacity to refuse to renew an inefficient franchisee.

Provision regarding franchisee whose lease has expired.
Death of franchisee.
Necessity of gambling on prohibition of sale of unauthorized products.
Interpretation of proposed legislation as applicable to freeze franchise agreements in their present form.

CONCLUSION

This legislation is not simply an effort to correct certain abuses, to redress an imbalance of power, to engage in fine tuning of a relatively peripheral sort.

Instead, it is a fundamental, radical, unprecedented effort to reconstitute long-standing relationships, abrogate traditional principles of law and equity, and establish new standards of business practice hitherto rejected by the judicial and legislative branches as well as by businessmen themselves:

The forced renewal provision of the legislation contradicts the fundamental principle of Western society that the law will not compel one man to deal with another with whom he does not wish to deal.

The bill is silent with respect to its applicability to existing, as opposed to newly issued, franchises.

The legislation goes far beyond any which Congress has ever enacted.

The legislation shifts the burden of proof to the franchisor.

In many respects the statute seems destined to insure that the relationship between franchisors and franchisees will principally be developed, not in the marketplace, but in the courtroom.

At yesterday's hearing one of the principal witnesses testified that the "fallout effect" of this legislation will be to "put an end to abusive practices"; that, "if you want the system to work, you must breathe life into it by passing S. 2335."

With all respect to that rhetoric, we suggest instead that the fallout effect may be to put an end to franchising itself; and that, far from breathing life into franchising, this legislation may well sound the death knell of what is widely conceded to be the form of distribution which holds out more hope for entrepreneurial opportunity to small businessmen and greater benefits to the American consumer than any other marketing development in this century.

Surely it is the height of irony that such legislation should have been described in yesterday's hearing as "pro competitive," and "pro consumer."

It is no less ironic that it should be seriously considered by a committee which has justly earned a reputation as a body which is both "pro competitive" and "pro consumer."

This bill is neither.

We urge that the bill be promptly and decisively rejected.

[The statement follows:]

STATEMENT OF PHILIP F. ZEIDMAN, WASHINGTON COUNSEL, INTERNATIONAL FRANCHISE ASSOCIATION

Mr. Chairman, Members of the Committee, I am pleased to have this opportunity to appear before you today to comment on S. 2335, captioned by its sponsors the "Fairness in Franchising Act." We oppose its enactment.

The International Franchise Association is the principal spokesman for those companies which engage in "franchising" as a method of distribution of goods and services. Later in the hearings, as well as through written statements submitted for the record, you will undoubtedly hear from a wide range of companies engaged in franchising, reflecting the extraordinary diversity of business relationships with which the term "franchising" is frequently associated. This bill would apparently seek to cover substantially all such relationships, without regard to the substantial business and legal differences which distinguish one from another. It would perhaps be useful at the outset, therefore, to indicate to the Committee what the typical franchise arrangement would encompass, while suggesting at the same time some of the frequent exceptions which are common, but which the bill does not address or recognize.

In a typical franchised relationship, the franchisor grants to the franchisee the right to operate under and pursuant to a trademark owned by the franchisor, and which he is required by law to protect and maintain. The franchisee's right may be to sell products or services or both. Typically, the franchisor must exercise some control over the manner in which the business is operated under the trade name, at the peril of losing those proprietary rights. Typically, the franchisor provides certain services to the franchisee, and requires the franchisee to meet certain obligations specified in the franchise agreement.

The term of this agreement may be short or long, renewable or non-renewable. It is fair to say, however, that the tendency in recent years is to provide for a longer term of agreement. In many cases the agreement also provides an opportunity for the franchisee to enter into a new agreement at the end of the original term, usually by agreeing to conform to the terms then being offered to, and the standards then being required of, newly franchised operators.

The compensation of the franchisor may come in the form of an initial payment; and a royalty or service fee, typically based upon the gross sales by the franchised unit. But an agreement called a "franchise" may include only one or neither of such sources of revenue, the franchisor instead simply distributing goods to the consuming public through a "franchised" system of distribution, with the franchisor's revenues emanating from any profits which it may make upon the sale of those goods to the franchisee for resale. Again, however, it is fair to say that the typical franchise with which the Committee is probably familiar is one in which an initial fee and a royalty is charged, and any revenues earned by the franchisor from goods which it offers for sale to the franchisee are in addition to, but not an essential part of, the franchised relationship.

It must be emphasized that the accuracy of this description, as it applies to any particular franchise, is entirely dependent upon the terms of the contract itself. The contract is, typically, an extensive document developed over a period of many years, and subject to the full panoply of state and federal laws.

SUMMARY OF THE PROPOSED LEGISLATION

The "Fairness in Franchising Act" would seek to establish a new set of federally prescribed and administered rights and obligations of the two parties to this private agreement. Those new requirements have as their principal features the following provisions—

1. The franchisor would be prohibited from exercising any contractual right to terminate the agreement unless the franchisor has "good cause" for doing so, or the franchisor is effecting a "marketing area withdrawal."

In order to demonstrate the existence of "good cause," the franchisor would be required to prove that the franchisee had failed to "substantially comply" with a requirement of the franchise agreement; that that requirement was both "essential" and "reasonable"; and that the franchisee's failure was "without reasonable excuse or justification." The franchisor might also be able to demonstrate "good cause" if it could prove that the franchisee had engaged in "bad faith conduct" or an "unjustified and unreasonable failure to act."

The bill apparently envisions a "marketing area withdrawal" as a withdrawal from the business of franchising within a particular marketing area of the United States. No franchisor would be permitted to make such a business decision unless he were willing to pay the franchisee "reasonable compensation for the value" of the franchisee's business, "including, but not limited to, goodwill." Further, a franchisor which makes such a business decision would thereafter be prohibited, for a period of five years, from reentering that "area" in any "commercial" fashion whatsoever.

2. At the end of the contractual term, a franchisor would be required to enter into a new agreement with the franchisee, despite the fact that neither party had contemplated such a new contract at the outset of the relationship. A franchisor would be required to enter into such a contract unless it could prove that it had "good cause" for not doing so, or was "effecting a marketing area withdrawal" (both as previously defined).

There is only one other basis upon which a franchisor might be able to avoid entering into an agreement against his will: if he can prove a "legitimate business reason" (defined only as "a commercial definition that is fair and reasonable in light of all the circumstances") for doing so; and the original agreement between the parties had been for a period of five years or longer; and the franchisor pays the franchisee "reasonable compensation" as previously defined. Thus, except in these extraordinary circumstances, a businessman would be compelled by an act of Congress to enter into a contract with another party, a contract for which neither party had bargained. The bill does not spell out the terms and conditions of the new contract. It is thus silent on the question of whether the franchisor may specify his own terms and conditions (which would raise some doubts as to the efficacy of the legislation), would require that the terms and conditions be those of the original contract (which would almost certainly require the franchisor to establish two separate and perhaps vastly different franchised systems, operating simultaneously), or would require some other terms and conditions, not specified in the bill.

3. The franchisor could neither cancel a contract nor refuse to enter a new contract with a franchisee unless he provided the franchisee with prior notice of his intention to do so, in a form specified in great detail by the bill. That notice must be provided at least 90 days in advance, a period far in excess of that provided for in most franchise agreements now extant. There are only two exceptions to this extraordinarily long period of notice: where shorter notice period is required in order to protect against an imminent danger to public health or safety, or in the case of insolvency, bankruptcy or receivership proceedings in which the franchisee is involved. Despite the apparent need for instantaneous action by the franchisor in these two situations, the bill would prevent the franchisor from acting even in such extreme circumstances for at least 48 hours.

4. The bill contains a number of other provisions providing for actions which the court may take, the provision for private action by the franchisee, the damages which may be awarded, including punitive damages, etc. A court may award the franchisee the value of "the franchisee's business" including "goodwill"—in effect, a Congressional determination that, notwithstanding the ownership of the trademark by the franchisor, as provided for by federal law, elements normally associated with the ownership of a trademark are to be decreed to be the property of the licensee, rather than the licensor. Franchisors and franchisees would be prohibited from agreeing that the provisions of the statute may be waived. The statute would shift the burden of proof from the plaintiff franchisee, upon whom traditional provisions of law would place it, to the franchisor who is being sued. And, finally, the bill would direct the Federal Trade Commission to conduct a three-year, $1,000,000 "study" of the "law applicable to franchises", with the objective of creating, among other products, "a restatement of the law" and "a 'model code' of franchise law."

* * * * * * *

For the reasons discussed below, the International Franchise Association is opposed to the enactment of S. 2335, the "Fairness in Franchising Act." The bill's "Declaration of Policy" asserts (§ 2(b)) that its enactment would "guarantee to consumers the greater benefits that would flow from more equitable franchise agreements and relationships." The truth, we submit, is that the bill would provide no such assurance; and would, in fact, be adverse to the interests of franchising and consumers alike. The "Fairness in Franchising Act" is unfair; it is unjustified; and it is anti-competitive.

THE STATES HAVE AMPLE POWER TO LEGISLATE IN THIS AREA. SOME HAVE ELECTED TO DO SO, WHILE OTHERS HAVE REJECTED SUCH PROPOSALS. FEDERAL INTERVENTION UNDER SUCH CIRCUMSTANCES IS BOTH UNNECESSARY AND INAPPROPRIATE.

We submit that, in the light of existing state law, there is neither need nor justification for the proposed legislation.

It should be noted at the outset that ten states have enacted legislation dealing with the problems of termination or refusal to renew franchises or distributorships. Attachment A lists those statutes.

As I shall discuss more fully later, most state statutes, both enacted and proposed, deal with the special problems which are asserted to exist in particular industries. But, as Attachment A reveals, some of this legislation deals with the full range of franchising. It is thus quite clear that a state which determines that such a problem exists within its borders, requiring remedy by statutory enactment, can and will deal with the problem in the manner most suited to that state's needs. One must surely ask, therefore, why there is a need for federal legislation in an area which is neither beyond the purview of states nor demanding of uniform federal legislation.

What is at least equally significant, however, is that a number of states have examined the problem which this bill asserts to exist, and have rejected the notion that legislation is required. Attachment B lists those states which have made such a decision in the last three years alone. It is difficult to avoid the conclusion that the states, which confront this issue on a daily and more direct basis than does the federal government, should in the first instance make their own determinations as to whether legislation is necessary. If a state concludes that no such action is warranted, surely an overwhelming case must be made before the Congress should override such a decision.

This is particularly so where, as is the case here, wholly apart from the existence or non-existence of specific statutory provisions dealing with termination or non-renewal, the great bulk of the abuses alleged to exist are in fact susceptible to treatment under traditional principles of existing law: the law of contracts, as interpreted in the courts of the several states. We urge the Committee to examine with great care the factual circumstances and the hypothetical cases asserted by the proponents of the legislation to constitute a basis for action. We believe that the criterion which should be applied to each such example is, first and foremost, whether it is subject to existing law and existing remedies. We believe that the Committee will conclude that, in virtually every instance, the answer is in the affirmative.

For example, it is clear that under the common law of contracts, franchisees are adequately protected against fraud and misrepresentation; against conduct which rises to the level of "unconscionability"; against terminations or refusals to renew which are based upon retaliation for non-compliance with illegally imposed obligations. In short, franchisees are already protected by existing state law against the very evils of which the proponents of this legislation now complain. The remedies—damages, rescission, restitution, reformation—exist under traditional principles of law and equity, and are demonstrably adequate.

The bill before the Committee assumes are contrary. "The law applicable" to the franchise relationship, it declares, "has not evolved sufficiently to protect the parties thereto. . . . The law applicable to franchise agreements and relationships should not be traditional agency and contract law doctrines to the extent that such doctrines permit inequities to occur and fail to provide sufficient remedies for conduct that should, in this context, be characterized as wrongdoing" (§ 2(a)(3)).

The "finding" thus made is, in fact, squarely contrary to the record of adjudicated cases. The principles of contract law, both under common law and under state statutes, have proven to be as applicable to franchising as to all other commercial relationships, and to be an adequate safeguard to the rights of the parties. Where principles of federal statutory law apply, the law of contracts yields, as it must. Thus, where the enforcement of a contract would violate the federal antitrust laws, the courts will not permit it to be enforced; where a sale of securities would violate the federal securities laws, the courts will not permit the sale to be consummated. The point of these exceptions is, of course, that they are themselves equally applicable to franchising. In the absence of powerful evidence of the inadequacy of principles of contract law which have been forged in our courts for centuries, surely the applicability of those principles should be presumed.

The proponents of this legislation have not demonstrated to the contrary, and indeed have made no serious effort to do so. In the face of such a paucity of evidence of need for federal action, we respectfully submit that there is an affirmative obligation upon the Congress not to introduce the federal government into this field.

Certainly this is so where federal action at this juncture would do more harm than good. The bill itself (§ 2(a)(3)) recognizes that, "Because the franchise relationship in its present form is a relatively new one . . . the law applicable thereto has not evolved sufficiently . . . ." At this embryonic stage of the development of franchising, and of the evolution of the state statutes dealing with the subject, it is at best premature for the federal government to add its own experimentation to a field of law which is rapidly developing in the light of the changes occurring in the franchising method of distribution.

Even if there had been enough experience under those laws to warrant conclusions by the federal government as to the need for uniform legislation, the very existence of those laws on the books dictates that there will, in all likelihood, be discrepancies between the federal statute and those in existence in the states. It is already clear that that will be the case. In the example of the notice provision, for example, the proposed legislation would create a rule of law which is contrary to that in existence in most states which have dealt with this subject.

In support of federal action, the argument is frequently made that such action is required, despite the capacity of the states to act, because there is some overriding need for uniformity and symmetry. That argument was made, for example, in support of the "anti-pyramiding" legislation (S. 1509, 94th Cong. 1st Sess. the "Pyramid Sales Act") which was supported in principle by the International Franchise Association, reported favorably by this Committee and passed by the Senate. Similarly, such arguments are made in support of legislation requiring certain forms of disclosure to be made by franchisors to prospective franchisees. No such argument can be made with respect to this legislation. In the case of sales of franchises, there is a clear need for the same laws to be applicable to all such sales, associated as they are with advertising and marketing through documents which must be prepared for use in large numbers of transactions, and for advertisements which appear in the national news media. A national franchisor, which operates in fifty states, is virtually disabled if it must tailor its advertising to the provisions of fifty different state laws. Similarly, there is no sound reason why prospective franchisees in two neighboring states should not be reachable by the same advertisement in a regional or national newspaper without violation of one of the two state laws. Almost by definition, however, the kinds of practices to which this proposed legislation refers is of a highly individual nature, well within the traditional role of state action. Surely it would be anomalous if the federal government, which has not yet acted even in the area where a need for uniform national regulation has clearly been demonstrated, i.e., disclosure, were to act instead in an area where no such demonstration has been made—and, indeed, where there is every reason to believe that no such demonstration can be made.

A final word is in order with regard to the relationship between state and federal law. There is no reason to believe that the states will cease their own experimentation with statutory laws—particularly in areas where, as in the case of particular industries, there may be reason to believe that such action is necessary. Similarly, there is every reason to believe that the law will continue to develop in the courts, not only interpreting those statutes, but also under the common law principles which apply to franchise agreements. The proposed legislation does not even address the question of the inconsistency which surely will develop between the state and the federal standards; there is no hint in the bill of any attempt to preempt such inconsistent state laws. The certain result of the enactment of this legislation would be, at a minimum, to increase vastly the cost of compliance by franchisors with what may ultimately be fifty-one different statutes, thus creating a barrier to entry into franchising by small franchisors, and greatly diminish the opportunity to enter franchising which is today available to small franchisees.

THE CONDITIONS UNDER WHICH FEDERAL ACTION IS APPROPRIATE ARE ABSENT

Under what circumstances, then, is action at the federal level appropriate? We do not suggest that the answer is "never." We suggest, instead, that such action is appropriate where certain circumstances can be demonstrated to exist. We submit that those circumstances do not exist in this case.

The first requirement, we respectfully suggest, is that there be clear evidence of a sufficiently pervasive and widespread abuse that federal action is mani-

festly warranted. We believe it is clear beyond question that this is simply not the case.

We believe that the burden of proof lies upon the proponents of this legislation to demonstrate its need. We submit that no such case has been made.

This is hardly surprising. For the truth is that franchisors rarely if ever terminate franchisees for failure to comply with franchise agreements where that failure is not of a substantial nature, one dealing with an integral element of the franchised relationship. This is so, not because of legal inhibitions, but because of the practical realities of business life, i.e., the cost—in terms of time as well as of dollars—of terminating an existing operation, locating a franchisee, training him and assisting him to establish himself in business, etc. It is also true because courts will typically interpret franchise agreements most strongly against the drafter of the agreement, the franchisor, and will insist upon material breaches of franchise agreements as the basis for termination. Typical terminations occur only in cases where, for example, there is a chronic history of late payments; where there are actions by the franchisee which are antithetical to the sound development of the franchised system; and where the quality of the franchisee's operation jeopardizes the trademark rights and the interests of other franchisees.

Similarly, there is simply no evidence whatsoever to suggest that franchises are terminated with inadequate notice; that franchisees are unable to recoup their initial investment, in the case of either terminations or non-renewals; that franchisees are not permitted to sell their franchises on reasonable terms to an acceptable purchaser; or that the decision to terminate a franchisee is usually, or even often, an ad hoc and impulsive decision, providing the franchisee with no opportunity to cure the violation. Finally, there is no evidence to suggest significant numbers of cases in which franchisees are not permitted to negotiate in good faith with the franchisor for an additional period as a franchisee—whether called a "renewal," "extension," or otherwise characterized—and whether pursuant to a provision of the franchise agreement providing for such additional periods or pursuant to an agreement not initially provided.

The lack of such evidence is amply demonstrated by Attachment C, which summarizes the best evidence of the paucity of such terminations and non-renewals as they exist in the records of one large industrial state where the law requires that the records of all such terminations and non-renewals be kept and disclosed to prospective franchisees. No one familiar with franchising will be surprised that this is so. Franchisors in fact will do everything within their power to avoid terminations, and to permit renewals, where that is consistent with the continued development of the system as it is then being marketed. This is so precisely because stable franchise relationships are in the best interest of the franchisor as well as the franchisee. In short, it is economics, not law, which dictates the present state of the relationships between franchisors and franchisees. To impose a legal requirement in the clear absence of any need for such a requirement is, we submit, contrary to all accepted principles of legislation.

A second criterion by which the propriety of national action should be measured is that the problem which is asserted to exist should be one which exists, not merely in certain industries, but in all industries to which the legislation would be applicable. In the instance of the bill before the Committee, the intended range of applicability would appear to be the entirety of American industry, in every field of endeavor in which franchising is utilized as a method of distribution.

In fact, we submit, the problems which the bill purports to address do not exist in franchising generally, but, if at all, in only a few industries. If that evaluation is correct, then we believe it is incumbent that any legislation be tailored to meet the needs of those industries. Surely the Congress has not been reluctant to do so in the past. Where the Congress concluded that legislation was required to deal with the problems of automobile dealers it acted (15 U.S.C. §§ 1221–1225 (1970), the "Automobile Dealers' Day in Court Act"). Where the Senate concluded, as it did last year, that there are special problems in the petroleum industry, it acted (S. 323 94th Cong. 1st Sess., the "Fair Marketing of Petroleum Products Act"). Where the states have concluded that there are problems in the beer industry or the farm implements industry or other industries, they have not hesitated to act, as illustrated by Attachment D.

It should not be sufficient for proponents of this legislation to cite a few examples of practices in a wide range of industries, and to assert on that basis

that legislation dealing with every industry is required. In a system of distribution which encompasses several hundred thousand individual businessmen—virtually every industry in which goods or services are sold to the American public through independent dealers or distributors—and a wide range of different techniques by which those goods are distributed, a legislature should be loathe to extrapolate from a few instances, arising in the context of particular businesses, to a general rule of law applying to all.

The proposed legislation deals, not just with all industries, but with all forms of contracts. The only exemption from the bill (§ 3(3)(D)) excepts "a relationship . . . in which annual gross volume is equal to or more than $25,000." The exemption is at best unclear: does it refer to sales at retail by the franchisee? sales at wholesale by the franchisor or to the franchisee? some other basis? If, as is apparently the case, it assumes that abuses are less likely in the case of small-scale operations, there appears to be no basis for such an assumption; indeed, such evidence as exists (see, e.g., the report by the Federal Trade Commission on the complaints it has received as to abuses in franchising) strongly suggests precisely the contrary. And the "exemption" would, in any event, have only the most miniscule effect on the scope of the bill.

The bill thus ignores the extraordinary diversity of relationships which exist under the general rubric of "franchising." It was those differences which led the Federal Trade Commission to comment on the House version, "[W]e believe that it may be particularly difficult to legislate a uniform solution to the problems in the franchise termination area due to the many conflicting interests, ambiuous terms and varieties of business situations involved therein." Nor are these differences trivial, matters of form rather than of substance. They go to the very heart of the franchise relationship, and their existence or nonexistence in particular forms of franchise agreements is critical to the argument made by proponents of this legislation that it is needed.

Thus, for example, the argument is made that there is disparity of bargaining power between franchisors and franchisees. That may well be true in some instances . . . but surely it is not true in all, as witness the many instances in which franchisees are as large as, or in some cases larger than, their franchisors.

The argument is made that legislation of this nature is needed because of short-term franchises, frequently associated with short-term leases, in which the franchisor as a consequence may be able to exercise unusual persuasive power over the franchisee. But what of the franchise, as is frequently the case, which is long-term, or in no way associated with a lease, and in which as a result the franchisor exercises no such power or potential power?

The argument is made that legislation is needed because of the substantial portion of a franchisee's life savings or resources which he commits to a franchise. But what of the franchises—and there are many—in which no payment at all is made for the right to franchise? And what of franchises in which no royalties are even paid, but which are in essence no more than product distributorships?

The argument is made that it is necessary to permit a franchisee to earn a return on his investment within the term of the franchise or any renewal which is required. But in the cases I have cited—either because of the length of the franchise or because of the minimum type of investment needed—it is quite clear that the investment, and in many cases a handsome profit, may be obtained in far less time than the term of the agreement itself.

Such anomalies are not isolated examples, but simply illustrative of the unjustifiable scope of the bill. Thus, the bill would apply to subfranchisors as well as to franchisors, even though in most cases the same considerations do not apply. Here, as elsewhere, it is apparent that the legislation would create more problems than it solves, by seeking to treat disparate industries in a like fashion, by ignoring the manifold differences which exist between different forms of franchising. In short, the bill would arbitrarily and in an undiscriminating fashion apply to all of franchising whatever remedies one may deem to be proper for problems which are perceived to exist in limited and relatively isolated cases.

The misguided nature of such an approach, and the misapprehensions about franchising upon which it rests, is nowhere more evident than in Section 4 of the bill, which would direct an extensive, expensive and protracted "review and study" of "the fairness, functionability and uniformity of the substantive and procedural law applicable to franchises and franchising." That "continuing

review and study," encompassing public hearings and comments, is to produce a final report within three years.

Perhaps the threshold observation which must be made is that, if three years of further study are needed, to determine whether "recommendations for legislative and administrative action by the Congress and the executive branch of the Federal Government and of the several state governments", the "finding" that federal legislation is warranted on the basis of evidence now available is seriously undermined. In the same connection, it seems anomalous to establish a new "study" by the Commission at the very moment when, after many years of deliberation, the Commission is preparing to promulgate its Trade Regulation Rule on franchising. The administration of that Rule will surely produce additional experience for the Commission, experience far more useful than that gained "in consultation with . . . knowledgeable groups and individuals."

The most serious misconception of the section, however, is the notion that franchising is unique, intrinsically distinguishable from other commercial relationships, should be subject to a separate set of laws and regulations . . . and that those new sets of standards can be sensibly and coherently applied to all forms of franchising. As we believe we have demonstrated, that nation is simply wrong, and a "restatement" or "model code" of franchise law is neither feasible nor desirable.

Finally, perhaps the single most compelling reason why it is not necessary for the federal government to act in this field is because existing federal law already covers what appears to be the gravamen of the attacks made by the proponents of this legislation. For the clear evidence from the ample litigation in this field is that the federal antitrust laws are more than adequate to deal with the alleged abuses.

The present bill is said to be needed to provide franchisees with adequate remedies in cases where their franchises are terminated or are not renewed for improper reasons. In fact, however, existing federal law, principally the antitrust laws, already protects franchisees from a wide range of potential abuses. The present bill would not fill a void but rather would subject franchisors to unparalleled restrictions and penalties going far beyond the rules which apply to all other businesses.

The federal antitrust laws effectively protect franchisees from a wide range of possible abuses by franchisor, including the following:

Price fixing (*Simpson* v. *Union Oil Co.*, 396 U.S. 13, 90 S.Ct. 30 (1969)).

Territorial or customer restrictions (*United States* v. *Arnold Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856 (1967)).

Tying arrangements (*Siegel* v. *Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971), cert. denied 405 U.S. 955, 92 S.Ct. 1172); *Chock Full O'Nuts Corp., Inc.*, 3 Trade Reg. Rep. ¶ 20,441 at 20,334 (FTC 1973)).

Unreasonable restrictive covenants (*American Motor Inns, Inc.* v. *Holiday Inns, Inc.*, 521 F.2d 1230 (3d Cir. 1975), aff'g in part, rev'g in part & remanding 365 F. Supp. 1073 (D.N.J. 1973)).

Monopolization and attempts to monopolize (*Rea* v. *Ford Motor Co.*, 497 F.2d 577 (3d Cir. 1974), cert. denied 419 U.S. 868 (1974); *Coleman Motor Co.* v. *Chrysler Corp.*, 525 F. 2d 1338 (3d Cir. 1975)).

The franchisee is protected from such abuses in several ways:

First, he can obtain treble damages, injunctive relief, reasonable costs and attorney's fees;

Second, he cannot be terminated, nor can renewal be refused, for refusing to comply with franchisor demands which violate the antitrust laws; if a franchisor attempts to terminate for these reasons, the franchisee can recover treble damages, including lost future profits (*Simpson* v. *Union Oil Co.*, *Greene* v. *General Foods Corp.*, 517 F.2d 635 (5th Cir. 1975) cert. denied, March 1, 1976).

Third, if a franchise agreement contains illegal provisions, the franchisee need not abide by them in order to keep his franchise; the illegal provisions can be stricken from the agreement, and the rest of the franchise remains in effect (*Sealy Mattress Co. of So. Cal.* v. *Sealy, Inc.*, 346 F. Supp. 353 (N.D. Ill. 1972); *Superior Bedding Co.* v. *Serta Associates, Inc.*, 353 F. Supp. 1143 (N.D. Ill. 1972)).

Fourth, if a franchisor tries improperly to terminate a franchise indirectly—for example, by setting up "company stores" to compete unfairly with the franchisee and drive him out of business—the full remedies of the antitrust laws are available to the franchisee (*Rea* v. *Ford Motor Co.*; *Coleman Motor Co.* v. *Chrysler Corp.*).

It is important to stress that the antitrust remedies which existing law provides to franchisees are both sensible and effective. They are sensible because they reflect the judgment of the Congress and the federal courts, developed over many decades of experience with many different industries and many different practices, as to what kinds of business arrangements are harmful to a free competitive economy and which practices in fact may promote competition. And they are effective; they provide franchisees with strong, meaningful protection, arising from several sources:

1. The criminal penalties of the Sherman Act, recently increased by the Congress, deter many potential abuses;

2. Antitrust enforcement by the Department of Justice and the Federal Trade Commission, whose budgets have been increased substantially in recent years, can often correct abuses without requiring any franchisee to file suit on his own;

3. If a franchisee is exposed to abuse, the uniquely generous remedial provisions of the antitrust laws—treble damages, attorney's fees and costs—provide the incentive and the means for franchisees to obtain effective relief in the courts;

4. In addition, if many franchisees are subjected to the same abuse, each need not proceed alone; a class action can be brought in behalf of all of them against the franchisor. I need hardly tell this committee that franchisees have not hesitated to make full use of the class action device.

5. The antitrust laws focus on substance, not form, and a franchisor's actual practices are as much subject to the law as are the contracts themselves.

In summary, the legislation proposed here, even if it were itself a sensible and constructive approach to the problems of franchising, is not necessary. The problems to which the bill purports to be addressed are already subject to the common law, to state statutes and to the federal antitrust laws . . . and to the full panoply of remedies which those laws provide.

THE PROPOSED LEGISLATION IS ANTICOMPETITIVE

Perhaps the consideration most difficult to measure, but one to which the United States Congress should be most sensitive, is the question of the far-reaching social and economic impact which legislation of this nature may be expected to have. Such an analysis requires an understanding of franchising and its place in the United States economy in the mid-1970's; an appreciation of the contributions toward the maintenance of competition and the welfare of small business which franchising has made and promises to make; and an understanding of the almost certain barrier to competition which will be erected by the passage of this legislation.

The contributions of franchising to our economy have been documented by many sources, public as well as private, but perhaps most thoroughly and most recently by the United States government itself. The most recent report by the United States Department of Commerce, the just-published Franchising in the Economy, 1974–1976, estimates that of total retail sales in the United States in 1975, $161 billion, or 28%, were made through a franchised system of distribution. And, despite a flat or downturning economy, the Department projected those sales to climb by 18% over the two-year period covered by the study. The enormous impact of franchising upon our economy can perhaps best be judged in the light of the statistics as to the total work force employed in the industry; 3½ million Americans were employed by franchising concerns in 1974, with estimates of substantial increases to occur over both the long and short term future.

That growth is not difficult to understand when one understands the benefits which a properly operating franchise relationship can confer upon the franchisor, upon the franchisee, and upon the community at large. The bill itself recognizes that "A substantial amount of useful business activity . . . is today carried on and conducted pursuant to franchise agreements" (§ 2(a)(1)), and that "such agreements and relationships are beneficial to the economy, the enhancement of commerce, and the promotion of competition . . ." (§ 2(a)(2)). Perhaps those benefits were best summarized in a landmark court decision rendered last month by the Court of Appeals for the Third Circuit, *Unger, et al.* v. *Dunkin' Donuts of America, Inc., et al.* There, the court said:

[S]ignificant advantages—both economic and social—are perceived to flow from the franchise system of distribution. Franchising is said to: (1) provide opportunity for individuals, including persons of modest means, to go into

business for themselves; (2) decrease the risk of failure of individual businesses; (3) decrease economic concentration by providing an alternate to vertical integration of business; and (4) benefit consumers by providing standardized products to an increasingly mobile public.

The formidable damage which this bill will wreak upon the state of competition in this country must be seen against this backdrop. That harm is apparent from a reading of the language itself. But the ultimate damage which it will inflict upon our competitive economy is a result, not of any language of the bill, but of the market forces which it will surely trigger.

The bill itself contains one of the most directly anticompetitive provisions contained in any legislation proposed in the United States Congress in recent years. The provision for a "marketing area withdrawal" (§§ 3(7); 6(a)(2); and 6(b)(1)(C)) require that a franchisor, in order to escape the harsh remedies of the bill, agree not to return to a particular market area which it has left, in any fashion, for a period of five years. Thus—whatever happens in that area during that period, whatever the needs of consumers, whatever the quality of goods or services being sold in that area by competitors, whatever price at which those sales are being made, whatever the consumer demand—a franchisor would be prohibited from meeting that demand, from supplying goods or services of better quality or at a lower price. In short, a franchisor would be forbidden to provide that which is the objective of our laws and of economic policy, i.e., competition. There can hardly be a better example of the evil which legislatures are called upon to inflict in the name of "fairness."

But the true anticompetitive effects of this legislation flow from the actions which franchisors will be required to take if the bill were to be enacted. A franchisor faced with legislation of this nature can be expected to follow one or more of the following courses of action:

1. The retention of incompetent dealers, rather than the risk of litigation—with all the costs to society and, ultimately, the direct increased costs to consumers, which that choice entails.

2. Vertical integration—the future expansion, not through independent franchisees, but through company-owned units, thus foreclosing to the independent small businessman the entrepreneurial opportunity offered by franchising.

3. The repurchase of franchises from franchisees, as a safer alternative to termination or non-renewal, with the elimination of competition which this form of vertical integration ensures.

4. The franchising, if at all, of only large established companies as franchisees, in order to increase the likelihood that the franchisee will maintain the standards necessary to insure success of the franchise system—with the decreased opportunities for new and small business which such a decision implies.

To the extent that the Bill may, for the above reasons, lead to the retention of incompetent or inefficient dealers, it can interfere with the efficiency of distribution and lead to higher costs for consumers.

And the Federal Trade Commission, while endorsing "the general objective of the bill, noted its serious reservations as to the potentially anti-competitive consequences of the proposed legislation:

However, it is important to note that placing restrictions upon the franchisor's ability to terminate a franchise arrangement may have a substantial impact on the freedom of a franchisor to adjust to changing business and marketing conditions. To the extent restrictions become so stringent that the franchisor loses the flexibility to choose the most efficient means of distribution as market conditions change, competition may be decreased and market inefficiencies increased to the detriment of the consumer. Further, the imposition of onerous standards upon the ability to terminate could ultimately lead to the abandonment of the franchise system altogether if the costs to franchisors become too great.

These anti-competitive effects are apparent to the Government agencies which commented on the House version of the bill. The Department of Commerce noted, in opposing the bill,

[E]nactment of the bill could have the undesired effect of restricting the grant of franchises. Many decisions to grant franchises to persons with marginal financial resources, but promising ability, would be eliminated because of the increased risk associated with that decision and the limited recourse the franchisor would have against the franchisee.

The Department of Justice opposed the bill, stating: There are substantial costs associated with a measure which makes it difficult to terminate contractual arrangements . . . .

The Bill may even have the effect of operating against the interests of franchisees in general by reducing a franchisor's willingness to appoint franchisees. A franchisor who is aware of the costs and difficulties of terminating franchises under this legislation might be reluctant to make future arrangements. Where feasible, a manufacturer, for example, might elect to integrate forward to perform functions which franchisees might otherwise efficiently perform. In other cases, a franchisor might try to minimize the problems of termination by appointing only a larger established distributor as franchisee.

And if the effects on the state of competition and on existing franchising which the consequences described above make clear are not sufficient evidence of the damage which this bill will do, one should consider the matter from the advantage point of the prospective franchisor. The attractiveness of franchising as a method of distribution has in recent years been made evident to some of the nation's largest companies, as well as to a number of companies which have developed new products and new services which require distribution to the American public. Those companies are today considering franchising as the most effective method of distributing the products of their labors. Surely there can be no doubt what the decision of those companies will be when faced with legislation such as this. They will not franchise. And the small business men who might have obtained the opportunity to become successful owners of thriving franchises will be deprived of those opportunities.

THE PROPOSED LEGISLATION IS INAPPROPRIATE

We suggest, then that the proponents of this legislation have failed to demonstrate that there is need for legislation of any form at the federal level, and have not addressed the question of the detriments to our economy which unjustifiably onerous legislation would inflict. Even if one were to conclude, however, that there is a need for some form of remedial legislation, it seems clear that legislation of the nature proposed here is of a peculiarly inappropriate character.

We believe that is is now generally conceded that the most appropriate form of protection which should be afforded to a prospective franchisee against overreaching on the part of the franchisor is legislation prescribing the disclosure which must be made to the franchisee prior to and at the time of the sale of the franchise, with adequate legal remedies provided in the event of failures of omission or misstatement. This is the approach taken by the Federal Trade Commission in its trade regulation rule proposed in 1971 (36 Fed. Reg. 21607 (1971)), which was the subject of extensive public hearings in 1972. It is the subject of a somewhat revised version of the FTC's trade regulation rule, promulgated in 1974 (39 Fed. Reg. 30360 (1974)) (Attachment E). In the absence of action by the Federal Trade Commission, however, twelve states have acted on their own initiative. Attachment F lists the states having legislation requiring disclosure to prospective franchisees. This disclosure is ordinarily in the form of the Uniform Franchise Offering Circular (see Attachment G), which is now in use, after several years of effort by the regulators charged with enforcing the franchise disclosure statutes at the state level. These state statutes give the franchisee powerful protection in the form of rights to rescission and damages; in addition, directors and officers of the franchisor are made personally liable.

We believe the most appropriate form of regulation is that of full and fair disclosure. That is the conclusion which has been reached by other Congressional Committees. It is the conclusion reached by the great bulk of states which have studied the problem. It is the conclusion which one must fairly draw from the studies of the complaints received by the Federal Trade Commission and by the report made by the Federal Trade Commission to the Congress.

A complete and adequate understanding of the nature of the respective rights and obligations of the parties, sufficiently in advance of entering the relationship, is the best protection which a franchisee may have against abuses by a franchisor. If, in fact, there is a disparity of sophistication between

franchisees and franchisors, as the proponents of this legislation contend, certainly the most effective antidote to that disparity of bargaining power is that of full and fair disclosure. The provisions of contractual arrangements which may provide the opportunity to exert "coercion" to "leverage"; the rights to reserved to the franchisor to terminate or refuse to renew; the record of those terminations of refusals to renew—as to all these matters full information can be and is being adequately provided for by proposed or enacted regulation covering disclosure.

The failure of the Federal Trade Commission to move expeditiously with respect to trade regulation rules was, of course, the subject of recent scrutiny by the other Congressional Committees. It is clear that that inaction has led to a feeling on the part of several state legislatures that the vacuum which was thus created necessitated action at the state level, at least until such time as the FTC could act. Whatever one may conclude, however, about the justification for the FTC's delay, it should not serve as the basis for action by the Congress to enact legislation of a quite different nature, and on the basis of so flimsy a record demonstrating the need to do so.

This is particularly the case where, as here, the legislation proposed would seek to place Congress in the position of intruding into private conduct in an unusually detailed and pervasive fashion. The definition of "legitimate business reason," of "essential," "reasonable," or "substantial compliance"—all these terms are left to later decision by the courts. This bill would simply have the Congress issue a broad fiat, directing the federal courts in the United States to engage in judicial second-guessing on a massive scale. And, in the first instance, the bill would permit—indeed, invite—franchisees to arrogate to themselves the power to determine such matters as which provisions of a contract into which they have entered are sufficiently "reasonable" or "essential" so that compliance with them is required.

This extraordinary undertaking by the Congress, moreover, is not dictated by the economic conditions of an industry which is in retreat or disarray. Quite the contrary, franchisees are acquiring additional franchises in increasing numbers. Many franchisors have waiting lists for new franchises of up to several years, comprised of existing as well as prospective franchisees. And there is every evidence that, in industry after industry, franchising has weathered the economic recession of recent years far better than have other methods of distribution. The symptoms are not those of distress, but those of success.

To enact this legislation, we submit, is to place franchising in a peculiarly disadvantaged position competitively. Quite apart from the Constitutional objections to such action—as a denial of equal protection, as an unjustifiable discrimination between classes of business, as an effort to benefit one class of merchants to the detriment of another—the economic effects of such actions would be severe. Franchisors would be crippled by their inability to react to changes in the market. Franchisors and franchisees alike would be injured by the increased difficulty and cost of maintaining quality standards. And the competitive disadvantage to which franchising would be exposed would in all likelihood drive franchising as a method of distribution into a distinctly unattractive position. That result, we submit, is beneficial to no one, least of all to the American public.

THE PROPOSED LEGISLATION IS UNCONSTITUTIONAL

Having suggested grave objections to legislation of so onerous a nature, one must turn to analyze certain highly specific objections to the proposed legislation itself.

The first and threshold objection is, of course, a Constitutional one, For this legislation is fraught with Constitutional infirmities which should, at the very least, give pause to the Congress and this Committee.

Because this legislation would seriously circumscribe franchisors' bargaining power, particularly as they would be prevented from protecting their accumulated customer good-will, it raises grave questions under the Contracts, Due Process and Equal Protection clauses of the Constitution. This proposal is constitutionally suspect because it is legislation on behalf of a special class, because it involves impermissible discrimination between franchisors and other similarly situated business, and because it deprives fran-

chise agreements beyond contractually valid termination, thereby depriving them of property rights.

But regardless of the impact of the foregoing Constitutional considerations, there appears to be no doubt that the proposed legislation, if held to have retroactive application, would be impermissible as a "Law impairing the obligation of contracts. . ." within the meaning of Article I, Section 10. While the Contracts clause applies expressly only to state legislation, judicial interpretations of the Fifth Amendment have extended to the federal government the prohibition against the impairment of contractual obligations. *Lynch* v. *UnitedStates*. 292 U.S. 571, 579 (1934).

If it is intended that this legislation, in effect, retroactively "amend" existing franchise agreements, there can be little question as to its Constitutional infirmities. Indeed, substantial guidance as to this issue can be found in decisions construing state legislation restricting franchisor termination rights. The first successful attack on state franchise termination regulation is found in *Fornaris* v. *Ridge Tool Company*, 423 F.2d 563 (1st Cir. 1970), *rev'd per curiam on other grounds*, 400 U.S. 41 (1970). By invalidating, on due process grounds, retroactive application of the "good cause for termination" requirement of the Puerto Rico Dealer Contract Law, the Court accepted the view that legislative modification of private contractual provisions is permissible only when such alterations are sufficiently minor and are justified by compelling public interests such as many be expressed in legislative findings. Chief Judge Aldrich fairly described the profound (and hence, impermissible) change in contractual relationships effected by legislative restrictions of termination rights:

If . . . a manufacturer has contracts with dealers that he could terminate at will without liability, and thereafter, because in the opinion of the legislature such a result would deprive the dealers of their expectations based upon their having "so efficiently fulfilled their responsibilities," it must make substantial payments on termination, *we can only regard this as increased payment for past services. Indeed, if it is not, it is an amendment to the contract to require an outright gratuity.* 423 F.2d at 567–8. (Emphasis supplied.)

The Court continued its analysis of the fundamental contractual changes created by the legislation:

No amount of research by parties or amici has discovered a case suggesting that to convert a contractual relationship terminable by either party without cause into one which, short of breach by the other party, can be terminated by one of the parties only by making substantial payments and without protection for its economic interests, is not a change of great magnitude. 423 F.2d at 567–8.

Although this ruling was reversed by the Supreme Court on the ground that the First Circuit should have abstained (since the "just cause" requirement of the statute might have been narrowed by the Puerto Rican Supreme Court to avoid Constitutional difficulties),[1] subsequent federal and state court decisions confirm the view that such provisions violate the Contracts clause.

In construing a similar statute, the Delaware Supreme Court held that the legislation made a "substantial change in the rights and obligations" of the parties and was therefore "proscribed by the Contract clause of the Federal Constitution." *Globe Liquor Co.* v. *Four Roses Distillers Co.*, 281 A.2d 19, 21 (1971), *cert. denied* 404 U.S. 873 (1971). See *Superior Motors* v. *Winnebago Industries*, Inc., 359 F. Supp. (D.S.C. 1973); *Mariniello* v. *Shell Oil Co.*, 363 F.Supp. 1401, 1403 (D.N.J. 1974), *vacated and remanded*, 511 F.2d 833 (3d Cir. 1975) (dictum recognizing persuasiveness of Contracts clause claim).

Other courts, in seeking to avoid the invalidation of such legislation, have found similar statutes to have prospective application only—that is, that they apply only to agreements between franchisors and new franchisees entered into after the effective date of the legislation. For example, in *AFA Distributing Co.* v. *Pearl Brewing Co.*, 470 F.2d 1210 (4th Cir. 1973), a federal court abstained from passing on the constitutionality of a Virginia franchise termination statute because it found that the state courts, if given an opportunity, might construe it to apply only prospectively. Similarly, in *Yamaha*

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[1] The Supreme Court of Puerto Rico itself ultimately found the statute to be unconstitutional. *Warner Lambert Co.* v. *Superior Court of Puerto Rico*, ——— P.R. ———, No. 0–72–106 (May 9, 1973).

Parts Distributors, Inc. v. *Ehrman*,———So.2d————(Fla. S.Ct., 1975), the court, in holding a termination statute to apply prospectively, accepted without discussion the franchisor's contention that the statute would violate the Contracts clause if held to apply to pre-existing agreements. While it is likely that such an interpretation would be made as to the proposed federal legislation, it is difficult to perceive any reason why a statute should be drafted in such a fashion as to invite constitutional attack.

Although a termination statute of prospective application only would avoid the contract clause issue, it would of course, create unintended and unfortunate distinctions between pre-existing and new franchise agreements. Quite apart from the discrimination between new and old franchisees which would be created, such a distinction could have significant consequences for the existing franchisee who wishes to transfer his interest to a new franchisee. Here, as elsewhere, the effects of the proposed legislation may not have been carefully considered by its drafters.

We have already suggested to the Committee that there exists a glaring lack of any evidence of need for this legislation, based upon the information provided to the Committee by the proponents of the legislation and based upon an analysis of all other objective sources of information. In the final analysis, however, it is the Constitutional objection to the legislation which suggests its most fundamental flaw: The bill lacks any real and substantial relationship to any legitimate object of legislation, because it will not serve the ends intended.

THE PROPOSED LEGISLATION IS FUNDAMENTALLY UNFAIR

If problems exist in franchising, they do not exist because of the ability to terminate or to refuse to renew franchise agreements. If there is an imbalance of power between the franchisor and the franchisee, that imbalance is a product of economic characteristics which were not unlawfully acquired, and which it is not properly the role of a legislature to seek to alter.

As the Third Circuit said last month in its *Dunkin' Donuts* decision:

> We do not imagine that many persons are, in any meaningful sense, forced to enter into franchising agreements. It may be that some do so because they have been deceived as to the terms, or the potential profitability, of the franchise; it may be that others do so because they lack sophistication and do not understand or appreciate the details of the bargain. More realistically, we would expect to find that arrangement apparently reasonable at its inception begins to seem burdensome to the franchisee as the business is successfully established.

The legislation before the Committee, we submit, is the product of just such a process—a process by which franchisees, who have made . . . and in most cases profited handsomely by . . . their bargains, now come to the Congress to seek to have those bargains altered. Whatever one may conclude as to whether there is a precise "balance of power" between the franchisor and the franchisee (and whether there is any legal imperative that such a balance exist), it seems indisputably clear that the effort to create such a balance has, in fact, led to a bill which, as presently drafted, is fundamentally unfair.

Despite the statement in the bill's Declaration of Policy that the legislation "provide[s] certain remedies to franchisors and franchisees," one may search the bill in vain to find any such even-handedness of treatment. The bill is, from beginning to end, an effort to establish a special and privileged position for franchisees—and, conversely, a second-class citizenship for franchisors—without parallel in other commercial relationships.

The bill permits franchisees, rather than franchisors, to make a determination of those provisions to which one party to a contract shall adhere. The bill makes the administration of the franchised system by the franchisor, as a practical matter, a matter beyond franchisor control. The bill hobbles the ability of the franchisor to expand a business in the fashion which he believes best for the benefit of the entire franchised system. The bill permits a franchisee, in effect, an extensive period of time during which he may continue with impunity to engage in violations of his agreement—including, quite likely, a failure to pay just obligations to the franchisor. The bill permits a franchisee to share in the goodwill of the business created by the franchisor, pursuant to a trademark owned by a franchisor. The bill shifts the burden of proof from the franchisee who accuses to the franchisor who is accused. And

the bill in some instances requires a court to award damages to franchisees, including punitive damages, but nowhere provides reciprocal treatment to franchisors who may suffer equal or greater injury at the hands of franchisees.

In short, a fair interpretation of the proposed legislation is that it seeks to guarantee every franchisee the prospect of a profit. We respectfully submit that this is no proper function of the law. No such comparable assurance is provided to the franchisor, nor does the franchisor seek it. To act in so one-sided and discriminatory a fashion is, we urge, a violation of the most rudimentary principles of legislative fairness.

THE PROPOSED LEGISLATION IS IMPERMISSIBLY VAGUE

Even if the proposed legislation were not fatally infected with this misdirection of purpose, it would be subject to criticism of almost equal force based upon the manner of its execution. For the bill is an extraordinarily imprecise, ambiguous and contradictory document, littered with circular definitions, inadequate draftsmanship and a number of provisions which would quite likely be found by a court to be void for vagueness.

The definition of "franchising" (§3(3)) is an instructive example. Contrary to the approach taken by other enacted and proposed legislation, and even by the most expansive definition contained in the Federal Trade Commission's proposed Trade Regulation Rule, the term "franchise," as defined by the bill, would cover every conceivable form of relationship by which one person authorizes another to sell the goods or services of the first person. It seems quite unlikely that even the most conventional form of buyer-seller relationship will escape so broad and undiscriminating a net. And it seems equally unlikely that the great bulk of American businesses which would be covered by this legislation are even aware of its existence.

At the same time, the complexities introduced by the 46 lines of statutory language devoted to the definition will without doubt lead to extensive uncertainty and disputes over interpretation. What, for example, is "more than nominal assistance to the franchisee" (§3(3)(C))? A sub-franchisee is covered, in the sense that a franchisee who is also permitted to sell franchises on behalf of the franchisor is described (§3(3)), but against whom do the rights of the sub-franchisee run? How is it to be determined whether (§3(3)) the parties "contemplate or anticipate" that the franchisee "will be involved, predominantly or primarily, in the sale or distribution of goods or services covered by such relationship"?

Perhaps the most obvious respects in which the bill falls short of the mark of legislative precision is in seeking to articulate those provisions of a franchise agreement which a franchisee is free to ignore, and to articulate the circumstances, however limited, under which a franchisor may be exempt from the coverage of the legislation. A franchisor, for example, may not cancel or terminate a franchise, or fail to renew it, unless the franchisor has "good cause" for doing so (§§3(4), 3(7), 6(a)(1), 6(b)(1)(A)). "Good cause" means "failure by the franchisee involved to comply substantially, without reasonable excuse or justification, with an essential and reasonable requirement imposed by such franchise." (§3(4)(a)).

What kind of compliance is "substantial," where, for example, the violation is of a failure to pay a just debt, or of a failure to maintain standards of quality control? What kind of an "excuse" or "justification" is "reasonable"? What requirements of a franchise agreement are "essential?" What requirements are "reasonable?" What guidance may even the most skilled and learned attorney offer to his client, whether franchisor or franchisee, as to the circumstances under which a franchisee may refuse to comply with a provision of a franchise agreement? What kind of experience will enable a federal judge to make decisions of this nature, in the context of a business of which he may have no prior knowledge: And what likelihood is there that any body of law can be established which will be of any precedential value in different businesses, under different factual circumstances, with different judges and different juries ruling in each case?

A franchisor may cancel or terminate a franchise (§6(a)(2)) or fail to renew it (§6(b)(1)(C)) if it is effecting what is called "a marketing area withdrawal." In circular fashion, that term is itself defined as a "cancellation, failure to renew or other termination of a franchise" for a limited purpose,

i.e., "the purpose of enabling such franchisor to withdraw entirely from the business of granting, organizing, supplying, or directing franchises "within certain described geographic areas" (§3(7)). While this "marketing area" is based on the consumer demand for the product or the service, or the demand for franchises, or on some other basis. Even this "exemption" is only available where there is no subsequent "commercial re-entry" into that marketing area by the franchisor within five years thereafter and "franchisor pays such franchisee reasonable compensation for the value of the latter's business (including, but not limited to, goodwill)" (§3(7)(B), (C)). And, while the franchisor may avoid the payment of such compensation by providing the franchisee "with a new and equivalent franchise for a different market area" (§3(7)(C)), such a substitute franchise must apparently be "exclusive" (§3(6)) to qualify, whether or not the original franchise had such characteristics; the determination of "equivalency" would be made by a court; and the franchisor would not be permitted to follow this approach without the "consent" of the franchisee (§3(7)(C)).

The questions which these further refinements of the "exemption" raise are legion. To cite only one, what is "reasonable compensation for the value of the latter's business?" Does it include, for example, the franchisee's outstanding lease obligations or obligations to pay for the real estate? Does it mean fair market value? going concern value? replacement value? unamortized value? Is it to include the unamortized initial fees? Is it somehow to take into consideration a reasonable return on the franchisee's investment—and, if so, how is that to be measured? What is the relevance of the existence or non-existence in the original franchise of a covenant not to compete, which may determine whether the franchisee is thereafter free to engage in the same or similar business. And how is "goodwill" to be calculated, in light of the fact that it is the franchisor, not the franchisee, who owns the trademark? And if the franchisee is deemed to have made a contribution toward that goodwill, how is one to take into account the efforts of other franchisees?

There is another basis upon which a franchisor may justify his refusal to renew a franchise. In limited circumstances (where the original duration of the franchise is of no less than a certain period of time), if the franchisor is willing to pay the franchisee "reasonable compensation for the value of the latter's business, (including, but not limited to, goodwill)", the franchisor may do so if he "has legitimate business reason for such failure to renew" (§6(b)(1)(B)). And what is a "legitimate business reason?" Helpfully, the statute provides a definition: a "commercial determination that is fair and reasonable in light of all the circumstances." "Fair" to whom? "Reasonable" by whose standards? Is it, for example, "fair" and "reasonable" for the franchisor simply to decide that, at the expiration of the contract, he wishes to operate henceforth on a company-owned basis? The statute provides no guidance—perhaps for the very good reason that it has never before been deemed an appropriate subject of legislation. Few pieces of proposed legislation in recent memory serve as more eloquent evidence of the risk and delicacy of a legislature undertaking to rewrite hundreds of thousands of existing contracts between private parties.

The bill bears as well the earmarks of a process of stitching together strands from a variety of sources, with little pattern. Thus, "good cause" is defined with respect to both "termination" and "attempted termination" (§3(4)) . . . but only the former (§6(a)), not the latter, is the subject of the bill's prohibitions. Similarly, the definition of a "termination" by "market area withdrawal" provides that "there is legitimate business reason for such withdrawal and good cause for such a termination (§3(7)) if certain conditions are met . . . but "good cause" (§3(4)) and "legitimate business reason" (§3(5)) *are independent* justifications for termination (§§6(a)(1), 6(b)(1)(A), (B)), not elements of the "marketing area withdrawal" provision.

The imperfections described above, however gross, relate largely to the failure of the drafters to contemplate the consequences of their actions. But these deficiencies are far more serious than matters of language or semantics. They go to the very heart of a complicated and significant bundle of rights and responsibilities, the franchised relationship. And they strike at the central core of those reciprocal obligations—the maintenance of quality controls which have been so instrumental in achieving the success of franchising, and the consumer acceptance of goods and services sold through the franchised method of distribution.

Does it, for example, constitute "good cause" to terminate a franchise that the franchisee has failed to pay his royalties or other just obligations? Which provisions of a set of quality controls will subsequently be deemed to have been "essential"? Since the limited provision pursuant to which a franchisor may cancel on short notice (48 hours) does not, for example, encompass such events as the abandonment of the business by the franchisee, or conviction of a felony or crime related to the business, or a sale of the business to an unapproved person, is a franchisor helpless to act even in such extraordinary circumstances? It will take no student of franchising to find within the language of this bill formidable evidence that those who drafted it knew little of the practical and economic incidents of the franchised relationship. We respectfully submit that it would be irresponsible to enact so ill-conceived and poorly executed a piece of legislation.

THE PROPOSED LEGISLATION IS UNWORKABLE

A final and dominating impression with which one is left after reading the bill is that it is simply unworkable. We respectfully suggest that it is not possible to operate a business under the franchised method of distribution in compliance with the statute as it is written. The enactment of this statute will put all franchisors, and their hundreds of thousands of franchisees, in the position of choosing between operation of a business with any semblance of logic, order and direction, on one hand or, on the other, compliance with the law.

The discussion which has preceded has already suggested some of the respects in which the bill is an unworkable charter. There are many others.

If a franchisor is faced with a franchisee who has engaged or is engaging in an act which constitutes "an imminent danger to public health or safety" (§5(b)(1)) this bill tells him that he may not terminate that franchise for a period of forty-eight hours, but must allow that "imminent danger" to continue, perhaps at grave jeopardy to the public, and certainly at the risk of imperiling his own legal status vis-a-vis enforcement authorities and consumers. Shall he comply with the law . . . or act in accordance with the dictates of common sense and good business judgment? Is not the answer clear?

This is no isolated example.

Should a franchisor sit idly by for a period of three months (§5(a)) during which time a franchisee may be systematically looting the business, following notice of an intent to cancel?

Should a franchisor renew an inefficient franchisee, to the detriment of his and other franchisees' business, for fear that "inefficiency" is not contemplated as an adequate basis for non-renewal?

Should a franchisor renew a franchisee whose lease from a third party has expired, or refrain from interminating a franchisee who has lost his lease due to eminent domain or condemnation?

Should a franchisor terminate a franchise agreement upon the death of a franchisee, or allow the franchise to fall into the hands of others, without regard to their qualifications or capacity?

Should a franchisor gamble that the prohibition on the sale of unauthorized products is an "essential" and "reasonable" provision of a franchise agreement, or should he forego enforcing such a prohibition at the possible risk of loss or impairment of his trademark rights under the Lanham Act?

Should a franchisor reissue franchise agreements upon the basis of outmoded and perhaps unenforceable franchise agreements, as the bill may be deemed to contemplate, or should be determinedly insist upon uniformity of all outstanding franchise agreements, and of the standards pursuant to which the franchised businesses are to operate?

This bill thus may well be interpreted to freeze franchise agreements in their present form, prohibiting franchisors from making necessary legal and business changes. Whether or not it is so construed, it is clear that it cannot be complied with by those who must live within the practical restraints of such a franchised relationship. No legislature should be called upon to enact legislation which can only be adhered to by ignoring the requirements of operating a business. A taking of private property without compensation need not be accomplished by confiscation alone; as this bill demonstrates, it can as

well be the product of the forced abdication of responsibilities dictated by common sense and sound business judgment.

CONCLUSION

Proponents of this legislation suggest that it is simply an effort to correct certain abuses, to redress an imbalance of power, to engage in fine-tuning of a relatively peripheral sort. Nothing could be further from the truth. We believe that this bill is a fundamental, radical, unprecedented effort to reconstitute long-standing relationships, abrogate traditional principles of law and equity, and establish new standards of business practice hitherto rejected by the judicial and legislative branches as well as by businessmen themselves.

The forced renewal provision of the legislation (§6) contradicts the fundamental principle of Western society that the law will not compel one man to deal with another with whom he does not wish to deal. It establishes a perpetual relationship without any mutuality of comparable obligations by the party on whose behalf it is established, unprecedented in the annals of commercial law.

The bill is silent with respect to its applicability to existing, as opposed to newly franchised, franchisees. If it is deemed to be applicable only to new franchises, it is difficult to understand the interest which existing franchisees have expressed in it. But if, as seems likely, the drafters intend it to be retroactive, it constitutes one of the most massive rewritings of existing private contracts which the Congress has ever been asked to undertake.

The legislation goes far beyond any which Congress has ever enacted. Its only predecessor was resoundingly defeated at the subcommittee level (S. 1967, 91st Cong., 1st Sess., the "Fairness in Franchising Act"). In at least one respect it is directly contrary to a decision recently made by the Senate (S. 323, 94th Cong., 1st Sess., §4(b)).[2]

By providing (§7(d)) that the burden of proof shall be upon the accused franchisor, rather than upon the accusing franchisee, the bill would engage in an unprecedented shifting of the costs and burdens of litigation, contrary to the usual rule of law and without foundation in logic or in the principles of fairness. By placing the burden on the party with least access to the knowledge (how, for example, is the franchisor to know whether the franchisee had any "excuse" or "justification" at all, not to speak of whether it was "reasonable"?), the bill insures that the party who has the burden of proof will be unable to carry it.

The bill is notable for the absence of any reference to the traditional "opportunity to cure" contained in franchise agreements, for its prohibition against the parties agreeing to waive provisions of the agreement (§8(a)), and for the limitations upon the circumstances under which the parties may elect to arbitrate rather than litigate (§8(b)). All suggest a statute destined to assure the relationship between franchisors and franchisees will principally be developed, not in the marketplace, but in the courtroom.

* * * * * * *

In short, this legislation is radical, drastic and without precedent. It is unfair, unjustified and anticompetitive. We respectfully submit that it should be promptly and decisively rejected.

Attachment A

STATE STATUTES ON TERMINATION OR NON-RENEWAL OF FRANCHISEES

Connecticut—Conn. Gen. Stat. §42-133 (e-g) *as amended* (effective Oct. 1, 1975).

Delaware—Del. Code, Title 6, ch. 25, subch. IV. §§2551 et seq. (effective July 1, 1970).

Hawaii—Hawaii Rev. Stat., ch. 842E (effective Jan. 1, 1975).

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[2] Section 4(b) of the "Fair Marketing of Petroleum Products Act" would have prohibited refiners from terminating and refusing to renew petroleum dealers except where, inter alia, it could be shown that the dealer had failed to comply with an "essential and reasonable" requirement of his franchise. The "essentiality" standard was deleted from this provision by an amendment introduced on the floor of the Senate, prior to enactment of the measure. 121 Cong. Rec. 11107 (1975).

Indiana—Indiana Code ch. 23–2.7 as amended by Act of Feb. 5, 1976 (effective July 1, 1976).
Michigan—Mich. Stat. Ann. §19.854 (effective Oct. 15, 1974).
Minnesota—Minn. Stat. ch. 80C.15 (effective Aug. 1, 1973); Rules of the Minn. Comm'r of Securities, Subdiv. 1714, §§(e,f) (filed Jan. 10, 1975).
Missouri—Pub. Act. 13, ch. 810 (effective Oct. 1, 1975).
New Jersey—N.J. Rev. Stat., Title 56, ch. 10 (effective Dec. 21, 1971).
Washington—Wash. Rev. Code, §§19.100.010 (effective May 1, 1972).
Wisconsin—Wis. Stat. §§553.01 et seq. (effective July 1, 1972).

Attachment B

STATES REJECTING LEGISLATION ON TERMINATION OR RENEWAL OF FRANCHISEES, 1971–75

Arizona, 1974.
Kansas, 1973.
Kentucky, 1974.
Massachusetts, 1973, 1975.
Mississippi, 1975.
New Jersey, 1975.
New York, 1975.
North Dakota, 1973, 1975.
Rhode Island, 1975.
Washington, 1975.

Attachment C

INFORMATION RE FRANCHISES REGISTERED WITH ILLINOIS SECURITIES COMMISSION USING UNIFORM FRANCHISE OFFERING CIRCULAR

Number of franchisors registered	61
Total number of franchise outlets licensed by those franchisors registered	27,245
Terms of franchises registered (in percent):	
20-year terms	26
15-year terms	15
10-year terms	18
5-year terms	8
1-year terms	5
Perpetual terms	3.5
Subject to lease	13
Others	11.5
Total number of terminations	853

(Terminations are 3.1% of total franchise outlets for the three-year period reported, or approximately 1.039% a year.)
Number of nonrenewals reported (Nonrenewals are less than 1% (0.1%) of total franchise outlets for the three-year period reported, or approximately 0.03% a year.)

Attachment D

STATES WITH LEGISLATION DEALING WITH FRANCHISE TERMINATION OR RENEWAL IN AUTOMOBILE, PETROLEUM OR BEER INDUSTRIES

Arizona
Arkansas
California
Florida
Georgia
Hawaii
Idaho
Indiana
Iowa
Kentucky
Louisiana
Maine
Maryland
Massachusetts
Mississippi
Montana
Nebraska
Nevada
New Hampshire
New Mexico
New York
North Carolina
Ohio
Oklahoma
Pennsylvania
South Carolina
South Dakota
Tennessee
Texas
Utah
Vermont
Virginia
West Virginia
Wisconsin

Attachment E[1]

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[1] This attachment is in the committee files.

Attachment F

STATES WITH LEGISLATION REQUIRING REGISTRATION AND/OR DISCLOSURE TO PROSPECTIVE FRANCHISEES

California—Franchise Investment Law Corp. Code, Sec. 310.000 (effective Jan. 1, 1971).

Hawaii—Franchise Investment Law Sec. 482E (effective Jan. 1, 1975).

Illinois—The Franchise Disclosure Act SHA CH. 121 1/2 Sec. 701 amended Jan. 1, 1976 (effective Jan. 1, 1974).

Indiana—Franchise Investment Law Ch. 23–2 (effective July 1, 1975).

Michigan—Registration, Disclosure, Pyramid Statute, MSA Sec. 19.854 (effective Oct. 15, 1974).

Minnesota—Minnesota Franchise Act Ch. 80C.01 (effective Aug. 1, 1973).

North Dakota—Franchise Investment Law SB 2479 (effective July 1, 1975).

Oregon—Franchise Disclosure (Antimisrepresentation) Statute ORS 650.007 *et seq.* (effective Nov. 1, 1973).

Rhode Island—Franchise and Distributorship Investment Regulations Act Sec. 19–28 (effective July 1, 1974).

South Dakota—South Dakota Franchise Law Chapter 37–5A (effective July 1, 1974).

Washington—Franchise Investment Protection Act, RCW 19.100.010 *et seq.* (effective May 1, 1972).

Wisconsin—Wisconsin Franchise Investment Law, Ch. 553, Subch. I (effective July 1, 1972).

ATTACHMENT G

UNIFORM FRANCHISE REGISTRATION APPLICATION

INSTRUCTIONS

The following instructions must be adhered to with respect to all applications for registration, registration renewal and amendment.

1. COMPLETION OF APPLICATION: An application for registration of the offer or sale of franchises shall include the following, all of which shall be verified by means of the prescribed signature page:

   A. Facing page.

   B. Supplemental information page(s).

   C. Salesmen disclosure form for all states except Washington.

   D. A copy of the proposed offering circular.

   The following shall be attached to the application:

   A. A second copy of the proposed offering circular.

   B. A cross reference sheet showing the location in the franchise agreement of the information required to be included in the application and in the offering circular. If any item calling for information is inapplicable or the answer thereto is in the negative and is omitted, a statement to that effect shall be made in the cross reference sheet.

   C. Two copies of any advertising to be used in connection with the offer or sale in this state of franchises.

   D. A consent to service of process.

2. DEFINITIONS:

   A. "Predecessor," for the purposes of the disclosure required by item 1 in the body of the offering circular, is defined as follows:

      A "predecessor" of a franchisor is (i) a person the major portion of whose assets have been acquired directly or indirectly by the franchisor, or (ii) a person from whom the franchisor acquired directly or indirectly the major portion of its assets.

B. "Franchise broker," for the purposes of the disclosure required by the cover page and item 2 in the body of the offering circular, is defined as follows:

> A "franchise broker" is any person engaged in the business of representing a franchisor or subfranchisor in offering for sale or selling a franchise, except anyone whose identity and business experience is otherwise required to be disclosed at item 2 in the body of the offering circular.

3. DISCLOSURE: Each disclosure item should be either positively or negatively commented upon by use of a statement which fully incorporates the information required by the item.

4. SUBFRANCHISORS: When the person filing the application for registration is a subfranchisor, the application shall also include the same information concerning the subfranchisor as is required from the franchisor; the franchisor, as well as the subfranchisor, shall execute a signature page.

5. SIGNING OF APPLICATION: The application shall be signed by an officer or general partner of the applicant; however, it may be signed by another person holding a power of attorney for such purposes from the applicant. If signed on behalf of the applicant pursuant to such power of attorney, the application shall include as an additional exhibit a copy of said power of attorney or a copy of the corporate resolution authorizing the attorney to act.

6. MANUALLY SIGNED CONSENT OF ACCOUNTANT: All applications shall be accompanied by manually signed consent of the independent public accountant for the use of their audited financial statements as such statements appear in the offering circular.

7. APPLICATION TO AMEND THE REGISTRATION: An amendment to an application filed either before or after the effective date of registration shall contain only the information being amended identified by item number and shall be verified by means of the prescribed signature page. Each amendment shall be accompanied by a facing page in the form prescribed on which the applicant shall indicate that the filing is an amendment and the number of the amendment, if more than one.

8. NOTE: This Uniform Franchise Registration Application is an alternative means of complying with the state franchise investment laws. Because the Uniform Application form was designed to satisfy the varied requirements of a number of states, it may call for more information than any one state demands. Applicants should be aware that they may, if they wish, elect to file in each state the application form prescribed in that state, rather than the Uniform Application form.

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9-2-75

UNIFORM FRANCHISE REGISTRATION APPLICATION

FILE NO.

(Insert file number of previous filings of Applicant, if any)

FEE: _____
(To be enclosed by Applicant at time application is initially filed)

Date of Application: _____

APPLICATION FOR (Check only one):

_____ REGISTRATION OF AN OFFER OR SALE OF FRANCHISES

_____ REGISTRATION RENEWAL STATEMENT OR ANNUAL REPORT

_____ POST-EFFECTIVE
_____ PRE-EFFECTIVE

} AMENDMENT NUMBER _____ TO APPLICATION FILED UNDER SECTION _____ DATED _____

1. Name of Franchisor.
Name under which the Franchisor is doing or intends to do business.
2. Franchisor's principal business address.
Name and address of Franchisor's agent in the State of (Name of State) authorized to receive process.
3. Name, address and telephone number of subfranchisors, if any, for this state.
4. Name, address and telephone number of person to whom communications regarding this application should be directed.

SUPPLEMENTAL INFORMATION

1. List the following:

   A. The states in which this proposed registration is effective.

   B. The states in which this proposed registration is or will be shortly on file.

   C. The states, if any, which have refused, by order or otherwise, to register these franchises.

   D. The states, if any, which have revoked or suspended the right to offer these franchises.

   E. The states, if any, in which the proposed registration of these franchises has been withdrawn.

2. With respect to all franchises sought to be registered set forth, in budget form, the total projected financing required by franchisor to fulfill the franchisor's obligations to provide real estate, improvements, equipment, inventory, training and all other items included in the offering. Show separately the sources of all of the required funds including any proposed loans or contributions to capital.

SALESMEN DISCLOSURE FORM

1. As required by this State's statute, list the persons who will engage in the offer or sale of franchises in this state and for each person list the following information:

   A. Name;

   B. Business address and telephone number;

   C. Home address and telephone number;

   D. Present employer;

   E. Present title;

   F. Social security number;

   G. Birthdate; and

   H. Employment or occupation during the past 5 years. For each such employment state the name of the employer, position held and beginning and ending dates for each such employment.

2. State whether any person identified in 1. above:

   A. Has any administrative, civil or criminal action pending against him alleging a violation of any franchise law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property or any comparable allegations?

      YES _____ NO _____

   B. Has during the 10 year period immediately preceding the date of the offering circular:

      (1) been convicted of a felony or pleaded nolo contendere to a felony charge or been held liable in a civil action by final judgment if such felony or civil action involved a violation of any franchise law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property or any comparable violations of law?

      YES _____ NO _____

      (2) entered into or been named in any consent judgment, decree, order or assurance under any federal or state franchise, securities, antitrust, monopoly, trade practice, or trade regulation law?

      YES _____ NO _____

(3) been subject to any order of any national securities association or national securities exchange (as defined in the Securities and Exchange Act of 1934) suspending or expelling such person from membership in such association or exchange.

YES _____ NO _____

C. With respect to each question above answered "YES" state:

(1) the name of each person or entity involved;

(2) the court, agency, association or exchange involved;

(3) a summary of the allegations;

(4) if applicable, the date of the conviction, judgment, decree, order or assurance; and

(5) the penalty imposed, damages assessed and nature thereof, terms and conditions of the judgment, decree, order or assurance.

UNIFORM CONSENT TO SERVICE OF PROCESS

KNOW ALL MEN BY THESE PRESENTS:

That the undersigned, _____,

(a corporation organized under the laws of the State of _____)

(a partnership) (an individual) (_____), for the
(other)

purpose of complying with the laws of the State of _____

relating to the registration, exemption from registration or sale

of franchises, hereby irrevocably appoints the _____,
(regulatory authority)

and the successors in such office, its attorney in the State of

_____ upon whom may be served any notice, process or

pleading in any action or proceeding against it arising out of or

in connection with the sale of franchises, or out of violation of

the aforesaid laws of said State; and the undersigned does hereby

consent that any such action or proceeding against it may be

commenced in any court of competent jurisdiction and proper venue

within said State by service of process upon said officer with

the same effect as if the undersigned was organized or created

under the laws of said State and had lawfully been served with

process in said State.

It is requested that a copy of any notice, process or pleading

served hereunder be mailed to:

_____

(Name and Address)

_____

Dated: _____, 19 _____.

_____

By _____

Title _____

(SEAL)

By _____

Title _____

CORPORATE ACKNOWLEDGMENT

STATE OF _____)
)ss.
COUNTY OF _____)

On this _____ day of _____, 19____, before me _____ (Name of Notary) the undersigned officer, personally appeared _____ and _____, known personally to me to be the _____ President and _____ Secretary, respectively, of the above named corporation, and that they, as such officers, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as such officers.

IN WITNESS WHEREOF I have hereunto set my hand and official seal.

_____
Notary Public

(NOTARIAL SEAL) My Commission expires: _____

INDIVIDUAL OR PARTNERSHIP ACKNOWLEDGMENT

STATE OF _____)
)ss.
COUNTY OF _____)

On this _____ day of _____, 19____, before me, _____, the undersigned officer, personally appeared _____ to me personally known and known to me to be the same person(s) whose name(s) is (are) signed to the foregoing instrument, and acknowledged the execution thereof for the uses and purposes therein set forth.

IN WITNESS WHEREOF I have hereunto set my hand and official seal.

_____
Notary Public

(NOTARIAL SEAL) My Commission expires: _____

I certify under penalty of law that I have read this application and the exhibits attached hereto and incorporated herein by reference, and know the contents thereof and that the statements therein are true and correct.

Executed at _____, _____, 19____

_____

_____
(Signature(s) of Franchisor and/or Subfranchisor)

By _____

(SEAL)

Title _____

STATE OF _____)
)ss.
COUNTY OF _____)

Personally appeared before me this _____ day of _____ 19_____ the above-named _____ _____(and) _____ to me known to be the person(s) who executed the foregoing application (as _____ and _____ _____ respectively, of the above-named applicant) and (each), being first duly sworn, stated upon oath that said application, and all exhibits submitted herewith, are true and correct.

_____

(Notary's Seal)

_____
(Notary)

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FINAL DRAFT
9-2-75

REQUIREMENTS FOR PREPARATION
OF A UNIFORM FRANCHISE OFFERING CIRCULAR

COVER PAGE: The outside front cover of the offering circular shall contain the following information:

1. The title in boldface type: FRANCHISE OFFERING CIRCULAR FOR PROSPECTIVE FRANCHISEES REQUIRED BY THE STATE OF (name of state).

2. The name, type of business organization, principal business address and telephone number of the franchisor.

3. If different than 2. above, the name, principal business address and telephone number of the subfranchisor or franchise broker offering in this state the herein described franchise.

4. A sample of the primary business trademark, logotype, trade name, or commercial label or symbol used by the franchisor for marketing its products or services and under which the franchisee will conduct its business. (Place in upper left-hand corner of the cover page.)

5. A brief description of the franchise to be offered.

6. A summary of items 5 and 7 of the offering circular, to wit: Franchisee's Initial Franchise Fee or Other Payment and Franchisee's Initial Investment, respectively. (See page 4.)

7. Effective Date: (Leave blank until notified of effectiveness by state regulatory authority.)

8. The following statement in boldface type:

THIS OFFERING CIRCULAR IS PROVIDED FOR YOUR OWN PROTECTION AND CONTAINS A SUMMARY ONLY OF CERTAIN MATERIAL PROVISIONS OF THE FRANCHISE AGREEMENT. THIS OFFERING CIRCULAR AND ALL CONTRACTS OR AGREEMENTS SHOULD BE READ CAREFULLY IN THEIR ENTIRETY FOR AN UNDERSTANDING OF ALL RIGHTS AND OBLIGATIONS OF BOTH THE FRANCHISOR AND THE FRANCHISEE.

ALTHOUGH THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE (name of law), REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE (state regulatory authority) THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE, ACCURATE AND NOT MISLEADING. A FALSE, INCOMPLETE, INACCURATE OR MISLEADING STATEMENT MAY CONSTITUTE A VIOLATION OF BOTH FEDERAL AND STATE LAW, AND SHOULD BE REPORTED TO BOTH THE FEDERAL TRADE COMMISSION, WASHINGTON, D. C., 20580 AND (name and address of state regulatory authority).

(name of law) MAKES IT UNLAWFUL TO OFFER OR SELL ANY FRANCHISE IN THIS STATE WHICH IS SUBJECT TO REGISTRATION WITHOUT FIRST PROVIDING TO THE PROSPECTIVE FRANCHISEE, AT LEAST (requisite time) PRIOR TO THE EXECUTION BY THE PROSPECTIVE FRANCHISEE OF ANY BINDING FRANCHISE OR OTHER AGREEMENT, OR AT LEAST (requisite time) PRIOR TO THE PAYMENT OF ANY CONSIDERATION BY THE FRANCHISEE, WHICHEVER OCCURS FIRST, A COPY OF THE OFFERING CIRCULAR, TOGETHER WITH A COPY OF ALL PROPOSED AGREEMENTS RELATING TO THE FRANCHISE.

9. The name and address of the franchisor's registered agent in this state authorized to receive service of process.

10. The name and address of the subfranchisor's or franchise broker's registered agent in this state authorized to receive service of process.

TABLE OF CONTENTS: Include a table of contents based on the requirements of this offering circular.

BODY OF OFFERING CIRCULAR: The offering circular shall contain the following information clearly and concisely stated in narrative form:

1. THE FRANCHISOR AND ANY PREDECESSORS: Set forth in summary form: (The disclosure regarding predecessors need only cover the 15 year period immediately preceeding the close of franchisor's most recent fiscal year.)

   A. The name of the franchisor and any predecessors thereto.

   B. The name under which the franchisor is currently doing or intends to do business.

   C. The franchisor's principal business address and the business address or addresses of any predecessors thereto.

   D. The business form of the franchisor whether corporate, partnership, or otherwise.

   E. A description of the franchisor's business and the franchises to be offered in this state.

   F. The prior business experience of the franchisor and any predecessors thereto including:

      (1) The length of time the franchisor has conducted a business of the type to be operated by the franchisee;

      (2) The length of time each predecessor conducted a business of the type to be operated by the franchisee;

      (3) The length of time the franchisor has offered franchises for such business;

      (4) The length of time each predecessor offered franchises for such business;

      (5) Whether the franchisor has offered franchises in other lines of business, including:

         (a) a description of such other lines of business;

         (b) the number of franchises sold in each other line of business;

(c) the length of time the franchisor has offered each such franchise; and

(6) Whether each predecessor offered franchises in other lines of business, including:

(a) a description of such other lines of business;

(b) the number of franchises sold in each other line of business; and

(c) the length of time each predecessor offered each such franchise.

2. IDENTITY AND BUSINESS EXPERIENCE OF PERSONS AFFILIATED WITH THE FRANCHISOR; FRANCHISE BROKERS: List by name and position held the directors, trustees and/or general partners, as the case may be, the principal officers (including the chief executive and chief operating officer, financial, franchise marketing, training and service officers) and other executives or subfranchisors who will have management responsibility in connection with the operation of the franchisor's business relating to the franchises offered by this offering circular and all franchise brokers. With regard to each person listed, state his principal occupations and employers during the past five years.

3. LITIGATION: State whether the franchisor, any person or franchise broker identified in 2. above:

A. Has any administrative, criminal or material civil action (or a significant number of civil actions irrespective of materiality) pending against him alleging a violation of any franchise law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property or comparable allegations. If so, set forth the name of the person, the court or other forum, nature, and current status of any such pending action. Franchisor may include a summary opinion of counsel as to any such action, but only if a consent to use of such summary opinion is included as part of this offering circular.

B. Has during the 10 year period immediately preceding the date of the offering circular been convicted of a felony or pleaded nolo contendere to a felony charge or been held liable in a civil action by final judgment or been the subject of a material complaint or other legal proceeding if such felony, civil action, complaint or other legal proceeding involved violation of any franchise law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property or comparable allegations. If so, set forth the name of the person convicted, the court and date of conviction or person against whom judgment was entered, penalty or damages assessed in connection therewith and/or terms of settlement.

C. Is subject to any currently effective injunctive or restrictive order or decree relating to the franchise or under any federal, state or Canadian franchise, securities, antitrust, trade regulation or trade practice law as a

result of a concluded or pending action or proceeding brought by a public agency. If so, set forth the name of the person so subject, the public agency and court, a summary of the allegations or facts found by the agency or court and the date, nature, terms and conditions of the order or decree.

4. BANKRUPTCY: State whether the franchisor or any predecessor, officer or general partner of the franchisor has during the 15 year period immediately preceding the date of the offering circular been adjudged bankrupt or reorganized due to insolvency or was a principal officer of any company or a general partner in any partnership that was adjudged bankrupt or reorganized due to insolvency during or within 1 year after the period that such officer or general partner of the franchisor held such position in such company or partnership, or whether any such bankruptcy or reorganization proceeding has been commenced. If so, set forth the name of the person or company adjudged bankrupt or reorganized or named in any such proceeding and the date thereof and any material facts or circumstances.

5. FRANCHISEE'S INITIAL FRANCHISE FEE OR OTHER INITIAL PAYMENT: Describe in detail the following:

A. The initial franchise fee or other initial payment for the franchise, if any, charged upon the signing of the franchise agreement, and whether payable in lump sum or installments. Set forth the manner in which the franchisor will use or apply such franchise fee or initial payment. State whether such fee or payment is refundable, and if so, under what conditions.

B. If an identical initial franchise fee or other initial payment is not charged in connection with each franchise agreement, state the method or formula by which such fee or payment is determined.

6. OTHER FEES: Describe in detail other recurring or isolated fees or payments, including but not limited to royalties, service fees, training fees, lease payments and advertising fees and charges that the franchisee is required to pay to the franchisor or persons affiliated with the franchisor or which the franchisor or such affiliated person imposes or collects in whole or in part on behalf of a third party. Include, if applicable, the formula used to compute such other fees and payments. State whether any such fee or payment is refundable, and if so, under what conditions.

7. FRANCHISEE'S INITIAL INVESTMENT: Describe in detail the following expenditures (which may be estimated or described by a low-high range, if not known exactly), stating for each to whom the payments are to be made, when such payments are to be determined, whether any payment is refundable, and if so, under what conditions and, if any part of the franchisee's initial investment in the franchise will or may be financed, an estimate of the loan repayments, including interest:

A. Real property, whether or not financed by contract, installment, purchase or lease. If neither estimable nor describable by a low-high range, describe the variable requirements, such as property, location and building size which make the real property expenditure neither estimable nor describable by a low-high range.

B. Equipment, fixtures, other fixed assets, construction, remodelling, leasehold improvements and decorating costs, whether or not financed by contract, installment purchases, lease or otherwise.

C. Inventory required to commence operation.

D. Security deposits, other prepaid expenses and working capital required to commence operation.

E. Any other payments which the franchisee will be required to make in order to commence operations.

NOTE: The following statement shall be inserted in the offering circular at this point:

THERE ARE NO OTHER DIRECT OR INDIRECT PAYMENTS IN CONJUNCTION WITH THE PURCHASE OF THE FRANCHISE.

8. OBLIGATIONS OF FRANCHISEE TO PURCHASE OR LEASE FROM DESIGNATED SOURCES: State any obligations of the franchisee or subfranchisor, whether arising by terms of the franchise agreement or other device or practice, to purchase or lease from the franchisor or his designees, goods, services, supplies, fixtures, equipment, inventory or real estate relating to the establishment or operation of the franchise business. Regarding such obligations, state the following:

A. The goods, services, supplies, fixtures, equipment, inventory or real estate required to be purchased or leased from the franchisor or his designees.

B. Whether, and if so, the precise basis by which, the franchisor, its parent or persons affiliated with the franchisor will or may derive income based on or as a result of any such required purchases or leases.

C. To the extent known or estimable by the franchisor, the magnitude of such required purchases and leases in relation to all purchases and leases by the franchisee of goods and services which the franchisee will make or enter into (1) in the establishment and (2) in the operation of the franchise business.

9. OBLIGATIONS OF FRANCHISEE TO PURCHASE OR LEASE IN ACCORDANCE WITH SPECIFICATIONS OR FROM APPROVED SUPPLIERS: State any obligations of the franchisee or subfranchisor, whether arising by terms of the franchise agreement or other device or practice, to purchase or lease in accordance with specifications issued by the franchisor, or from suppliers approved by the franchisor, goods, services, supplies, fixtures, equipment, inventory or real estate relating to the establishment or operation of the franchise business. Regarding such obligations, state the following:

A. The goods, services, supplies, fixtures, equipment, inventory or real estate required to be purchased or leased in accordance with specifications or from suppliers approved by the franchisor.

B. The manner in which the franchisor issues and modifies specifications or grants and revokes approval to suppliers.

C. Whether, and for what categories of goods and services, the franchisor or persons affiliated with the franchisor are approved suppliers or the only approved suppliers.

D. Whether, and if so, the precise basis by which, the franchisor, its parent or persons affiliated with the franchisor may derive income from purchases made from it or from other approved suppliers, if this is the case.

10. FINANCING ARRANGEMENTS: State the terms and conditions of any financing arrangements offered directly or indirectly by the franchisor, its agent or affiliated company, including:

A. A description of any waiver of defenses or similar provisions in any note, contract or other instrument to be executed by the franchisee or subfranchisor.

B. A statement of any past or present practice or of any intent of the franchisor to sell, assign, or discount to a third party, in whole or in part, any note, contract or other instrument executed by the franchisee or subfranchisor.

C. A description of any payments received by the franchisor from any person for the placement of financing with such person.

11. OBLIGATIONS OF THE FRANCHISOR; OTHER SUPERVISION, ASSISTANCE OR SERVICES: Where applicable, describe the following:

A. The obligations to be met by the franchisor prior to the opening of the franchise business, citing by section and page the provisions of the franchise or related agreement requiring performance.

B. Other supervision, assistance or services to be provided by the franchisor prior to the opening of the franchise business although franchisor is not bound by the franchise or any related agreement to provide the same. As part of this disclosure franchisor must disclose that he is not so bound.

C. The obligations to be met by the franchisor during the operation of the franchise business, including, without limitation, the assistance to the franchisee in the operation of his business. Cite by section and page the provisions of the franchise or related agreement requiring performance.

D. Other supervision, assistance or services to be provided by the franchisor during the operation of the franchise business although franchisor is not bound by the franchise or any related agreement to provide the same. As part of this disclosure franchisor must disclose that he is not so bound.

E. The methods used by the franchisor to select the location for the franchisee's business.

F. The typical length of time between the signing of the franchise agreement or the first payment of any consideration for the franchise and the opening of the franchisee's business.

G. The training program of the franchisor, including:

(1) The location, duration and content of the training program;

(2) When the training program is to be conducted;

(3) The experience that the instructors have had with the franchisor;

(4) Any charges to be made to the franchisee and the extent to which the franchisee will be responsible for travel and living expenses of the person(s) who enroll in the training program;

(5) If the training program is not mandatory, the percentage of new franchisees that enrolled in the training program during the 12 months immediately preceding the date of the offering circular; and

(6) Whether any additional training programs and/or refresher courses are available to the franchisee and whether the franchisee will be required to attend the same.

12. EXCLUSIVE AREA OR TERRITORY: Describe any exclusive area or territory granted the franchisee and with respect to such area or territory state whether:

A. The franchisor has established or may establish another franchisee who will also be permitted to use the franchisor's trade name or trademark.

B. The franchisor has established or may establish a company-owned outlet using the franchisor's trade name or trademark.

C. The franchisor or its parent or affiliate has established or may establish other franchises or company-owned outlets selling or leasing similar products or services under a different trade name or trademark.

D. Continuation of the franchisee's areal or territorial exclusivity is dependent upon achievement of a certain sales volume, market penetration or other contingency and under what circumstances the franchisee's area or territory may be altered.

13. TRADEMARKS, SERVICE MARKS, TRADE NAMES, LOGOTYPES, AND COMMERCIAL SYMBOLS: Describe any trademarks, service marks, trade names, logotypes or other commercial symbols to be licensed to the franchisee including the following:

A. Whether the trademark, service mark, trade name, logotype or other commercial symbol is registered with the United States Patent Office and, if so, for each such registration state the registration date and number and whether or not the registration is on the principal or supplemental register.

B. Whether the trademark, service mark, trade name, logotype and other commercial symbol are registered in this state or the state in which the franchise business is to be located and the dates of such registrations.

C. A description of any presently effective determinations of the Patent Office, the trademark

administrator of this state or any court, any pending interference, opposition or cancellation proceeding and any pending material litigation involving such trademarks, service marks, trade names, logotypes or other commercial symbols and which is relevant to their use in this state or the state in which the franchise business is to be located.

D. A description of any agreements currently in effect which significantly limit the rights of the franchisor to use or license the use of such trademarks, service marks, trade names, logotypes or other commercial symbols in any manner material to the franchise.

E. Whether the franchisor is obligated by the franchise agreement or otherwise to protect any or all rights which the franchisee has to use such trademarks, service marks, trade names, logotypes or other commercial symbols and to protect the franchisee against claims of infringement or unfair competition with respect to the same.

F. Whether there are any infringing uses actually known to the franchisor which could materially affect the franchisee's use of such trademarks, service marks, trade names, logotypes or other commercial symbols in this state or state in which the franchise business is to be located.

14. PATENTS AND COPYRIGHTS: If the franchisor owns any rights in or to any patents or copyrights which are material to the franchise, describe such patents and copyrights, their relationship to the franchise and the terms and conditions under which the franchisee may use them, including their duration, whether the franchisor can and intends to renew any copyrights, and, to the extent relevant, the information required by Section 13 above with respect to such patents and copyrights.

15. OBLIGATION OF THE FRANCHISEE TO PARTICIPATE IN THE ACTUAL OPERATION OF THE FRANCHISE BUSINESS: State fully the obligation of the franchisee or the subfranchisor, whether arising by terms of the franchise agreement or other device or practice, to participate personally in the direct operation of the franchise business or whether the franchisor recommends participation in the same.

16. RESTRICTIONS ON GOODS AND SERVICES OFFERED BY FRANCHISEE: State any restriction or condition imposed by the franchisor, whether by terms of the franchise agreement or by other device or practice of the franchisor, whereby the franchisee is restricted as to the goods or services he may offer for sale, or limited in the customers to whom he may sell such goods or services.

17. RENEWAL, TERMINATION, REPURCHASE, MODIFICATION AND ASSIGNMENT OF THE FRANCHISE AGREEMENT AND RELATED INFORMATION: With respect to the franchise and any related agreements state the following:

A. The term and whether such term is affected by any agreement (including leases or subleases) other than the one from which such term arises.

B. The conditions under which the franchisee may renew or extend.

C. The conditions under which the franchisor may refuse to renew or extend.

D. The conditions under which the franchisee may terminate.

E. The conditions under which the franchisor may terminate.

F. The obligations (including lease or sublease obligations) of the franchisee after termination of the franchise by the franchisor and the obligations of the franchisee (including lease or sublease obligations) after termination of the franchise by the franchisee or the expiration of the franchise.

G. The franchisee's interest upon termination or refusal to renew or extend the franchise by the franchisor or by the franchisee.

H. The conditions under which the franchisor may repurchase, whether by right of first refusal or at the option of the franchisor. If the franchisor has the option to repurchase the franchise, state whether there will be an independent appraisal of the franchise, whether the repurchase price will be determined by a predetermined formula and whether there will be a recognition of goodwill or other intangibles associated therewith in the repurchase price to be given the franchisee.

I. The conditions under which the franchisee or its owners may sell or assign all or an interest in the ownership of the franchise or of the franchisee or in the assets of the franchise business.

J. The conditions under which the franchisor may sell or assign in whole or in part.

K. The conditions under which the franchisee may modify.

L. The conditions under which the franchisor may modify.

M. The rights of the franchisee's heirs or personal representative upon the death or incapacity of the franchisee.

N. The provisions of any covenant not to compete.

18. ARRANGEMENTS WITH PUBLIC FIGURES: State the following:

A. Any compensation or other benefit given or promised to a public figure arising, in whole or in part, from:

(1) the use of the public figure in the name or symbol of the franchise, or

(2) the endorsement or recommendation of the franchise by the public figure in advertisements.

B. Any right the franchisee may have to use the name of a public figure in his promotional efforts or advertising and any charges to be made to the franchisee in connection with such usage.

C. The extent to which such public figure is involved in the actual management or control of the franchisor.

D. The total investment of the public figure in the franchise operation.

19. ACTUAL, AVERAGE, PROJECTED OR FORECASTED FRANCHISEE SALES, PROFITS OR EARNINGS:

A. If the franchisor discloses to prospective franchisees the actual or average sales, profits or earnings of franchisees, an exact copy of the same shall be included in or as an exhibit to the offering circular. Such actual or average sales, profits or earnings shall contain the following legend in not less than 10-point boldface type:

THESE SALES, PROFITS OR EARNINGS ARE (AVERAGES) OF (A) SPECIFIC FRANCHISE(S) AND SHOULD NOT BE CONSIDERED AS THE ACTUAL OR POTENTIAL SALES, PROFITS OR EARNINGS THAT WILL BE REALIZED BY ANY OTHER FRANCHISE. THE FRANCHISOR DOES NOT REPRESENT THAT ANY FRANCHISEE CAN EXPECT TO ATTAIN THESE SALES, PROFITS OR EARNINGS.

B. Where projected or forecasted franchisee sales, profits or earnings are proposed to be used, an exact copy of the same shall be included in or as an exhibit to the offering circular. Such projected or forecasted sales, profits or earnings shall contain the following legend in not less than 10-point boldface type:

THESE PROJECTIONS (FORECASTS) OF SALES, PROFITS OR EARNINGS ARE MERELY ESTIMATES AND SHOULD NOT BE CONSIDERED AS THE ACTUAL OR POTENTIAL SALES, PROFITS OR EARNINGS THAT WILL BE REALIZED BY ANY SPECIFIC FRANCHISEE. THE FRANCHISOR DOES NOT REPRESENT THAT ANY FRANCHISEE CAN EXPECT TO ATTAIN THESE SALES, PROFITS OR EARNINGS.

C. With regard to Items 19. A. and B. above:

(1) The basis and assumptions for such actual, average, projected or forecasted sales, profits or earnings must be disclosed in detail;

(2) All actual, average, projected or forecasted sales, profits or earnings must be for or based upon a substantial number of franchisees in a concurrent equal period of time; provided, however, that any such representation is accompanied by a clear and conspicuous disclosure of the percentage of the total number of franchisees who have achieved such results; and further provided that if the sales, profits or earnings represented, projected or forecasted from were not made in the franchisor's fiscal year immediately preceding the date of the representation, the time period in which they were made must be clearly disclosed in immediate conjunction with such representation and with the same conspicuousness;

(3) All actual, average, projected or forecasted sales, profits or earnings must be prepared in accordance with generally accepted accounting principles and the amounts represented may not be in excess of sales, profits or earnings actually achieved by existing franchisees;

(4) If franchises have not been in operation long enough to indicate what sales, profits or earnings may result, then the use of actual, average, projected or forecasted sales, profits or earnings is prohibited;

(5) Franchise locations upon which actual, average, projected or forecasted sales, profits or earnings are based must be identified by address, number of years of operation, whether substantially similar to the franchises offered, whether owner managed, whether such franchises received any services not generally available to other franchisees and whether such sales, profits or earnings have been audited;

(6) All projections or forecasts of sales, profits or earnings shall include a statement of the extent to which such projections or forecasts relate to:

(a) Franchises of a type substantially similar to the franchises offered by this offering circular operating in the state where the franchise is to be located;

(b) Franchises of a substantially similar type throughout the United States;

(7) All projections and forecasts of sales, profits or earnings must include a break-even point insofar as sales and expenses and also must disclose other relevant financial ratios; and

(8) Franchisor shall include a statement that substantiation of all actual, average, projected or forecasted sales, profits or earnings will be made available to prospective franchisees upon reasonable demand.

20. INFORMATION REGARDING FRANCHISES OF THE FRANCHISOR: State the following as of the close of franchisor's most recent fiscal year:

A. The total number of franchises, exclusive of company owned or operated distribution outlets, of a type substantially similar to those offered herein and of that number, the number of such franchises which were operational as of the date of this offering circular.

B. The number of franchises in this state, exclusive of company owned or operated distribution outlets, of a type substantially similar to those offered herein and of that number, the number of such franchises which were operational as of the date of this offering circular.

C. The total number of franchises substantially similar to those offered herein for which a business is not yet operational although a franchise agreement has been signed.

D. The number of franchises in this state substantially similar to those offered herein for which a business is not yet operational although a franchise agreement has been signed.

E. The names, addresses and telephone numbers of all franchisees under franchise agreements with the franchisor or its subfranchisor which are located in the state where the proposed franchise is to be located. To the extent that there are fewer than 10 such franchises located in said state, the list shall include at least the 10 such franchises which are most proximate to the location of the proposed franchise; and if fewer than 10 such franchises exist, the list shall identify all such franchises and include a statement to that effect.

In lieu of the above disclosure, the franchisor may attach to the offering circular a list of the names, addresses and telephone numbers of all its franchisees under franchise agreements with the franchisor or its subfranchisors.

F. An estimate of the total number of franchises to be sold or granted during the one year period following the date of the offering circular.

G. An estimate of the number of franchises to be sold or granted in this state during the one year period following the date of the offering circular.

H. State the number of franchises in each of the following categories which within the three-year period immediately preceding the close of franchisor's most recent fiscal year have:

(1) been cancelled or terminated by the franchisor for:

(a) failure to comply with quality control standards; and

(b) other reasons;

(2) not been renewed by the franchisor;

(3) been reacquired through purchase by the franchisor; and

(4) been otherwise reacquired by the franchisor.

21. FINANCIAL STATEMENTS: Financial statements shall be prepared in accordance with generally accepted accounting principles. Such financial statements shall be audited by an independent certified public accountant or, if permitted by the franchise law of a particular state, an independent public accountant. Unaudited statements may be used for interim periods.

A. The financial statements required to be filed by a franchisor shall include a balance sheet as of a date within 90 days prior to the date of the application and profit and loss statements for each of the three fiscal years preceding the date of the balance sheet and for the period, if any, between the close of the last of such fiscal years and the date of the balance sheet. The balance sheet as of a date within 90 days prior to the date of the application need not be audited. However, if this balance sheet is not audited, there shall be filed in addition an audited balance sheet as of the end of the franchisor's last fiscal year unless such last fiscal year ended within 90 days of the date of the application in which case there shall be filed an audited balance sheet as of the end of the franchisor's next preceeding fiscal year. The profit and loss statements shall be audited up to the date of the last audited balance sheet filed, if any.

B. Controlling company statements: Where state law permits, in lieu of the disclosure required by Item 21. A., complete financial statements of a company controlling the franchisor may be filed, but only if the unaudited financial statements of the franchisor are filed and the controlling company absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor under the franchise agreement should the franchisor become unable to perform its duties and obligations.

C. Consolidated and separate statements:

(1) Where a franchisor owns, directly or beneficially, a controlling financial interest in any other corporation, the financial statements required to be filed should normally reflect on a consolidated basis the financial condition of the franchisor and each of its subsidiaries.

(2) A separate financial statement will normally be required for each substantial franchisor or subfranchisor related entity.

(3) A company controlling 80% or more of a franchisor shall normally be required to file its financial statements.

(4) Consolidated and separate financial statements shall be prepared in accordance with generally accepted accounting principles.

22. CONTRACTS: Attach a copy of all franchise and other contracts or agreements proposed for use or in use in this state, including, without limitation, all lease agreements, option agreements, and purchase agreements.

23. ACKNOWLEDGEMENT OF RECEIPT BY PROSPECTIVE FRANCHISEE: The last page of each offering circular shall contain a detachable document acknowledging receipt of the offering circular by the prospective franchisee.

Senator Moss. We will proceed and finish the panel.

First, Mr. Robert Rosenberg is the next witness.

Mr. ROSENBERG. Mr. Chairman, my remarks are relatively brief this morning.

I am Robert Rosenberg and I am president of Dunkin Donuts Inc. Our company is a franchisor of over 700 donut shops throughout the United States. Dunkin Donuts was founded 25 years ago by my father. He believed he could build a successful business by providing the public with high quality donuts and coffee in clean shops conveniently located. The effective execution of that idea over the years led to the growth of our chain.

Despite our growth over the last 25 years, our systemwide sales are but a small fraction of the $63 billion away-from-home food industry. Although publicly traded, our firm is still family controlled and we compete for retail customers and franchise owners in the very competitive $13 billion fast food segment of the away-from-home food market.

I am here today to testify against the passage of S. 2335 entitled the Fairness in Franchising Act. My opposition stems from my strong belief that the assumptions underpinning the need for this legislation are incorrect and passage of this law would, in fact, undermine the very system of distribution the bills' proponents believe they are furthering. If, as I believe, these assumptions are incorrect, then the need for the legislation embodied in S. 2335 is unnecessary and I believe dysfunctional to a healthy, rapidly growing, and productive element of our economy.

Although not explicit, a fundamental assumption upon which the legislation is based in that nonrenewal of a franchise owner is unjust. This line of reasoning on its face is quite seductive. Whether in business for 1, 5, or 20 years, a franchise owner who has worked hard and contributed to the growth of his system should not be dismissed merely because the term of his contract is at an end.

Surely, the argument goes, the franchisee is entitled to some job security. The view of the franchisee is as an unsophisticate paying little attention to or not understanding the terms of his agreement. As appealing and emotional as that argument may be, it does not square with reality.

First, a fact of life is that all franchisors compete for franchisees. They compete on economic grounds, including the duration of the agreement and the return on investment a franchisee can expect to earn during that term. The term of the franchise agreement is disclosed in the agreement.

Our agreements are for a 20-year term and each franchise prospect is informed as to the duration of his franchise. Whether a franchisee uses sophisticated present value techniques or not, he is interested primarily in his return on investment. Before he buys, he wants to know and will evaluate how much his investment will be, what he is likely to earn and whether or not it is worth the risk to him.

Return on investment is dependent on three elements: the investment, the resultant cash flow and the time period during which the cash flow is likly to occur. Each individual is different; with different alternatives and different risk quotients. Only a free and open marketplace can hope to bring into balance these significant variables.

Is a franchisee who invests $30,000 in a 20-year franchise, and draws an annual salary of $16,000, earns a 30-percent after tax return on his investment, really "entitled to a better deal than he bargained for?"

I consider 20 years a long time. It is clearly more than a sufficient period for a franchise owner to earn a reasonable return on his investment. Under these conditions, the franchisee has been compensated for his efforts and his investment by the amount he has withdrawn from the business during its term.

If he has sold the business at a profit, he has been compensated by the amount he has realized upon its sale. What is it in this arrangement that cries out for congressional intervention? Where are the equities that require a franchisee to have his fixed-term agreement extended perpetually if he so desires? Is Congress in a better position to determine the length of time, appropriate risk and return, than the marketplace?

I submit the marketplace is by far the more efficient determinent of value and equities than the Congress. If the term of the agreement utilized by one franchisor is too short to enable a franchisee to earn an acceptable return, the marketplace will reflect that fact by devaluing that franchise.

Is the Congress prepared to step into each business relationship in the name of fair dealing? For example, what will the Congress do to protect me from a landlord with whom I have a 20-year lease? Surely, by my payment of rent for the 20 years, I have helped the landlord with his cash flow, and enjoy the resultant benefits from inflation that has taken place over the years.

Will the Congress now make it mandatory for the landlord to renew my lease for another 20-year term?

Quite clearly, the instances of fixed-term agreements and resultant mutual benefits are legend in business. It seems particularly unjust that the Congress would select only this area of commercial activity to force renewal. The growth of franchising among new owners, the continued expansion among existing franchisees, and the willingness of substantial corporations to accept franchises on the same basis as individuals are clear indications to me that the market system is doing what it does best, balancing the elements of risk and return. The facts do not support the assumption that fixed term agreements are unjust.

The second assumption upon which this proposed legislation is built is that franchisors are big and powerful and franchisees are small and weak. The natural outgrowth of this assumption is that something sinister occurs under these conditions and the Congress must step in and pass a law that will somehow compensate for this imbalance.

There are two faults with this assumption. The first is an infirmity characteristic of all generalities. In many cases, franchisees are larger than franchisor companies and, in fact, may be larger than the company who issues their particular license. Within our own industry, Gino's and Collins Foods are Kentucky Fried Chicken franchisees and both are larger in terms of revenue and profits than Dunkin Donuts. So, too, is Self Service Restaurants a franchisee of

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Burger King Systems. Within our own Dunkin Donuts system, there are several franchisees who are larger in terms of assets and/or revenues and profits than we are.

From my observation of many other franchise systems, there are franchisees who are large—larger, in fact, than most franchisors. In the franchise food service industry, there are 245 franchising companies. The top 6 account for almost 50 percent of the sales and shops, while the bottom 200 account for only 16 percent.

There are a significant number of franchisors who are small and, in fact, who can ill afford additional legislative burdens imposed on the mistaken assumption that an imbalance must be corrected. Differing size between franchisor and franchisee does not justify converting an agreement for a fixed term—20 years in our case—into a perpetual license.

A third assumption equally suspect is that existing laws are inadequate to protect franchisees from the illegally imposed requirements of their franchisor. This assumption is based on the belief that franchisors use renewals as a weapon to accomplish price fixing, antitrust tie-ins, and other various and sundry illegal activities. The record developed on similar legislation before the House Subcommittee on Consumer Protection and Finance does not suport this assumption.

Experience in my own company refutes the likelihod of these abuses. Franchising, with its growth, history and potential for litigation has spawned a network of adversary attorneys. In many major markets where Dunkin Donuts operates, a lawyer has emerged who represents many Dunkin·Donuts owners in that market. These attorneys have shown little aversion for litigation. Class action litigation with its massive potential damages is an often used judicial procedure in franchise disputes.

In this environment, there is very little likelihood that franchisors could utilize their supposed leverage from renewals to impose illegal requirements. I believe that existing laws are adequate to deal with these assumed abuses.

If, as I believe, the assumptions upon which this legislation is based are incorrect, then what, in fact will the passage of S. 2335 accomplish? Speaking for Dunkin Donuts, the passage of this bill will inhibit rather than further the growth of franchising. I think that's important. Speaking for our company, the passage of this bill will inhibit rather than further the growth of franchising.

And that would be a shame because I agree that:

> Franchise relationships are beneficial to the economy, the enhancement of commerce, and the promotion of competition because they provide a means of combining centralized planning, direction and standard setting with local decision-making, initiative and capital formation in a way that appears to be as effective or more effective than commercial arrangements based on principal and agent relationships.

And as for Dunkin Donuts, I believe in a policy of renewal. Although our agreements are for a fixed period of 2 years, our management has long felt that owners who have participated in building the system, subscribed to its standards, paid their obligations and are willing to upgrade their facilities should be considered for renewal.

However, a law forcing us to renew every franchisee would weaken our system. For example, perpetual renewal would force us to be

burdened forever with marginal franchisees. You must recognize that there are franchisees who really don't deserve renewal rights. Their shops, their products, their service to consumers are far below average. We hope to weed them out of the system over time. The system will suffer if they are granted perpetual licenses.

This is not to say that we will seek to terminate their franchises during the term of their agreements, for they occupy a kind of gray area. Their violations are not so flagrant as to justify our devoting the time and resources necessary to terminate them, particularly in a judicial atmosphere which generally is not hospitable toward interm terminations. But, 20 years is long enough to suffer with a marginal franchise owner.

It is important to note that no one supports that point more than our own franchise owners. In fact, one of the Dunkin Donuts franchise owners testified to this point on the companion bill before the House.

Should a law be passed that would require us to renew those who weaken our system by not subscribing to our standards or force us to litigate each nonrenewal, Dunkin Donuts would change its franchise policy.

I understand this committee is in receipt of testimony and letters from franchise companies stating this fact. That they, too, in the event this bill gets passed, will change their franchise policies.

We would discontinue our policy of acquiring realty for prospective franchisees who could not finance their own growth. The balance of risk and equities would, in our opinion, tip to the point where we would be unwilling to invest in a franchise owner. We would reserve all our capital and debt for company-owned stores and only franchise to those who could afford the $200,000 necessary for the realty of a Dunkin Donuts shop. The impact of our decision would be to preclude people of modest means from entering our franchise system. A result quite contrary to the objectives of the proponents of the bill.

In conclusion, I believe proposed S. 2335 solves none of the problems for which it was intended. The law would, in fact, create a morass of litigation due to vague terms. In addition, franchise growth would be curtailed because I do not believe governmental control can be as effective as the marketplace. The growth of franchising to date is testimony to the viability and fairness of the system. I implore you not to tamper with it.

Mr. Chairman, that brings to a conclusion my prepared remarks, but I would like to ask your indulgence for a moment, if I may.

For yesterday I understand a former Dunkin Donut franchise owner testified before this committee. He related his experience as a Dunkin Donuts owner. Unfortunately his experience was a bitter and unfortunate one.

I as the franchisor am one who becomes involved in the hopes and dreams of people who join our system. I'm grieved by the experience this individual had in our system. I sincerely wish I could have prevented it. Unfortunately I can't prevent business failures.

There are and there will continue to be failures in our system. We attempt to minimize those cases. When I found out Mr. Bolinger's intentions to testify I called the district sales manager to find out the facts in that case.

I found out that the shop the Bolingers purchased opened successfully. When the business became unprofitable and Mr. Bolinger was unable to sell it, Dunkin Donuts, although not legally required to, stepped in and purchased that business from that family.

They relieved him of $18,000 of personal notes that the family was indebted for and we paid his $2,000 in cash. We paid the rent for some number of months until we found an existing owner to open the store as a satellite.

There is no doubt in my mind that the Bolinger family suffered. It is real and regrettable. It is important to know that this legislation cannot ameliorate the problems in this case. The company did not use termination as a weapon. In fact, the company stepped in and paid $20,000 for the business.

I underscore that this legislation cannot and will not affect cases like theirs. No matter how effectively and artfully termination and renewal legislation is drafted, the hard and unalterable facts are that the Congress cannot legislate away business failures and guarantee success.

I thank you very much for the time of the committee in allowing me to testify on these matters this morning.

Senator Moss. Thank you, Mr. Rosenberg.

We have now about an hour and a half and we only have three witnesses that have been heard.

I again state that all of these statements are placed in the record in full. I ask the remaining two witnesses to summarize as best you can to make your point.

The next one is Mr. Burrow.

Mr. Burrow. Thank you, Mr. Chairman.

I will summarize my remarks as you request.

I am Charles Burrow. I'm with the legal staff of Holiday Inns, Inc., based in Memphis, Tenn.

We are the parent company franchisor of over 1,700 Holiday Inns around the world, representing approximately 275,000 rooms.

We are listed on the New York Stock Exchange with total revenue of $928 million.

I would like to refer to the imbalance of power concept.

Holiday Inns, like other hotel and motel franchising companies, is a little unique in that we simply do not fall in that category in your wildest imagination.

We have a sizable investment that is required to get into the franchise business.

As an example, a 100-room Holiday Inn in an area outside a central, center-city metropolitan area might cost $15,000 a room or a $1,500,000 total investment

A 600-room high rise, downtown location could run as much as $30,000 to $40,000 a room or a total investment of $18 million.

It's not unusual for a franchisee to have equity into a project of that nature in the amount of 25, 35, 40 percent.

We are dealing with people of substance, and, in fact, we have included a yardstick over the years that a prospective applicant must at least reflect approximately a $1 million net worth in order to qualify for this magnitude of an investment.

At the same time, we have franchisees that are publicly owned themselves. These represent hundreds of Holiday Inns around the world.

Certainly, the imbalance of power concept does not apply to the majority, overwhelming majority of our franchisees.

With respect to the question of the right to terminate and right to not renew being the source of this imbalance, I will speak briefly on the history of our company. With few exceptions we have only terminated under severe economic conditions such as foreclosure by a secured party, bankruptcy, abandonment of the property, and I might add, in those cases, they were very few, prior to the recent recessionary period we have faced.

There have been occasions in the past 2 years where one or more of our franchisees have overextended themselves. The franchise itself was in most cases profitable, but the properties were taken over by other parties. In those cases, we have had to deal with someone other our franchisee.

As far as terminating for failure to maintain standards, to my knowledge, we have terminated only 3 in the entire 22 year history of our company.

Our franchisees are sophisticated businessmen and at the appropriate time, when major capital outlay might have been required to upgrade or rehabilitate, they chose to sell the property.

In a case where there was a qualified purchaser who desired to maintain the property in accordance with Holiday Inn standards, we have usually allowed the inn to remain as part of our system. With respect to renewal, based on the age of our company and franchising program, we are getting now into that area.

This year, we had a handful of renewal applicants. We have dealt with each of them individually. We have not refused to renew to date.

Next year, we will possibly entertain 100 applicants, and the year after that, it will be getting into the 300 and 400 category.

Our goal is not to threaten to not renew, but our goal is, if in fact the market is still viable, and the franchisee has a good record and one of cooperation throughout the term of his franchise, that we will assist him in making the determination of whether or not it's economically feasible to rehabilitate or upgrade the facility to meet the competition in that market, as well as to meet the quality standards which the franchise represents.

We attempt to work this out together. It's not something we put on the table and say "Either you do it this way, or we will not renew."

We attempt to negotiate in a cooperative spirit with our franchisee.

There have been two occasions this year where a franchisee volunteered to surrender his franchise even though he had an automatic renewal right. He said "I choose not to exercise this option."

One of our franchisees, Ralph Deckelbaum, submitted a statement in the House hearings on proposed H.R. 8339. He is the chairman of the Legal Legislative Committee of the International Association of Holiday Inns, which is comprised of every Holiday Inn in the world, including the parent company.

He submitted a statement in opposition to that bill. I will touch upon his statement. His concern was that such an enactment would cause the franchising process to become unattractive to franchisors, and that they might view growth only in terms of additional company units.

Second, the reduction in value of existing franchises would be the resulting effect if the franchisors chose not to expend. He is looking after the value of his own franchise.

It might cause reduction in value of existing franchises if the system is unable to "weed out" subpar and/or undesirable or marginal operations.

Our franchise has always contained a provision which states that the success of every Holiday Inn in the Holiday Inn system is directly dependent upon the business conduct and good will created by every other franchisee.

Our franchisees not only recognize this, but they remind us of this constantly, particularly when they come in contact with a substandard inn.

Rather than go through the remaining portion of this. I will summarize and say that Holiday Inns is opposed to the enactment of this legislation, because it attempts to curb abuses that allegedly exist across the board in the franchise relationship when, in fact, it's not so in our case.

It purports to address needs of all franchisees; we do not feel, nor do our franchisees feel that it's in our best interest or their best interest to enact this type of legislation.

Thank you for your time.

[The statement follows:]

STATEMENT OF CHARLES W. BURROW, ASSISTANT VICE PRESIDENT AND HOUSE COUNSEL, HOLIDAY INNS, INC., MEMPHIS, TENN.

Mr. Chairman and Members of the Committee, my name is Charles W. Burrow. I am Assistant Vice President and House Counsel of Holiday Inns, Inc. based in Memphis, Tennessee. Holiday Inns, Inc. is listed on the New York Stock Exchange with total revenues of approximately $920,000,000.

At year end 1975, there were 1714 inns with 274,969 rooms in operation throughout the Worldwide Holiday Inn System. About one-fifth (1/5) of these properties are company owned or operated, with the balance operated pursuant to franchise license agreements.

Based upon this brief description of Holiday Inns, Inc., one might assume, as was asserted at the hearings yesterday, that there inherently exists an "imbalance of power" between Holiday Inns, Inc. and its franchisees. In this regard it might be helpful to examine our program.

What is the size of the investment in a Holiday Inn Project? It depends on the size of the proposed facility, the amount of land and its value, the type of building design, the cost of financing, and local conditions. It could be anticipated that a small (100 room) two story Holiday Inn facility away from metropolitan areas will cost about $15,000 per room or $1,500,000 for the entire project. A large (600 room) hi-rise structure in a center city location with large commercial facilities (restaurants, lounges, meeting and exposition rooms) could cost around $30,000 per room, or $18,000,000 for the entire project. In general, the franchisee is required to have an equity investment of about 25% to 35% of the total cost.

Thus, it should be obvious that an investment of this magnitude requires a prospective franchise applicant to have a substantial net worth. In fact, it is a rare occurrence for Holiday Inns, Inc. to approve an applicant showing a net worth of less than $1,000,000. Additionally, several of our franchisees

are publicly-owned (e.g. United Inns, Inc., American Motor Inns, Inc., Servico, Inc.), representing hundreds of Holiday Inn properties. The "imbalance of power" concept thus simply does not apply with respect to the overwhelming majority of our franchisees.

Proponents of S. 2335 suggested that the source of the imbalance of power is the right to terminate franchises and the right not to renew franchises possessed by a franchisor. During the twenty-two (22) years that Holiday Inns, Inc. has been franchising, with few exceptions, the right to terminate has been exercised only where severe economic justification existed, such as a foreclosure of the property by a first or second mortgagee, the filing of a petition in bankruptcy and abandonment of the property by the franchisee. Even those instances were practically non-existent prior to the depressed economic conditions that we all have experienced during the past three years. Also, to my knowledge, we have terminated but three franchises during our history for a franchisee's failure to maintain Holiday Inn standards of operation.

With respect to renewal, since our franchises issued prior to the early 1970s contained a basic term of twenty (20) years with a year-to-year renewal right thereafter possessed by the franchisee, we have only recently been confronted with the realities of this area of development in our system. New franchises issued since the early 1970s contain a fixed term of twenty (20) years. In both cases, Holiday Inns, Inc. has not pursued, nor even considered, the adoption of a policy to not renew; rather, we have taken the approach that, if market conditions continue to appear favorable for a specific location and if the franchisee has a history of good performance, we assist the franchisee in determining the economic feasibility of an undertaking to renovate or rehabilitate the facility to meet competitive demands and to insure the quality standards which the franchise represents.

Regarding each of these areas of concern, it should be noted that Ralph H. Deckelbaum, a Holiday Inn franchisee, in his capacity as Chairman of the Legal and Legislative Committee of the International Association of Holiday Inns, submitted a statement to the House Subcommittee during hearings on H.R. 8349 in behalf of our franchisees in opposition to that bill. I will be happy to comment on his statement if you wish and make a copy of it available to you as well.

The concern expressed by proponents of S. 2335 that franchisors are motivated to terminate or refuse to renew franchises for the purpose of replacing a franchised operation with a company operation does not apply to Holiday Inns, Inc. We have never contemplated such a practice nor have we been accused of same by our franchisees. In fact, the ratio of franchise operations to company operations has steadily increased over the years. When I joined Holiday Inns, Inc. ten years ago, there were approximately three franchises for each company inn; today the ratio is about 5 to 1.

We believe that a ninety day termination notice requirement is not only impractical under certain conditions but also unfair to a franchisor, other franchisees and the public. We have experienced abandonment of a property by a franchisee; we have experienced bankruptcies and receiverships; we have experienced changes in ownership of franchises without our knowledge or approval to unqualified purchasers. Consumers' reaction to substandard facilities clearly demonstrates the damage to the franchisor's reputation and to the success of other operations. Our franchise has always contained a provision stating that the success of the franchisor and franchisee and all other franchisees is directly affected by the business conduct of each franchisee in the Holiday Inn system. With so much of our success dependent upon our Holidex reservation referral system, the wisdom behind that provision has been readily acknowledged and accepted by our franchisees.

With further regard to renewal and withdrawal from a market, we believe S. 2335 fails to recognize the extreme handicaps that would be placed upon franchisors, particularly those comparable in scope to the Holiday Inn system, if they were not allowed to require the upgrading of a franchised facility to meet competition and to provide the consumer with the standards of quality associated with a given trademark as a necessary condition to renewal of the franchise. Similarly we believe S. 2335 fails to recognize that changing business and market conditions might justify withdrawal from a market. For instance, when interstate highways began to bypass towns and cities through-

out the southern states, we and our affected franchisees were faced with immediate problems that were unforeseen by either at the time those franchises were granted years before.

In essence, we oppose S. 2335 because it attempts to curb abuses that allegedly exist in all franchising systems when in fact they do not. While S. 2335 purports to address needs of all franchisees, I am certain that it is not in the best interests of our franchisees.

Senator Moss. Thank you.

We will hear from Mr. Aaron.

Mr. Aaron. I am Gerald T. Aaron.

I would like to give you a little background on Pizza Hut, Inc., and give you a little background on our system.

We are listed on the New York Stock Exchange. Our company sales are $250 million.

Our total system sales are around $400 million. We operate in 47 States and 12 foreign countries.

We have a total of 2,300 stores with 1,200 being operated by the company and 1,100 by franchises.

Up to 1969 we were primarily a franchising company.

In 1969 we had a class B reorganization—stock for stock—and, at that time, one-third of the chain became company-owned.

Since that time we, as a company, now are developing 200 of our own stores per year and our franchises are developing an additional 200.

As justification for this bill, the tremendous disparity in bargaining size and the inherent and superior strength of the franchisor versus franchisee is assumed. It is assumed that franchisors impose unfair conditions, because of their so-called terminal powers.

We only have 106 franchisee groups. Our 10 largest operate 450 Pizza Hut restaurants. The 30 largest operate a total of 700.

They are large multiple unit operators. They operate Burger Kings, Kentucky Fried Chicken and other food concerns.

We have no need to threaten franchisees with termination or with failure to renew to gain other economic advantages.

Our income—80 percent comes from the company-owned store. We have not increased franchise fees for over 8 years. It has been our policy, rather than to have a single location franchise, to grant franchises by large metropolitan areas and then impose reasonable development standards.

We are in the distribution business. We have eight distribution centers; 90 percent of our franchisees acquire most food products almost solely and exclusively from us.

The only thing they are compelled to purchase is the company's secret spice blend, which is a trade secret.

Our philosophy in terms of selling product to franchisees is to assure quantity and quality of supply.

Attorney Fine mentioned yesterday that he is not familiar with any situations where franchisees have been able to negotiate or change the printed word.

We have a franchisee association which is made up of all franchisees. They have six elected directors. They have five full-time people working for that association. It is a large, independent, well-managed association. Three years ago, we went to that association,

because we had an ambiguity in the franchise agreement regarding purchase of supplies.

The contract read that the franchisee must purchase the spice blend from the company, but as far as any other products are concerned, if the company should ever choose to sell the products, we would do so at our cost price.

That is a hell of a thing to have hanging over your head.

We negotiated with the franchise association board. They recommended and agreed that we could make 2½ percent net profit on the sale of products to franchisees.

All 106 franchisee groups signed that contract.

I think we have heard here, and its been assumed that the franchisor or franchisee relationship is an adversary relationship.

We consider the franchisee to be a partner.

We provide service today far in excess of what the franchise agreement contemplated 15 or 12 years ago.

Our franchisees require management training type of service.

They require long-range planning assistance. They require out-of-store training as opposed to how to operate a specific store.

In 1971, we made a decision to allow our franchisees to grow stronger by adopting a policy that we would not franchise to anyone new.

We also chose at that time to give automatic renewal rights and since that time we have given automatic renewal rights.

Franchisees that have some of the older contracts have come in and we have given automatic renewal rights under the same terms and conditions as their original contract.

Due to the makeup of our franchisees and our business philosophy, that is fine.

It is not Pizza Hut's belief that any company which refuses to give automatic renewal is somehow doing something immoral or illegal.

The multiple-unit operator in our system is a strength. I don't feel it is unreasonable for a company not to give automatic renewal.

I have a problem with the position that somehow the government should step in here and should alter contracts entered into 15 to 20 years ago, and to tell one party he should do business with another in perpetuity.

In our history, we have had two terminations. One involved a franchisee who had the Detroit Metropolitan Area and he had a contract for 4 years and never put on a store.

Another one involved abandonment. Attorney Fine expressed yesterday how could reputable companies that make up the IFA be concerned with the passage of this bill.

It would seemingly only affect a disreputable franchisor. Our only concern has to do with the area of termination. We feel it is the inherent authority vested in the termination provisions of the franchise agreement that assures us we will have quality control standards in the Pizza Hut Restaurant, be it North Dakota or Florida or wherever.

We make quarterly inspections of the franchise unit. If we have a marginal operator we find out about it from a franchisee. I haven't heard anyone deny that if there is a poor operator that they don't want the franchisor to be able to get him out of the system.

We must assure to the public when they come into the Pizza Hut Restaurant that they will get a similar product and see the same business format.

That is a requirement or we run the risk of losing our trademark.

If we lose the rights to use the words "Pizza Hut," obviously our national advertising program would be worthless. I'm concerned with the 90-day termination notice. The 90-day notice, coupled with good cause requirement allows the franchisee to file a lawsuit alleging that the franchisor is terminating for other than good cause in that the franchisee is not violating an essential or reasonable part of the contract.

We recognize the entrepreneurial spirit that exists with the franchisees and, in fact, many of the product extensions, new products, other innovations of our system, have come from franchisees to the benefit of the entire system.

I feel the benefits would not have been obtained, had it not been for a good relationship between the parties. I think that in order to justify legislation such as this, there has to be a need. It is apparent to me, if there are abuses, that it's occurring in one, two, three industries, and it's not covering franchising in the broad sense I know it.

I think an attempt to regulate the entire franchise system, for example, the type of franchisors you are hearing from today, I don't think it can be done.

I hope the hearings have demonstrated the different types of franchisors, different business formats and philosophies that they exercise, and how futile it is to attempt to pass a law that regulates all.

Thank you.

[The statement follows:]

STATEMENT OF GERALD T. AARON, SECRETARY, GENERAL COUNSEL, PIZZA HUT, INC., WICHITA, KANS.

Mr. Chairman and Members of the Committee, my name is Gerald T. Aaron. I am Secretary and General Counsel of Pizza Hut, Inc., based in Wichita, Kansas. I'd like to give you some background on Pizza Hut, Inc., describing the company generally, describing the makeup of our franchisees, and a brief history of how we got where we are today so you can understand our position on S. 2335.

Pizza Hut, Inc., is listed on the New York Stock Exchange and has total sales of approximately $250,000,000 and system wide sales totaling approximately $400,000,000.

Pizza Hut, Inc., and its franchisees operate restaurants in 47 states and 12 foreign countries. We have a total of approximately 2,300 stores with 1,200 being operated by the company and 1,100 being operated by franchisees.

Up until 1969, Pizza Hut was primarily a franchising company in that it only operated 6 stores in Wichita with the remainder being franchised. We had a reorganization early in 1969, the end result being that approximately 1/3 of the chain became company owned or 125 stores. From that date forward, we have developed company owned stores and made some acquisitions of franchised stores each year thereafter. As a company, over the next 12 months we will develop approximately 200 stores and franchisees will open an additional 200 stores.

As justification for S. 2335, the tremendous disparity in bargaining size and strength of franchisee vs. franchisor is assumed. However, I'd like to tell you about our franchisees. We have 106 franchisee groups. Our 10 largest operate 450 Pizza Hut restaurants. Our 30 largest operate nearly 700 units. We have one franchisee that's a publicly held company. In September of 1974, we merged with Pizza Corporation of America, a franchisee of Pizza Hut that operated

223 stores at that time. Our franchisees also operate other restaurants such as Burger King, Kentucky Fried Chicken, and numerous other restaurants. So they're large concerns operating many multi-food type of restaurant operations.

We have no need to threaten franchisees with termination or with failure to renew to gain other economic advantages. 80% of Pizza Hut's revenue comes from company operated stores. We have not increased franchise fees in eight years. Rather than the single location franchise, we have always franchised large geographical areas and imposed reasonable development standards. We also operate eight distribution centers selling products and supplies to company and franchised locations. Franchisees need only acquire the company's spice blend from Pizza Hut, Inc. However, 85% of the franchisee stores acquire goods through Franchise Services, Inc., a subsidiary of the company. Pizza Hut is contractually limited to 2.5% net profit derived from sales of products to franchisees. Our philosophy regarding sale of products is to be able to assure quantity and quality of goods. We commit on the front end, not our franchisees. Due to economics, the franchisees acquire most of their products through our distribution company.

One almost has the impression that the franchisor-franchisee relationship is an adversary one. Such is not the case. We consider the franchisee to be a partner, a continuing relationship. There are numerous situations which arise which were not contemplated in franchise agreements entered into twelve years ago. Today, we provide services far in excess of what we are legally obligated by the franchise agreement. In order to keep abreast of changes and deal with common areas of concern, the company meets at least quarterly with elected representatives of franchisees.

In 1971 the Company made a decision to encourage its present franchisees to grow even stronger and thus elected only to sell franchises to existing franchisees. We also chose to give automatic renewal rights to franchisees based upon the same economic terms and conditions as their original contracts. We believe that the above courses of action certainly fit our type of business format and philosophy. We are not sorry we made those decisions. We believe that multiple unit operators are a strength. However, I do not believe that it is unreasonable for a company to choose not to give automatic renewal, nor do I believe that it's unreasonable for the franchisee to execute the then current agreement and to pay the then current fees. I certainly don't think there should be a federal law like S. 2335 that would dictate to a franchisor that he must automatically renew unless there is good cause not to do so. The idea that this law could have retroactive effect is totally incomprehensible to me. The government has no position in altering contracts entered into between private individuals which were negotiated 15 to 20 years ago and dictating that you must continue to do business in perpetuity.

Pizza Hut, Inc., in its entire eighteen year history has had two situations that we could describe loosely as terminations. One occurred in Bellingham, Washington, which amounted to an abandonment by franchisee, and Detroit, Michigan, wherein a franchisee had the total Detroit metro market and failed to put on one location in four years. We terminated, and refunded his initial fee.

Well, then you ask, how does this bill affect us since Pizza Hut has had a minimal history on terminations and gives automatic renewal. It affects us in the area of termination. Although termination has been rarely used by Pizza Hut, Inc., it is ultimately the authority vested in the termination provisions that assures us that quality control standards and the business format of operating Pizza Hut restaurants are adhered to. We make quarterly inspections of franchised units. However, if we have a marginal operator who operates a poor store, the input usually comes from one of his fellow franchisees. This was brought out in the House hearings by Richard Frankel of the McDonald Operators Association who stated that the franchisees expect their fellow franchisees to run good, quality, clean operations, and if they don't, they want the franchisor to be able to terminate the franchisee to protect the reputation of the system.

We recognize that the Pizza Hut trademark is one of our most valuable assets. The Lanham Act (Federal Trademark Law) requires that we, as owner of the trademark, assure the public that the goods sold under the Pizza Hut trademark are of the same nature and quality no matter which Pizza Hut

restaurant they enter, be it company or franchised, be it in North Dakota or Florida. If our ultimate authority through termination provisions is lost, then we run the risk of losing our trademark because of lack of uniformity. We must enforce our quality standards, and our business format, or it could ultimately destroy our franchise system. If other people had the rights, ultimately, to use the mark "Pizza Hut", our national advertising would become worthless. S. 2335 establishes a "good cause" requirement for termination. Coupled with a 90 day notice this allows a franchise to file a lawsuit alleging that the franchisor is attempting to terminate for other than good cause in that the franchisee is not violating an essential or reasonable part of the contract. I don't have confidence in the fact that all judges uniformly interpret and apply trademark law, and that they will uniformly agree that quality control standards are essential and reasonable.

We recognize that the entrepreneurial spirit which exists to a great extent in our franchisee ranks has led to new products, improvements, and extension of existing product lines which has benefited the entire system.

So we're not interested in terminating franchisees. It would only be a drastic situation where this would occur, but S. 2335, if enacted, could seriously increase the opportunity of franchisees running very marginal operations, and the franchisor not being able to enforce quality control standards and thus running the grave risk of losing his trademarks which would be injurious to the entire system.

In order to justify legislation such as this, a need should be demonstrated. Where are the abuses of excessive terminations? If they exist, they exist in one or two industries. So why attempt to regulate the entire franchising spectrum, wide and divergent as it is. I hope that these hearings clearly demonstrate the different formats and operating practices used by franchisors and how difficult it is to legislate a standard that covers all.

Thank you.

Senator Moss. Thank you very much.

I appreciate your statement and the statement of the other witness.

I have one or two questions.

Mr. Opack, does the IFA support the FTC disclosure rule?

Mr. OPACK. We support that disclosure rule in principle and in concept. We did have some problems with the original and revised proposal as it was introduced and as it went through the administrative process.

We are in favor of full disclosure. Our code of ethics requires that member companies subscribe to that.

We have worked with State administrators to put together a disclosure statement which is more extensive and more detailed than even the FTC original proposal.

So the answer is, yes: in principle, although some of the provisions, because we favor, particularly, uniformity, so there won't have to be different disclosure for different States and different disclosures for Federal compliance also, we are in favor of full disclosure, and we are generally on record as saying it should be part of franchising as a business operation.

Senator Moss. I wonder is there any lasting value to a franchisee's work? Aren't some of the franchising companies success attributable to the formula of the franchisor coupled with the diligence of the franchisee to make the system work?

What lasting value does he get out of his contribution?

Mr. OPACK. It's impossible. I have been struggling with that question myself. It's impossible to measure what intangible value, if any, the franchisee might contribute to a system. Just as it's unlikely to be able to determine in measurable terms what adverse conse-

quences of action a franchisee may have contributed to a particular system.

The way it has to be considered and measured is, did the franchisee get the benefit of his bargain?

Did he get everything he bargained for?

Or was he deprived of the benefit of his bargain?

There is no way to predict in advance at the outset of a relationship what might occur over the course of 20 years.

But if he were fairly apprised of what it was that he was paying for and what it was that the franchisor was receiving and each party got the benefit of their bargain, then I believe the arrangement has been fairly consummated.

Senator Moss. Mr. Zeidman, do any of the franchising agreements have clauses which restrict the ability of the franchisee to go to court?

Mr. ZEIDMAN. I'm not aware of clauses which restrict the ability of the franchisee to go to court per se. I know there are provisions in individual franchise agreements which have such clauses as, for example, in the case where it is decided that arbitration should be a part of a franchise system, a requirement to resort to arbitration prior to going to court.

There may be provisions in agreements which require that, if litigation is initiated, it must be in a particular location, which provision may be enforceable or unenforceable, depending on how the law develops. There is no uniquely franchise-oriented limitation on resort to the courts that I am aware of.

Mr. OPACK. May I comment on that?

I believe that there was a suggested amendment made by the proponents yesterday that would have required the parties to a franchise agreement to go to binding arbitration in the event that there were a dispute of renewal terms.

Senator Moss. Yes.

Mr. OPACK. That would have the effect of depriving citizens and companies in this country of access to the courts.

I am not aware of any such precedent that would deprive individual franchisees or franchisors from having a judicial examination of a dispute.

So, although I'm not aware of any other State or precedent that would do that, that was the suggestion made yesterday.

Senator Moss. That is, when there is a renewal negotiation going on and it comes to an impasse. Isn't that what the proposal was?

Mr. OPACK. It's not clear what it is. But even so, it would be an unfair or unreasonable, cause to fail to renew, if the parties didn't apparently agree on terms.

That would be the basis upon which the arbitrator would have to decide. Was this an unreasonable termination or failure to renew.

Senator Moss. That is where we get back into this discussion of whether this is a truly even bargaining situation.

As Mr. Burrow says, there wasn't any advantage on one side and yet in the testimony of Acting Chairman Dixon of the FTC says, and this is, I think, from the time he appeared before the House:

A franchisor normally occupies such an overwhelmingly strong bargaining position that he is able to accommodate the term of a franchise agreement in

such a way as to maximize his power to control the franchisee throughout the relationship. Even assuming full disclosure and inferior bargaining position may leave a prospective franchisee with no meaningful choice, other than to accept the terms as dictated or to forgo the business investments.

One result of this imbalance of power is the inclusion of provisions in the franchisee contract which permit the franchisor to terminate the relationship or which limit the duration of the agreement to a short term, thus enabling the franchisor arbitrarily to fail to renew.

The threat of termination or failure to renew, either of which can result in substantial loss to the franchisee, may become an effective device by which the franchisor can force the franchisee to relinquish a substantial degree of control over his business.

Now, in this situation we were talking about in this renewal matter, the franchisor really is in charge, isn't he?

The franchisee doesn't have anything to bargain with at that point. It becomes a take it or leave it.

Mr. OPACK. I believe Mr. Dixon was referring to a line of cases that the Commission had involvement in.

Mr. ZEIDMAN. Our response on that would be as follows: First of all, we think that ex-Chairman Dixon is wrong. We think the position which he is describing of the normal position of power ascribed to the franchisor over the franchisee is just not true.

In Mr. Dixon's case what he was speaking of, principally, is the history of cases in one particular industry, the oil industry in which you have the classic example of the largest of large companies dealing with the smallest of small business—the oil company dealing with the individual franchisee.

In that case the Supreme Court held there is an inherent coercion in that situation, particularly, as it was reinforced by 30-day leases giving the tremendous power which the court in another case said "coercively laced in" the franchisee.

We say, not only is Mr. Dixon wrong, but even if he isn't wrong the notion that the Congress should come in and legislate parity of bargaining power is, as we see it, a doctrine which has almost unforeseeable consequences in terms of the range of contracts in this country.

If it were concluded that the Congress should under certain circumstances do that, we think the circumstances don't exist here, where there is free and ample competition by franchisees for other franchise agreements.

If a franchise agreement poses undue and onerous provisions, you can rest assured the franchisee will seek out other franchises for other franchise systems which do not contain those provisions.

The marketplace, rather than the Congress, dictates the result.

If, in fact, the kinds of things which are spoken of are sought to be imposed—price fixing agreements, tie-in agreements, the kind of abuses people speak of—are attempted to be imposed by the franchisor over the franchisee (whether he is able to do that, because of the nature of the original contract or the nature of the disparity of bargaining power or not, is irrelevant), if he does that, he is subject to attack under the antitrust laws of the United States.

That is amply demonstrated to be available to franchisees and to have been used by franchisees over the last decades in this country.

We think there is no reason for this legislative approach to this issue.

Senator Moss. If I have a franchise to deliver the *Philadelphia Enquirer* in the area of Philadelphia and I get into a dispute and I'm cut off by my franchisor, what other franchise do I seek out to replace that with.

Can I start selling other kinds of newspapers in there?

Mr. ZEIDMAN. I assume you can, Mr. Chairman.

Let me say on this——

Senator Moss. You assume I can sell *The Washington Post* in the Philadelphia area.

Mr. ZEIDMAN. I'm sure *The Washington Post* is not as attractive in the Philadelphia area as the *Philadelphia Enquirer*. But if Pizza Hut imposes onerous burden on prospective franchisees, so as to make Pizza Hut franchises unattractive, the prospective Pizza Hut franchisee will be going to Dunkin Donuts or Holiday Inns or to any of the 1,000 franchisors that exist in this country today.

With respect to the issue of the newspaper situation, and I do think this is one of the unfortunate aspects of the format of the hearings, it is impossible as well as inappropriate for us to attempt to respond to the testimony on the newspaper situation. We are not familiar with the newspaper industry.

We assume the newspaper people will be giving their own response.

It has nothing in common with the kind of people who we represent.

None of the newspaper people are members of this Association.

Similarly, I think it is a little unfortunate that yesterday's hearing was used as a forum, and I'm not suggesting any impropriety, but it was used as a forum to discuss individual litigated cases. In the case of the McDonald's franchisee who was in litigation with his franchisor, what was not brought out is that McDonald's has filed not only an answer denying every allegation in the lawsuit and made yesterday in the hearings, but also has filed substantial counterclaim against the gentleman.

Senator Moss. Which we have in the record.

Mr. ZEIDMAN. It is difficult for us to respond to all of the kinds of allegations made yesterday.

I assume the record will provide an opportunity for those affected to do so.

Senator Moss. Do franchisors use suggested retail prices?

Mr. ZEIDMAN. Is this question posed to me?

Senator Moss. Yes.

Mr. ZEIDMAN. Some franchisors do and many do not.

The suggested retail pricing is much more common in product distribution as opposed to what you see here, in the way of business format franchising.

There are unquestionably, however, suggested pricing techniques, which are used by American businesses throughout, whether franchised or not.

However, if that suggestion process goes beyond the suggestions to a resolute enforcement of suggested pricing, the antitrust laws have over many, many years prevented that and provided for treble damage actions, as well as actions by the Department of Justice and the Federal Trade Commission.

Senator Moss. I think I should ask this of Pizza Hut or Dunkin Donuts or Holiday Inn.

Do any of you have company-owned outlets that you operate by the company itself?

Do you build them on a regular basis or are these repossessed stores, or how does the company come in possession?

Mr. ROSENBERG. In Dunkin Donuts' case we have both. Out of the 820 Dunkin Donuts shops, 67 are company-owned stores.

At one time the only shops we did operate were those we had to take over.

More recently, we have been operating stores of our own for training purposes, marketing research, providing methods of operation that benefit the entire system.

We monitor those stores and evaluate them in their profitability, as if they are franchised.

They have the same franchise fee and rental arrangement. We look at the bottom line profit margins the same way as if they are franchised.

Senator Moss. Your percentage is increasing now of company-owned stores?

Mr. ROSENBERG. Yes, slowly, but our objective over the next 3 years is possibly to get it up to something on the order of 15 percent of the total distribution.

Mr. BURROW. We too have company-operated and franchised. Of the 1,700 total number of operations one-fifth of those are today company-owned.

Ten years ago when I came to the company the ratio was 3 to 1.

We have increased the number of franchises steadily as opposed to company operations.

We have never purchased a franchised operation and converted it to a company operation. We have lately entertained the procedure of disposing of company operations that are getting of such an age that we cannot economically justify the capital outlay to bring them up to standard.

The same requirement we are now demanding of our franchisees to meet competition. We do not have the process of picking towns, cities, looking for franchises, as opposed to a company operation.

We have survived through the years in looking at it as one big family.

We have towns with company operations and franchised operations working cooperatively throughout the world.

Mr. AARON. Mr. Chairman, Pizza Hut, we have approximately 2,300 stores. Fifty-five percent are owned and operated by the company. We had a very substantial merger in 1974, wherein we merged with our largest franchisee that had 223 stores.

We are now developing 200 company-owned locations a year. Our franchisees are developing a minimum of 200 a year.

We foresee that basically a 50–50 relationship will exist in the future.

Senator Moss. That is what you are seeking, roughly 50–50?

Mr. AARON. That is what we have and we will maintain that.

Mr. BURROW. To correct an earlier statement, 4 years ago, three of our substantial franchisees got together collectively and made an

offer on a stock swap arrangement. They offered us 74 inns as a package in exchange for Holiday Inn stock.

That is the one major occasion where we have converted franchised operations to company units.

The gentleman that brought that package together is now first vice-chairman of the board of Holiday Inn.

Mr. OPACK. The Commerce department survey indicated that this year, insofar as the total number of establishments go in the hotel-motel industry, the franchisor establishments will increase 5.4 percent. Franchisees will increase 7 percent.

Senator Moss. Thank you, gentlemen. We appreciate your testimony and are glad to have it in our record.

Mr. OPACK. Thank you, Mr. Chairman.

Senator Moss. We now have Mr. Thomas Power. We are glad to have you, Mr. Power, and I will ask you to summarize; otherwise, we will have witnesses who will not be able to say anything at all. Your statement will be in the record in full. We will ask you to proceed to highlight it to us.

STATEMENT OF THOMAS W. POWER, GENERAL COUNSEL, FOODSERVICE AND LODGING INSTITUTE

Mr. POWER. I'm Thomas Power and I'm general counsel for the Foodservice and Lodging Institute.

The Foodservice and Lodging Institute is an association, the membership of which consists of 25 companies engaged in multi-unit multi-State operations in the food and lodging business.

About half of our members are in the franchising, fast-food franchising business and therefore we are very much interested in this legislation.

However, Mr. Chairman, all of our members that are in franchising are also members of the International Franchise Association, and I appreciate the fact that they have made a comprehensive and complete statement here this morning.

I would like to, for the record, endorse it in its entirety and to state that we do not want to repeat anything they have already said, points they have already made.

As you pointed out, we filed a statement for the record and we would appreciate its inclusion.

In summary, I would say that we are, speaking for the foodservice and lodging industry, we regard ourselves as unique in franchising in general. That is one of our criticisms of this legislation, that it is equally applicable to all franchising across the board. We think the foodservice and lodging industry is a different and unique problem. In general, we believe there are sufficient remedies to correct whatever problems exist with respect to franchising generally in the United States under existing contract law and we think the courts in recent years are improving their ability through the interpretation and application of equitable doctrines in court that will solve any problems that might exist in the area of franchising.

We believe this legislation will restrict further franchising to the detriment of both franchisors and franchisees. Our opinion is that

the legislation is unconstitutional and in violation of the due process clause and equal protection clause. In the interest of conserving your time and the time of the Committee I will conclude my remarks at that point, but I will be happy to answer any questions you may have.

Senator Moss. I wish to thank you. You have a very well-written statement and it is in the record, so we can examine it very carefully. Particularly, we will examine your suggestion that the proposed statute would be unconstitutional. Because that does raise a question that we must examine before we proceed.

I appreciate your summary here and the fact that we had this rather full presentation immediately before your appearance, I think gives us a fairly good picture of the view in the part of the industry that you would be concerned with anyway here.

Mr. POWER. I agree, Mr. Chairman.

Senator Moss. Thank you very much. We appreciate your appearing today.

[The statement follows:]

STATEMENT OF THOMAS W. POWER, GENERAL COUNSEL, FOODSERVICE AND LODGING INSTITUTE

Mr. Chairman, distinguished members of the Subcommittee, my name is Thomas W. Power. I am general counsel of the Foodservice and Lodging Institute which is a Washington, D.C.-based trade industry group of major multi-unit, multi-state food service, restaurant and lodging companies throughout the United States. The majority of twenty-five companies which are members of the Institute represent the predominant companies in the fast food franchising industry. In fact, they are among the pioneers of that industry.

I appreciate the opportunity to present testimony here today on behalf of the Institute in connection with the Subcommittee's consideration of Bill S. 2235, the proposed "Fairness in Franchising Act."

As far as we know, every member engaged in franchising is also a member of the International Franchising Association, from whom you have already heard. At the outset, may I say that we support the position taken by the International Franchise Association with respect to this legislation. In addition, we would like to add additional information and observations which the Institute feels will be relevant to the Subcommittee in deliberating and evaluating the need for legislation. We would also like the opportunity to discuss some of the myths which have been allowed to perpetuate fast-food franchising.

The Foodservice and Lodging Institute is convinced there is no need for this legislation and we oppose this bill in its entirety. We believe it is unnecessary and we are convinced that sufficient remedies exist under contract law to protect all parties. We are convinced that passage of this legislation will restrict further franchising in our particular industry; will damage existing relationships by making good-faith contracts immediately suspect; and will substitute an adversary relationship in all dealings between the two parties.

In agreement with the position of the International Franchise Association, the Foodservice and Lodging Institute advocates full and fair disclosure of all information relevant to the purchase and operation of the franchise, as many states now require and as the Federal Trade Commission is now considering. If a franchisor and prospective franchisee desire to enter into a contract after full disclosure of all terms, they should be allowed to do so. Under such a contract, equitable and legal remedies are available if either side violates the contract or fails to perform as disclosed. To force parties to accept contractual terms which have not been established through full disclosure is an infringement upon their constitutional right to contract. This we can never support.

FAST FOOD FRANCHISING IS A DYNAMIC FORCE IN THE NATION'S ECONOMY

In the years between 1964 and 1974, the fast-food franchising industry has become an institution in our lives and a dynamic force in the American economy.

According to Institutions/Volume Feeding magazine, an industry trade publication which conducts a reliable and widely-used annual survey of the top 400 companies in the industry, franchisors have achieved a phenomenal growth rate of 483% in that ten year period. Volume of business rose from $1.62 billion in 1964 to $9.47 billion in 1974. During the same ten years franchisees had an equally enviable growth rate of 456%, from $141.2 million in 1964 to $786.2 million in 1974. Eliminate the two recognized industry leaders, McDonald's and KFC Corporation, and the growth figures are even more startling since franchises had a better growth record than franchisors. Franchisors, outside of McDonald's and KFC, showed a growth rate of 326%, nearly 130% less than franchisees.

Ten years ago, only four franchisees were large enough to be listed in Institutions/Volume Feeding's annual 400 ranking; their combined sales totalled $90 million. Today, there are 27 franchisees listed with sales totalling more than $1 billion.

And not every franchisor is a McDonald's or Kentucky Fried Chicken. On that same top 400 list, the top franchisee Collins Foods International, outranks all but the top 13 franchisors in the country.

Despite the fact that the voices of doom say that the fast-food market has reached its saturation point—a remark which has been voiced since 1972—not everyone holds to that prediction. Economists estimate that volume of business, which reached more than $13.6 million in 1975, will climb to more than $15 billion this year and will surpass $26.3 million by 1980.

Many fast-food companies have not shown a decline in earnings in any quarter of the past three years and analysts are impressed by the recession-resistant qualities of the industry leaders.

In 1975, it was reported that only nine fast-food companies with 35 company stores and 327 franchisee-owned establishments went out of business compared with 44,724 units still in operation.

This successful marriage of franchisor and franchisee has created 807,000 jobs—the largest block of employees in non-traditional franchise firms. This is 26% of all employees in the food service industry.

Two years ago, a brokerage firm in New York sounded the death knell for the industry. The reports of the industry's death were greatly exaggerated. Today, analysts are reporting that eating and drinking places decline less than the Gross National Product, go down last and recover first. The industry is extending into schools and colleges, into downtown locations, zoos, museums and office buildings.

Even with the proven performance record, excellent growth, new market entry, the franchised fast-food industry continues to undergo reformation to stretch its appeal. It is developing new and innovative management techniques, training methods, menu expansion, new product marketing, and modern electronic cash control systems for better record-keeping and inventory control. It is developing new store concepts which enhance existing communities and blend with existing structures while at the same time being environmentally sound. It is designing more attractive structures which are more economical to operate.

Ironically, fast-food may be the "young turk" of the entire food service industry but the whole industry is following these innovations closely. While the franchised fast food industry is leading the way, not one segment of the industry is marching to the beat of a different drummer.

PRESENT LAW PROVIDES SUFFICIENT REMEDIES TO PROTECT BOTH PARTIES FROM UNLAWFUL DEALINGS

After a study of the legal remedies now available under the law of contracts, the Uniform Commercial Code, and case law involving contract terminations, the Foodservice and Lodging Institute is convinced that adequate protection for parties in a franchise agreement already exists and that further legislation will serve no purpose other than to discourage further expansion through the vehicle of franchising.

Legislative solutions are always tempting alternatives when the evolution of common law lags behind changes in society or the manner of doing business. In some situations, no doubt, a statute may be preferable. However, a judicial approach is generally the best solution particularly when the situation requires flexible rules capable of being adapted to a wide variety of factual situations.

A franchise agreement in the fast food industry is an unique form of legal arrangement. While primarily a contract for the sale of goods, the franchise also embodies a contract for the use of a trade name, a licensing agreement. Due to the special characteristics of such arrangements and the numerous situations under which arrangements can be utilized, the courts have had difficulty in shaping legal doctrine to avoid inequitable results in litigation between franchisors and franchisees.

The history of case law in the area shows an early reluctance of the courts to rule on franchise contract termination and instead, turned to the time-honored "freedom to contract" doctrine in deciding disputes. Most contracts were terminable at will so such results in favor of the franchisor were hard to avoid.

Further, as Professor Ernest Gellhorn points out in an article entitled "Limitations on Contract Termination Rights—Franchise Cancellations," published in Duke Law Journal [1967 Duke Law J. 472], applying standard contract doctrines to franchise agreements required in most cases, a substantial stretching of the doctrines. Those cases in which contract analysis did apply, unfortunately fell within the statement that "hard facts make bad law."

Gellhorn also emphasized: "A franchise cannot be held liable to a franchisee merely for having exercised a contract right—the right to terminate—regardless of its motive or the effects resulting from the termination. If the power to terminate is conditioned and the condition has been satisfied, the right to terminate is absolute; if the termination is not conditioned (or is implied), its exercise cannot be questioned."

He clarified this however by stating: "On the other hand, the legal right theory has been limited by holdings that a contract cannot be exercised in an unreasonable or oppressive manner."

"This does not mean, however, that the contract right cannot be exercised," Gellhorn states, "only that its method of exercise must be reasonable."

As years passed and as franchising began to emerge as a viable and startling successful form of commerce, the courts began to tackle the issue more strenuously while extending existing doctrines to cover the novel questions and problems to franchise agreements. This was nothing more than the mere evolution of common law.

Beginning with the development of the Uniform Commercial Code, the doctrine of unconscionability has played an ever expanding role in contract interpretation. Other doctrines now used by the courts in interpretations of contracts include adhesion, fraud, economic duress, waiver and estoppel and even tort liability.

One point is clear. The courts will not tolerate unreasonable interpretations under the fairness doctrine employed under the equitable jurisdiction of the courts. In most cases, the court will require that the party which unreasonably interpreted and terminated or suspended the contract reinstate it and compensate the aggrieved party in damages. When the contract is not explicit on the particular issue at bar, the court will imply conditions to carry out the intention of the parties. The intent of the parties will be determined by the courts to be the intent deduced from the contract as a whole not by focusing on one provision. And by extrapolation from the doctrine of unconscionability and employing the doctrine of contra-proferendum, (i.e. construing the contract against the drafter) courts can reach reasoned and equitable results.

Despite comments of some of the proponents of this legislation, and with due respect to the distinguished chairman of this Subcommittee, FLI firmly believes that the legislative approach is the wrong approach. What is described as a simple franchise agreement is, in reality, much more. Modern franchising can and does embrace every conceivable contractual arrangements and is the licensing of almost every kind of product and service available.

As illustrated briefly above and more fully explained in Professor Gellhorn's article, judicial scrutiny provides remedies to the many situations involving franchising agreements. Opposed to a judicial approach, a statutory solution stands unyielding and unchangeable in the face of the still evolving judicial pronouncements.

Franchising is still a novel mode of doing business and one to which the judiciary has, arguably, yet to catch up. The judiciary may continue to lag behind, but to jump the law ahead a few steps through enactment of a tight statute will only freeze the law at a point outside of common law, which will soon be behind what is needed.

On the other hand, judicial evolution will continue, in the common law tradition, to meet the demands of changing situations in a changing society.

THE PROPOSED LEGISLATION IS IMPERMISSIBLY BROAD SO AS TO BE UNWORKABLE

The intent of the legislation is, in fact, directed at every form of franchise without regard to the varied arrangements involved or the substantial business and legal difference which distinguish one type of arrangement from another while all the time remaining within the scope of the franchise system. For example, statutory protection for one group, where numerous disputes are evident and solutions not available, may be well advised. This bill may eliminate those problems. But to apply this proposed legislation uniformly to all types of franchises will serve only to magnify existing but reconcilable problems and will create new problems where none previously existed.

There are diametric differences between each specific industry within the franchise system, a fact that Congress has acknowledged by enacting both the "Automobile Dealers-Day-in-Court Act" and the "Fair Marketing of Petroleum Products Act."

A blanket law, no matter how thorough and no matter how detailed cannot be applied over the entire gamut of franchising. Products are different, business operations and controls are different. Investment by franchisees differ immensely from one group to another. So do termination and cancellation provisions of contracts.

And ironically, the truth is that those disreputable franchisors who are intent to operate under a cloak of darkness will continue to do so whether or not Congress passes this legislation.

Contrary to what might have been said at yesterday's hearings by proponents of this legislation, fast-food franchisors are, in fact, extremely reluctant to cancel or terminate a franchise and even for the most grossest breaches of contract provisions attempt to solve the problems internally rather than move toward termination or cancellation. The industry recognizes the important contributions of franchisees particularly when, as now evident, there are nearly three times as many franchised establishments in the fast-food industry than there are company-owned locations. Following are figures as to number of establishments released recently by U.S. Department of Commerce:

NUMBER OF ESTABLISHMENTS

	Franchisor	Franchisee
1974	10,115	29,681
1975	11,168	31,904
1976	12,258	35,053

Claims by proponents that franchisors are making concerted efforts to "dump" franchisees and take over operations is just loose talk. The Department of Commerce's statistics also point out that only 477 franchisee operations were repurchased over for company operation in 1974. And in most of these purchases the franchisor ceased franchising altogether.

The importance of the franchise to the franchisor is self-evident in the following summary taken from the 11th Annual Francise Issue [March 1976] of Restaurant Business:

"Franchisors, in turn, are becoming more attentive and more responsible to their franchisee needs. In the last few years, many companies have established national advisory boards and councils to open up two-way communications between franchisees and company officials.

"Although some franchisees would dispute it, fransors claim they have a vested interest in assuring that franchisees do in fact succeed.

"To this end, the programs and services provided operators have been greatly expanded and improved by the franchising companies. Companies are placing greater emphasis on formal training programs to insure franchisees have the know-how to succeed under their trademarks. They're developing new store concepts and equipment systems that are designed to make their units

more attractive and more economical to operate. It is this ability to adapt to the changing economic and legal environment in which they operate that will insure the continued success of the franchising chains. Those companies that can come to new terms to meet the economic and legal realities of the day will continue to advance, those that stand still will be left by the wayside."

THE PROPOSED LEGISLATION WILL ABROGATE THE DUE PROCESS AND EQUAL PROTECTION PROVISIONS OF THE U.S. CONSTITUTION

By creating an unprecedented set of commercial relationships which infringe directly upon the right to contract, by regulating the contract relationship itself and imposing terms upon contracting parties which are totally unrealistic, and by settnig up a judicial machinery which provides damages to a franchisee even in the event that he was justifiably terminated, this proposed legislation raise grave questions under contract law and the due process and equal protection provisions of the United States Constitution.

Rather than protecting the consumer and the franchisee by requiring complete disclosure as has been done under legislation governing securities, trade and commerce and consumer affairs, this legislation attempts to protect the franchisee by regulating the contract relationship itself and imposing terms upon the contracting parties which are totally unrealistic and not even subject to discussion or agreement by the franchisor and franchisee. This approach is an unprecedented infringement upon the constitutionally guaranteed right to contract and is also a taking of property without due process of law.

Section 6(a) of Bill S. 2235 makes it illegal for a franchisor to cancel or terminate a franchise except for "good cause" or to "effect a market area withdrawal." This provision completely ignores the contractual intent of the parties and the franchise contract itself. Termination of the franchise is only a remedy of the franchisor if the parties agree to it by contract. Yet this bill alters the agreed terms of the franchise contract with respect to termination by imposing upon the parties extra contractual provisions which they themselves may not feel are desirable, let alone necessary. As such, this bill violates the right of the parties to contract and constitutes a taking of property without due process of law.

Section 6(b) of the bill goes further. It makes it illegal for a franchisor to fail to renew any franchise except for "good cause," a "legitimate business reason," or to "effect a market area withdrawal." This provision takes one of the most essential elements of the franchise contract, the term of the contract itself, and says, in effect, "regardless of what term the parties established, this bill will make the term of the contract of unlimited duration." Again, this provision is an unprecedented infringement upon the constitutional rights to contract and is additionally a violation of the parties' right of due process.

In addition to the unconstitutionality of its operational provisions, the remedial or penal provisions of the bill (Sec. 7) are also unconstitutional because they violate the equal protection clause of the Constitution. This legislation has several provisions which are unique in the history of American Jurisprudence. First, a plaintiff franchisee may be entitled to have his attorney's fees paid by the franchisor even if he loses. This provision is extremely unfair, if not unconstitutional, and will invite protracted litigation because the franchisee will have little incentive to settle short of a full trial and exhausted appeal regardless of his chances of success.

Furthermore, Section 7(a) places the entire burden of proof upon the defendant franchisor. The franchisee is not even required to prove the barest prima facie case. This is unprecedented in the history of the legal system in this country and it is inconceivable that any court would uphold such a provision.

Finally, the bill would appear to be unconstitutionally broad in its application. It regulates all franchisors, large or small, good or bad, old or new, without regard to the differences in their various businesses and the need for regulation. Because of the broad definition of commerce, it regulates the intrastate sale of franchises as well as interstate commerce. Moreover, since it apparently applies to franchise contracts executed before the bill as well as after the bill, it has retroactive effect, another constitutional infirmity.

In addition the severe Constitutional questions, the bill is so ambiguous that it would provide no guidelines for a franchisor who desires to comply with it. The act allows a franchisor to refuse to renew a franchise for "good cause".

However, the Supreme Court itself would have trouble knowing what was "good cause" as defined in Sec. 3(4) of the bill. This definition is not a legal definition but is a very casual laymen's definition. It defines good cause by the use of four terms—"comply substantially", reasonable excuse or justification", essential requirement" and "reasonable requirement." None of these terms have an exact definition or history of construction by the Courts. If terms of art used in other areas such as "material," "breach," and "misrepresentation" were used, a franchisor would understand the restrictions because these terms have been judicially defined. Given the ambiguity of these terms and their lack of judicial construction, no franchisor could safely terminate a franchise for any reason.

A franchisor can also make a "legitimate business decision" not to renew a franchise. However, the definition of this term is, if possible, even more ambiguous than the definition of "good cause".

Thus, to safely terminate a franchise, a franchisor has but one choice; he can effect a "market area withdrawal" as defined by Sec. 3(7) (A), (B), and (C). By doing so he is making a decision that he will not reenter that "market area" within the next five years regardless of any circumstances which may make re-entry advantageous or necessary than under situations which may have existed five years prior. However, this procedure is also fraught with danger because the bill does not define "market area". Thus, a franchisor has no idea how large or small an area he must withdraw from or where he may reenter.

This bill places a franchisor who wishes to comply with the statute in an impossible position. It rewrites the contract between the franchisor and franchisee. Consequently, if the franchisor follows the statute, he will violate the contract. If he follows the contract, he will probably violate the statute. Thus, in addition to being unconstitutional, the statute places the franchisor in a position where he will be sued either way.

THE FRANCHISOR AND FRANCHISEE

Contrary to what proponents of this legislation and similar legislative proposals would have us believe, the franchise arrangements in the fast-food industry are not consummated in some dark alley. The franchisor has been painted as a sharp-talking, glib-tongued entrepreneur surrounded by a battery of top-flight attorneys ready to swoop down, like vultures to the carrion, on an unsuspecting innocent prospective franchisee.

We have heard here, and before the House Commerce Subcommittee on Consumer Protection which concluded hearings on similar legislation recently, of general claims of "atrocities" which were never enumerated; we have heard that franchisors wield dictatorial superiority over the franchisee. This supposedly "dictatorial superiority" in plain fact is merely nothing more than the franchisor insuring the quality of their trade name and product and the prevention against the operation of a substandard establishment, a requirement which is most likely universally endorsed by all franchisees.

We have heard cries that unless this bill is enacted, franchisees will continue to be thrown out in the streets without a penny, saved for their equipment which will be thrown out with them.

This is an interesting and provocative picture and one that strains our motions. However, it is also not true.

Franchisees are selected carefully and judiciously. Not everyone who applies obtains the right to do business under the trademarks. It is a jealously guarded right and selection consists of a number of factors. Each franchisee in the system has a vital stake in the company's ability to make the correct choice.

It is extremely rare that a franchisee in the food industry has been forced into a termination. The industry's continued growth over the past twenty years substantiates this.

In fact, the franchisor makes every effort possible to avoid termination because of the already existing legal implications inherent in such an action.

Instead, the franchisor strives earnestly to assist in working with purported contract breaches which could necessitate termination or cancellation. Considerable time is spent and expense and talent is provided to upgrade a marginal operation. As time for a decision approaches, remedial efforts are intensified.

If all this fails, the franchisors set into motion mechanisms to assist the franchisee to sell his business at an agreeable price. The only stipulation the franchisor requires is that the new buyer be approved by the franchisor much in the same manner that the original franchisee was approved.

Despite the failure to use termination or cancellation provisions of the contract, the right to use such provisions cannot be abrogated.

The continuation of the existing contract beyond the expiration date is an interesting concept but is also economically unsound.

Franchisees have argued they want recognition of an automatic right to renewal at the terms and conditions and subject to the same royalty fees as the old contract.

Most of these expiring contracts were twenty years in length. Some were offered at abnormally low terms as inducements to prospective franchisees to become involved in a new and at that time, yet-to-be proven facet of the free enterprise system. To set a forced renewal at terms established under a 1956–57 economy is beyond reason.

Thousands of reputable franchisors who are doing business today under proven formulae and sound business principles will see their programs disrupted if this legislation is enacted. Who will suffer? Everyone. The franchisor will look at further expansion with a jaundiced eye. The employment market will suffer. But most of all, by imposing the burdensome strictures inherent in this bill on the vast majority of ethical franchisors to punish the few, Congress will effectively close off one of the few remaining avenues yet open to individuals to own their own business.

To force the parties to accept contractual terms which they did not establish through full disclosure and negotiations is an infringement upon the constitutional right to contract which we could never support. To compound the unconstitutional infringement in an ambiguous bill which does not even provide the franchisor with adequate definitions which will allow him to comply is unconscionable. The result would be to force franchisors to stop franchising entirely.

We sincerely hope that you will not recommend the enactment of this legislation.

Thank you.

Senator Moss. Mr. August Bequai, who was formerly with the SEC and lives here in Washington.

Mr. Bequai, we are pleased to hear from you, sir.

STATEMENT OF AUGUST BEQUAI, ESQ., FORMER TRIAL ATTORNEY WITH THE DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. BEQUAI. I will make it brief.

Mr. Chairman, in conformance with your request, I am pleased to testify today before this committee over S. 2335.

Although I take no formal position on the bill itself, I would like to raise for the committee's consideration some of the problems the franchisee faces daily. In so doing, I am drawing on several years of experience as a trial attorney with the Division of Enforcement, U.S. Securities and Exchange Commission—SEC.

However, before I continue with my testimony, I wish to make it perfectly clear that I have no vested interest in this matter and that my sole purpose in appearing before this committee today is motivated by my great concern for the erosion of the individual and our free enterprise system before the onslaught of corrupt and arrogant bureaucrats from both the private and governmental areas.

I wish to further express my sincere conviction that this country today faces serious internal problems. Let us hope that ours will be a different faith than that of Ancient Rome.

At the SEC I worked on a number of investigations that touched on the franchising industry. I spent more than 1 year investigating the fast food industry and a little less time investigating the beer industry.

My investigations revealed that—the fast food investigation involved 2 years' work: (1) Franchisees are forced by their franchisors to engage in illegal activities; and (2) they are also forced to sell their products at prices that suit the economic needs of the franchisor, many times to the detriment of the franchisee.

In July 1971, Heublein Corp., a conglomerate with offices in Connecticut, acquired Kentucky Fried Chicken Corp.—KFC. KFC had more than 1,000 franchisees at this time.

Heublein soon embarked on an acquisition policy and targeted more than 100 franchisees for acquisition. The larger franchisees, in turn, were prevented from merging with fellow franchisees, and thus becoming more competitive.

When Collins Foods International, Inc., attempted to merge with Davis Food Service, Inc., both KFC franchisee, Heublein moved in to upset those merger plans and eventually acquired Davis Food, paying a higher than normal price so as to check the growth of Collins Foods in the southeast area, one of the most lucrative areas in the country for the fast food business.

In addition, Heublein pursued a policy of denying its franchisees foreign territories, thus limiting their expansion capability. And I was told that strong-arm tactics were used on occasion.

In addition, whenever two growing franchisees sought to merge, Heublein usually put pressure to stop the merger for fear that strong franchisees would be less dependent on her.

The Heublein strategy was twofold: (1) Acquire lucrative territories back from the franchisees; and (2) check their growth so as to eventually encourage them to sell out to the franchisor, Heublein.

I might also add that Heublein followed a strategy of total dependency. When Collins Foods made plans to buy a chicken farm with Davis Foods in mid-1972, and thus attempt to lessen their dependency on Heublein for their chicken supply, the latter put pressure and the plan was soon afterward dropped.

In early 1975 I received information from a reliable source in the beer industry that the Joseph Schlitz Brewing Co. had a $1 million fund set aside to induce various restaurants, hotels, and food stores to sell only its beer, and exclude that of its competitors. Among those named were Holiday Inns; Emersons, Ltd.; and Seven-Eleven; Pizza Hut.

In addition, I was also told that Schlitz funneled some of these payoffs via its franchisees, so as to escape prosecution.

I soon began to investigate this matter further, and a pattern began to emerge; one that involved the large giants of the beer industry—Anheuser-Busch; Miller Brewing Co., a subsidiary of Philip Morris—I later learned that Philip Morris also funneled payoffs via the Miller franchisees to various beer accounts—Pabst Brewing; and Falstaff.

These practices were in open violation of the Federal Alcohol Administration Act, and also various State liquor laws.

The agreements were usually entered into by the representatives of the beer companies themselves. However, the franchisees were then directed by these companies to do their dirty laundry. They became the medium through which these illegal payoffs were made. The franchisee was given two choices; obey or lose your license. Many in fact did obey. Those who did not, lost their businesses.

In the old days of the beer industry, this practice—the making of illegal payoffs—had been known as blackbagging. A company representative with a black bag full of cash actually made the rounds and paid various accounts inducements in cash.

However, the practice had become more sophisticated and refined with time. In addition, no longer did the company itself engage in illegality, but rather ordered and directed its franchisees to do so. The latter were instructed to: (1) Funnel company merchandise to the accounts; (2) they were to pass money to the accounts from the company; (3) they were to offer discounts and rebates, and sometimes the company reimbursed them for these losses while many times it did not; (4) they funneled bribes, especially to military accounts involving the Army and the Air Force; and (5) they made loans, signed leases and extended credit to the various company accounts when directed to do so. By accounts, I mean the national accounts, and also the local accounts, restaurants and so forth.

It should be pointed out that the Federal Alcohol Act prohibits the giving of any loans or inducements which: (1) Violate State law; and (2) are designed to result in the exclusion of a competitor's products.

The act also provides criminal penalties. Many States also make such activity illegal through a series of alcohol acts. All forms of payoffs for acounts; discriminatory pricing; giving of free merchandise and free services are usually in violation of State alcohol acts.

The Bureau of Alcohol, Tobacco and Firearms—BATF—is the Federal agency charged with policing this area.

There are also a number of State commissions known as Alcohol Beverage Commissions [ABC's], which police State laws in this area. However, ironical as it may seem, their targets are usually the franchisees and not the big companies.

The SEC investigation disclosed that some franchisees did not always take this lying down. One Schlitz franchiseee in Florida was ordered to make illegal payoffs to military personnel at the local base. In addition, he was also directed to sell his beer to the military at below cost.

He refused, fearing prosecution.

Schlitz revoked his license.

The franchisee lodged a complaint with the BATF, but the latter took no action against Schlitz. When the ABC for the State of Florida began to take an active interest in these practices, the franchisors lobbied to have it "legislated out of existence."

The same pattern took effect in many other States. Many franchisees complained and some even came forth and testified before the SEC. However, neither the BATF nor the FTC, nor any other Federal body took any steps to protect the franchisees.

Whatever the SEC itself did was limited and hampered by lack of cooperation from BATF.

I, personally, had several meetings with high officials at BATF to discuss the general problems of this industry. In early June 1975, I met with an Assistant Director of that agency its general counsel and also their chief of enforcement. They acknowledged that they knew about these problems, but refused to open their files to our investigators.

In the latter part of that month, I told Warren McConnelly, an assistant director with the BATF, that if "Congress got a wind of the fact that they weren't cooperating, what would BATF say."

He promised to help. In early July 1975, I was granted formal authorization in writing by Mr. Rex Davis, Director of the BATF, to allow me to study their files.

As our investigation progressed, the BATF became more and more reluctant to cooperate. Rex Davis personally instructed his field "investigators" not to cooperate with the SEC any longer.

In early September 1975, he formally revoked our authority to have access to BATF files.

It should be pointed out that many franchisees, who could have easily come forth and testified and helped end these illegal practices, were fearful to do so and had no confidence in either the Federal or State authorities.

In late June 1975, the U.S. Attorney for Milwaukee met with officers of the SEC, myself included, who were involved in the beer investigations. I might add, it is not in my presentation but there is right now a grand jury sitting in on some of these problems in Milwaukee, Wis. He remarked that he had never seen anyone so frightened as were the franchisees, "not even in organized crime cases."

The vice president for marketing at Schlitz, in testimony before the SEC, told the staff of a meeting involving Rex Davis and some of his subordinates in mid–1973, with officers of the large companies.

Davis told the companies to "cool it a bit."

When we asked if Davis and BATF knew of the practices in the industry and of the "plight of the franchisees," his answer was that they did but had never done anything about it.

I might add that Eugene Flaningan, associate general counsel for Miller Brewing, reiterated this also.

I left the SEC in early October 1975. At that time I remember speaking with a Schlitz franchisee about some information he had passed on. "Do you think we'll have an impact on these practices," I asked him.

"No," he replied. "Who'll protect us when you guys go away?"

It then dawned on me that he was right. The sad truth is that in this country the franchisees are but one of many groups whose cry goes unanswered. A free society finds its support in the middle strata. When that goes, then so does her freedoms.

If the plight of the franchisee today is not serfdom, then what is? This, gentlemen, is the tragedy of America today.

Senator Moss. Thank you very much for your statement. It contains a lot of very disturbing material.

Do you have any clients or investments that are related to franchising?

Mr. BEQUAI. No, sir. Neither do I or my family. I don't even own any stock. I had some McDonald hamburgers this morning.

Senator Moss. So I can presume you are not being paid by any client that has anything to do with franchising, for your appearance?

Mr. BEQUAI. No. I just want to go on record. I have no Swiss acounts; I don't have anything.

Senator Moss. You stated that Heublein embarked on a franchise acquisition policy.

Did it terminate franchises in order to acquire, or fail to renew, or did it buy out franchises at other than fair market value?

Mr. BEQUAI. Heublein had its forces concentrated on Davis Food Service, Inc. They had in mind objectives of acquiring other franchisees and I know that because they submitted a confidential list of their plans.

Since our concentration was on Davis, Heublein was fearful that Collins Food—I might add these franchisees were publicly held companies. Davis traded in the American Exchange and Collins traded on the New York Stock Exchange.

To grow, the company has to produce, and to produce you have to merge. Collins was concerned about this and they wanted to merge with Davis, which would have given them the southeastern part of the United States, one of the most lucrative areas in the country for fast foods.

Heublein tried to stop the merger. Collins had in mind a company called Marks in Orlando, Fla, a franchisee with 120 stores.

Heublein knew if Collins acquired Marks, it would be an easy thing to acquire Davis. Heublein moved in on Marks and stopped that acquisition. It moved in on Davis and paid more money than it would have paid for a franchisee and Davis today is owned by Heublein or KFC.

We named several Heublein officers for court action after investigations of several years.

Senator Moss. In this beer business, you suggest that the brewer would enter into an agreement with an establishment to sell his beer, and then direct that the franchisee either cut prices or pay off the management of the establishment.

What would happen if a wholesaler refused to cut off prices as dictated?

Mr. BEQUAI. I can tell you of a couple of instances that I do know.

Their licenses were revoked under a pretext of "your shoes aren't polished sufficiently, the beer cans aren't polished, I don't like to way you wear your clothes."

KFC had somewhat of a similar policy.

Senator Moss. Now when you were looking into these practices from the standpoint of the SEC (and yesterday a witness testified he told the Bureau of Alcohol, Tobacco, and Firearms about some of the questionable practices) were you working with the BATF on any of these investigations?

Mr. BEQUAI. The investigations were national in scope.

The SEC had worked and was working with the IRS, BATF, military investigatory bodies, et cetera.

We were concerned about payoffs regarding military personnel to get beer products on military bases.

We found from an interesting source who I will call Mr. M, who worked for Paul Seigs, he indicated that the payoff or kickback on a case of beer was 10 cents.

The companies had become sophisticated. If you wanted your money banked abroad, he would do so. If you wanted your money banked in Switzerland, then our ex-ambassador to Portugal would deposit payoffs in a Swiss bank.

There was another situation where an Irish citizen leaving Ireland, working out of Hong Kong, had set up a scheme whereby you went to him and he would take your money and set up a dummy corporation and reinvest your money back into this country.

You had a lot of choices, even women.

Senator Moss. Did BATF bring these matters to criminal prosecution?

Mr. BEQUAI. I am glad you asked that.

For one thing some of our loyalty goes very shallow in the beer industry. Some of the big giants gave us information they had on each other. One company gave us two filing cabinets which listed 1,000 violations.

We had a meeting with an agent of BATF. We indicated to him that if they wanted it, they could take the appropriate legal action, write to the Commission, et cetera, and we would be happy to Xerox it and mail it over.

That didn't work.

We then contacted them and that didn't work.

As I understand it, eventually it was mailed to the BATF.

I don't know if that worked. They knew about it; yes, sir.

Senator Moss. Where does the testimony of the Schlitz vice president appear?

Is it in the deposition at a hearing?

What has the SEC done?

Mr. BEQUAI. It is in a transcript at the SEC under oath. After having testified, they went to BATF and complained of the fact that we were picking on them, I think.

Senator Moss. What about this Heublein matter, was that ever brought under any charge, or was it dropped by SEC?

Mr. BEQUAI. As far as I know, the Heublein matter is still at the SEC. I concluded my investigation a long time ago. I went on to grander things after that.

As far as I know I completed my memo and in it I recommended they name several vice presidents of the companies, including the president of KFC, general counsel of KFC and several of the vice presidents of the subsidiaries.

What has come of it, I don't know, sir.

Senator Moss. I take it that I could summarize your testimony that the power to terminate or not to renew is often used as a threat to coerce franchisees to engage in illegal activities?

Mr. BEQUAI. Yes, sir.

I might also add by the way, that it is a sad commentary on the prosecutorial systems in this country that the franchisees, and I have heard some of the testimony, by the way, going on, really have no place to go.

To say they can have access to counsel and bring antitrust litigation, if you have a franchisee who makes $16,000 a year, no way can he afford to pay counsel $50 an hour.

Senator MOSS. I understand your testimony is an indictment of the Federal Government and the system we have as much as of those who are abusing their powers against franchisees. As you point out, he has no place adequately to seek a remedy.

Mr. BEQUAI. Yes, sir, that is exactly what I am saying.

Senator MOSS. I do appreciate your coming to testify for us, to give us this point of view, to direct at any legislation we might work on.

I am grateful for your coming.

Mr. BEQUAI. Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

KFC CORP.,
Louisville Ky., April 29, 1976.

Hon. FRANK E. MOSS,
U.S. Senate, Room 3121, Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR MOSS: It has come to our attention that a portion of the testimony of Mr. August Bequai in the hearings held by Senate Commerce Committee on Senate Bill S. 2335 (the "Fairness in Franchising Act") was directed at alleged policies and practices of KFC Corporation and its parent company, Heublein, Inc. Much of Mr. Bequai's testimony concerned matters which have no relationship to Senate Bill 2335 and while we would like to clarify the record we do not feel it would assist the Committee in its review of the proposed legislation for us to comment on these matters. We would, however, like to comment on those portions of Mr. Bequai's statement which are directed at KFC Corporation and Heublein, Inc. and which relate to issues which are relevant to the Committee's consideration of the proposed bill.

Mr. Bequai made several statements concerning KFC's and Heublein's policies regarding the termination and renewal of franchises which are totally unfounded and need to be corrected. Mr. Bequai accuses KFC and Heublein of embarking on a policy of checking the growth of KFC's franchisees and acquiring back lucrative territories from its franchisees. KFC has never embarked on a policy of limiting its franchisees' expansion. On the contrary, the number of KFC franchised stores has increased every year for the past eleven years. In addition, the number of franchised stores is expected to increase at an even greater rate over the next several years. Mr. Bequai's statement that KFC uses strong-arm tactics to acquire back lucrative franchised territories is totally unsupported by the facts. Without attempting to deluge the Committee with a detailed response to this accusation we would only point out that KFC has not bought back a single franchised store in nearly three years.

During Mr. Bequai's testimony he was asked the question: "Did it [KFC/Heublein] terminate franchises in order to acquire, or fail to renew, or did it buy out franchises at other than fair market value?" Mr. Bequai's response to this was to focus on a single acquisition in which he concluded that KFC bought back the franchise at a price *greater* than its fair market value. Even if this conclusion were correct (we feel a review of the particular acquisition mentioned by Mr. Bequai will clearly show that KFC paid the fair market value for what it acquired) paying more than fair market value is certainly not the problem contemplated by the proposed legislation. We believe KFC's acquisition history and policies on termination and renewal have always been and will continue to be fair and equitable to our franchisees. Throughout the years KFC has been granting franchises I cannot find any instance where we failed to re-

new any franchise at the end of its initial term for any reason. Further, there is not a single case where a terminated franchise has been acquired back by KFC for conversion to a company-owned operation. While KFC did acquire several franchises prior to 1973, none of the franchises for these units were terminated or subject to termination proceedings at the time of the acquisition, nor were any threats made of termination in order to reduce the value of the franchise. In all cases KFC paid at least fair market value for the franchises it acquired.

Finally, I would like to say, contrary to Mr. Bequai's personal feelings, that the franchisor's right to terminate or not renew a franchise is a right that is used by KFC only in extreme cases and only as a last resort. There is a substantial effort made by KFC in the selection and training of its franchisees as well as continuous ongoing efforts to assist franchisees in their operations. It does not make sense to throw this investment of time, resources and money out the window and start all over again with a new unproven franchisee except in those few isolated instances where it is absolutely necessary.

We trust this helps clarify the possible misconceptions that Mr. Bequai's testimony may have given the Committee. We would appreciate this letter being made a part of the record in the Senate hearings. Thank you again for allowing us to correct the record.

Very truly yours,

JOHN F. COX,
Vice President—Franchising.

DEPARTMENT OF THE TREASURY,
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS,
OFFICE OF THE DIRECTOR,
Washington, D.C. April 29, 1976.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR SENATOR MOSS: Recent testimony before your committee by a former SEC attorney, Mr. August Bequai, indicates that the Bureau of Alcohol, Tobacco and Firearms has refused to cooperate with the SEC in investigations of the liquor industry and has failed to take strong action against brewers to the detriment of beer franchisees.

Mr. Bequai's testimony was inaccurate and misleading in several major aspects. We believe that leaving such testimony unchallenged would be detrimental to the efforts of the committee and would have an adverse effect on our efforts to regulate the liquor industry.

Therefore, we respectfully request that the enclosed statement be entered in the hearing record so that it immediately follows the testimony of Mr. Bequai, thus providing the committee and those others who might review the testimony an opportunity to assess the value of Mr. Bequai's statement in the proper perspective.

Sincerely yours,

REX D. DAVIS, *Director.*

Enclosure.

STATEMENT OF REX D. DAVIS, DIRECTOR, BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, DEPARTMENT OF THE TREASURY

I wish to thank the Chairman of the Consumer Subcommittee, Senator Frank Moss, for the opportunity to make this statement for the record.

Recent testimony before your committee by a former SEC Attorney, Mr. August Bequai, indicates that the Bureau of Alcohol, Tobacco and Firearms has refused to cooperate with the SEC in investigations of the liquor industry and has failed to take strong action against brewers to the detriment of beer franchisees.

Although we are unable to comment on specific cases mentioned in that testimony because they are currently the subject of on-going investigations, we feel that Mr. Bequai's testimony was inaccurate and misleading in several major respects. We believe that leaving such testimony unchallenged would be detrimental to the efforts of the committee and would have an adverse effect on our efforts to regulate the affected industry.

First, ATF has in the past, and is at present, closely cooperating with the SEC and other Federal agencies in investigations of the liquor industry. In fact, if the committee were to ask these agencies, we are confident they would find that such cooperation has added to the effectiveness of their investigations. Further, the following sequence of events should illustrate that none of our efforts have served to "thwart" investigations conducted by the SEC as Mr. Bequai testified.

Early in 1975 the SEC learned that we were investigating a major brewery with respect to furnishing things of value to retailers in violation of the Federal Alcohol Administration Act (FAA). The Act is a trade practice and consumer protection law enforced by the Bureau. Realizing that such violations might also result in violation of statutes enforced by the SEC, several SEC representatives, including Mr. August Bequai, contacted our office for information about the investigation.

During this initial meeting we agreed to supply SEC with investigative information (including closed case reports) where final action had already been taken against an industry member. This understanding was later confirmed in a letter to the SEC as shown by Exhibits I and IA.[1] The SEC also requested specific information about a major brewer. However, since such investigation was currently the subject of a grand jury probe, we told the SEC that in accordance with an agreement with the U.S. Attorney handling the case, any release of information would have to be approved by him.

While the other SEC representative understood the reason for this restriction, Mr. Bequai apparently was not satisfied with our response. A few days later he contacted our regional office in Chicago and indicated (erroneously) that he had my approval to secure our files pertaining to this case. Just prior to releasing the information to Mr. Bequai, the regional official contacted our office in Washington and was surprised to find that Mr. Bequai had misrepresented his right to such files.

It is interesting to note that Mr. Bequai later contacted the U.S. Attorney as initially instructed and was successful in gaining access to our investigative files. In fact some of the information he testified about before your committee came from ATF reports.

At about the same time Mr. Bequai made the abortive attempt to secure information from our regional office, he met with ATF staff members in Washington to review our complete file of closed cases to search for violations of SEC laws. When told we had no information for him with respect to another major brewer, he accused one of our staff members of deliberately withholding information from him. It was pointed out to Mr. Bequai that the subject of his specific inquiry was currently under investigation by ATF and in accordance with a previous understanding we were only furnishing information on completed cases. Since our staff member felt Mr. Bequai was challenging his integrity by insinuating he was deliberately withholding information from him, he complained to his supervisor about Bequai's conduct and prepared attached Exhibit II, as a memorandum to the file to document the occurrence.

Upon learning of Mr. Bequai's attempt to secure investigative information without clearance by the U.S. Attorney and upon hearing of his accusations that our staff was deliberately withholding information from him, our Assistant Director for Regulatory Enforcement advised all Bureau employees that future requests from Mr. Bequai would first have to be cleared through his office.

In Mr. Bequai's testimony before your committee he attributes this action as personal intervention by me to limit cooperation with the SEC. The committee should be aware that the above step was taken to insure that adequate controls were maintained to prevent unauhorized release of information by our regional offices through misrepresentation and to protect lower level staff members from unwarranted allegations by Mr. Bequai. Further, the action in no way prevented Mr. Bequai or any other SEC representative from receiving information we had agreed to furnish them.

Since the SEC felt that our restriction against sharing investigative material on current investigations (in addition to the one before the grand jury) was adversely affecting their ability to timely respond to possible SEC violations, they requested another meeting with our staff to review and if agreeable, revise

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[1] The exhibits referred to in this statement are in the committee files.

the agreement. At that meeting we expressed our concern about Mr. Bequai's attempts to misrepresent our earlier agreement in contacts with our regional offices and his insinuation that our staff members were somehow trying to hide information from him to protect the industry.

After receiving assurances that these actions were not indicative of the SEC's relationship with our Bureau, we agreed to expand our earlier agreement and provide them with any and all information we had on both open and closed investigations. This was done with SEC's assurance that it would make no public release of information so received or use of it in their contacts with publicly owned companies until we had completed our intended criminal or administrative action. This latter understanding was considered necessary since premature release of such material could significantly jeopardize prosecutive or administrative sanctions.

The results of this meeting were confirmed in writing in a letter from the SEC which is attached as Exhibit III. For the committee's information this represents the current guidelines for cooperation between SEC and ATF. It is also important to note that since Mr. Bequai's departure from the SEC, there have been no problems in relationships between our two agencies. This is certainly contrary to Mr. Bequai's testimony to your committee about our willingness to cooperate.

With respect to the testimony that ATF has not vigorously enforced the laws relating to brewers and has thereby imperiled franchisees (wholesalers), we believe a review of our efforts over the past few years will reveal this too as a completely inaccurate statement.

We have always felt that a high degree of voluntary compliance was a desirable and obtainable objective in a highly regulated industry. With limited manpower it is far better to prevent violations before they happen rather than expend considerable investigative manpower to prove them after they occur.

However, beginning in mid-1972, we became concerned that the degree of compliance by the industry with the FAA Act was below an acceptable level. At that point we launched a two-pronged attack on the problem.

First, I and our top executive made a series of speeches before the national industry meetings voicing our deep concern over the number of violations we were finding. We urged the industry members to voluntarily comply and to engage in a strong self-policing effort while at the same time putting them on notice that future violations would be met wih heavier penalties and the possibility of criminal actions. Mr. Bequai had characterized these speeches as meeting with industry for the purpose of telling them to "cool it." Mr. Bequai alleged that Mr. Robert A. Martin, Vice President for Marketing at the Schlitz Brewing Company, stated in testimony before the SEC that I had warned a group of brewing executives to "cool it a bit", apparently in light of ongoing investigations of the brewing industry. It should be noted that a review of Mr. Martin's testimony before the SEC indicates that he (Mr. Martin) gave no testimony to support Mr. Bequai's allegation.

We have attached several of these speeches made during the past few years, and feel the committee will find them to reflect a hard-nosed approach aimed at getting compliance—not merely a message to "cool it."

Second, and more importantly, we diverted significant amounts of manpower from revenue-oriented programs into the FAA program, this latter program being aimed at investigating brewers and wholesalers, among others, for violations of the FAA Act. At present, there are 352 investigations underway involving unlawful trade practices by industry members.

I would like to cite some statistics in support of our increased efforts:

In Fiscal Year 1972, ATF accepted 20 offers-in-compromise totaling $34,000. In Fiscal Year 1973, a total of 45 offers-in-compromise in a dollar amount of $546,300 were accepted; in Fiscal Year 1974, 56 offers totaling $473,500 (includes one offer-in-compromise in the amount of $250,000) and in Fiscal Year 1975, 64 offers totaling $252,892. These figures include a total of 28 offers accepted from *producers* in a dollar amount of $557,000. We believe these figures are significant in view of Mr. Bequai's contention that ATF has not been as strict with producers as with distributors. Further, during the period from January 1, 1974, through March 31, 1976, 42 alcoholic beverage permittees have been suspended for Federal violations.

A complete breakdown of the results of this shift in priority are even more dramatic as shown by attached Exhibit IV. In addition to the more common

sanctions imposed by the Bureau, we have recently been attempting to obtain convictions of willful or repeated violations although to this point we have met with little success in this arena. We intend, however, to continue to utilize this latter approach where the more routine administrative options seem inadequate.

In addition, we feel it's important to note that our intensified investigative efforts in this area are not a response to an increase in efforts by other investigative agencies. To the contrary, investigations by agencies such as the SEC are often the result of earlier ATF investigations and are examples of the close cooperation that exists between such agencies at both the Federal and State levels.

A final implication from the earlier testimony is that ATF has been unsympathetic to the plight of franchisees (wholesalers) and has permitted brewers to force these industry members into violations of the FAA Act. The Committee should be made aware that as a routine part of all FAA investigations into illegal inducements to retailers, our inspectors attempt to determine whether the impetus for the violation comes from the brewer, the wholesaler, or both. Where it is determined that a brewer has used a wholesaler as an unwilling conduit, the more serious action is taken against the brewer.

It is also fair to point out, however, that in such instances we do not consider the wholesaler completely free of blame. In some cases it's impossible to determine where the violation originated as it gets to be the word of one segment of the industry against the other, where both are trying to avoid blame for an illegal action. Further, unless the wholesaler agrees to go along with the illegal inducement, the violation can usually be avoided since in many states a brewer cannot sell directly to a retailer. Admittedly it requires courage to take a firm stand against pressure from a brewer, but each wholesaler must nevertheless remain accountable for his actions. With this accountability comes the very real possibility of being penalized for participating in an illegal transaction, even though one does not originate it.

We also should point out that our administrative sanctions against franchisees (wholesalers) are much greater than those against brewers as the operations of the former are conducted pursuant to permits issued by ATF. Brewers, unlike distillers and vintners, are not required by law to secure these permits. Accordingly, the only sanctions available against brewers are offers-in-compromise or the seeking of indictments. Since FAA violations are misdemeanors, U.S. Attorneys have shown little willingness to proceed criminally. Wholesalers on the other hand are subject to having their permits suspended or revoked in addition to the above two sanctions.

To summarize, we believe that this statement demonstrates the scope and success of our FAA Enforcement Program. We have discussed the areas in which ATF has taken steps to deter violations: quick, sure action against violators, additional manpower commitments in problem market areas, and cooperation with Federal and State agencies. Our program will continue until we have reduced unlawful trade practices in the alcoholic beverage industry to the lowest achievable level.

Senator Moss. Mr. Raphael Cohen, Independent Dealer Committee Dedicated to Action.

We will ask Mr. Cohen if he will come forward, please. We are glad to have your testimony.

Anything you can do to summarize and help us get through in a hurry, we will appreciate.

STATEMENT OF RAPHAEL COHEN, INDEPENDENT DEALER COMMITTEE DEDICATED TO ACTION, RIDGEWOOD, N.J.; ACCOMPANIED BY HAROLD REESE

Mr. COHEN. I will highlight the testimony before the committee and hope that in the future you might communicate any questions you have to us that are not covered here this morning.

Sitting to my left is Mr. Harold Reese. He is a franchised new

car dealer, member of the executive committee of IDCDA, and a Chrysler Corp. franchisee in excess of 30 years.

There are two observations I would like to make before I start. One was I felt a little like my son, Andrew, sitting out there listening to the five previous witnesses. Andrew is a basketball advocate and he is not that great. Generally he is sitting on the bench until the last 30 seconds and then they press him into action. He tries to win the game, and it is not a very successful endeavor.

I want to say to Andy, for the record, I know how you feel.

Secondly, I would like to make comments on a remark of Mr. Rosenberg in which he considered 20 years a long period of time.

I entered my father's business. I am a franchised new car dealer. IDCDA is made up of franchised new car dealers, both import and domestic. I entered the business in 1947 as a second generation dealer. Our agency was founded in New York City in 1940. We have been in Yonkers, N.Y. since 1943.

Looking back from 1947 to today, 20 years doesn't seem very long. Maybe Mr. Rosenberg is slightly younger than I am and that could be a reason for his nonrecognition of that fact.

In my statement, I speak of the great concentration of economic power in this country. There is no secret that the big are getting bigger and the small are getting smaller.

The only thing that has kept this free society free is the promise of opportunity, the promise of some day achieving what your efforts will produce.

And the franchise system does hold out that kind of promise. If it does hold out that kind of promise, what are we speaking of today? The thing we are speaking of today is that there is a great deal of variance between promise and performance.

The franchising industry falls into two categories: One is covered by the McDonalds, Dunkin Donuts, Carvels and others of their type as represented by NFAC, and the second more sophisticated system, represented by auto dealer.

There is a great investment made by automobile dealers in their franchise and our franchisor points out to us on every occasion available that our success is really totally based on his production of a vehicle.

They say we pay no fees, so Mr. Ricardo testified in opposition to the Dealer Day in Court Act. I will make reference to this later. He stated there is no good will in auto agencies.

Well, with some of the consumer complaints a good argument could be given for that, but if there is no good will in a retail business, there is no retail business.

In speaking to Congressman Scheuer after the hearings on the Mikva bill, or during the hearings on the Mikva bill, I disagreed with a statement that he made, respectfully, of course, that the franchisee is a glorified employee of the franchisor, that he isn't a free and independent businessman, that he is placed there because of the opportunity for pilferage in a McDonald franchise or Dunkin Donuts franchise, and therefore he really hasn't these rights.

I disagreed with him and he questioned me and said, "Are you a franchisee?" And I said, "Yes, I am."

He said, "What kind of franchise?" And I said, "Automobiles."

He said, "What kind?" And I said, "Cohen's."

Mr. Chairman, that is what I sell. Which is what my father sold, and if my son is as unfortunate as I am, he will come on to sell them also.

Now, what is the benefit to the franchisor of an auto franchise? It gives him a national distribution system for the merchandising of products. It relieves him from supplying and supervising personnel to accomplish marketing and servicing.

It relieves him from negotiating thousands of organized labor contracts throughout the 50 States, one which I am now in the process of negotiating in my own dealership, controlled nonnegotiable prices at wholesale for their products.

We do not negotiate what we pay.

Assistance in promoting through dealer-paid advertising of products they sell.

A buffer between manufacturer and consumer to handle problems created by products they produce.

The payment by the franchisee of substantial inventory costs for inventorying their vehicles—and it might be pointed out at this point that before that gate swings open and the car goes out, it is already paid for.

We can sometimes receive this piece of merchandise 45 days later, but they have had the use of the money for 45 days, and we haven't even had the use of our product. This is a substantial benefit. Billions of dollars of insurance costs assumed by the franchisees, the use of billions of dollars withheld from dealers in what is termed as dealer holdback for a period of 1 year.

I footnoted that in my statement and pointed out that the auto manufacturer withholds, according to the corporation, between 2 and 2½ percent of the dealer discount for the year and the dealer gets that at the end of the year.

In the case of my manufacturer, Chrysler, I will readily admit in the case of hardship they will release this on a quarterly basis, and have.

But GM, when they went on strike the model run had already been completed and their dealers were in financial straits and asked that they be paid their own money. They were offered the great option of borrowing it from GMAC and paying interest and using the money due them as security.

There is a little benefit to the auto manufacturers in this respect.

Now, in the past when we have tried to have legislation like this brought before the Congress, the auto manufacturers have stated that we pay no fee and that the trademark really is the only thing of value. That the franchise was a privilege with sole rights to grant or continue such relationship the exclusive right of the franchisor.

I think the listing of those 10 benefits should certainly put that myth to sleep.

The question comes about why are we looking for protection under law. The straightforward answer is that the manufacturer has been guilty of abuse of power.

Recently, General Motors executed a new dealer agreement with their dealers. This agreement was placed before some of them 30

days before renewal, others 60 days before renewal, but there was no negotiation.

It had clauses in it that were not in the previous franchise agreement.

Let's examine this.

They have a franchise agreement that runs for 5 years. They are your landlord, hold your lease and you have to look to rent that apartment from them next year.

What are my bargaining powers? Where do I sit? They put terms in that franchise agreement that are totally unreasonable. For example, if a fraud takes place in a dealership, unbeknownst to the franchise holder, General Motors reserves the right to terminate that dealer. It is automatic termination.

He didn't know it; the inference is he should have known it.

Well, I have been selling these products for a long time and when GM put out that Vega with the engine that overheated, they didn't stop them. They kept producing them and kept selling them to the franchisee who sold them to the consumer. They didn't fire the chairman of the board.

I don't see why a small franchisee should be exposed to this kind of thing.

I have made reference to a few examples. One is Swift Dodge in Kansas City, Mo., run by Bob Lutz. This is in litigation. I am not involved in the litigation and therefore I feel free to comment on it.

Bob Lutz took over a factory financed facility. It never made a profit. He turned this small entity into a modest profit, got some security for his family out of it. Then Chrysler decided they wanted to buy a piece of real estate some place in an area they felt was upcoming.

They said to Lutz, "We want you to move."

He said, "No way. There are no houses out there and no people."

They said, "They are coming."

And he said, "When they get there I will go."

And they said, "No, you have to be there first."

He got into the chicken-and-egg argument, and after much conversation, Chrysler stated picking faults with Lutz that had nothing to do with the move. He wasn't meeting minimum sales responsibility.

There is a clause in our franchise agreement on minimum sales responsibility.

That clause automatically precludes at least 50 percent of the dealers of attaining that minimum sales responsibility and therefore, at all times, 50 percent of Chrysler Corp. dealers are in default of their contract and at the mercy of the franchisor.

Now, I have heard this morning a great deal of discussion of the benevolence of the Dunkin Donuts people and the IFA, and I think they did a fine job in representing their point, but I respectfully disagree with it.

You asked a question, Mr. Chairman, and I would like to insert this in the record at this time about vertical integration, because it is a vital area to the consumer, as you know.

When you take competition out of the marketplace, you tend to price fix and get a concentration of power that is very dangerous to

this Nation. If we have had any lessons in the past 2 years, we should learn what the concentration of economic power means.

It has disgraced us internationally.

You asked a question of the placing of company-operated stores in an area. Now, this comes out of the statement placed in the record by the Consolidated Franchise Association, which I believe to be a group of Dunkin Donuts franchise operators.

They quote in exhibit 4 from the annual 1974 report of Dunkin Donuts and the following question and answer appears.

Question 6. Why hasn't Dunkin Donuts expanded with more company owned shops?

Answer. Dunkin Donuts is currently giving more emphasis toward company-owned operations than ever before in its history. In fiscal '75 approximately 40 percent of all new shops planned to be opened will be company-owned up from 24 percent in 1974. In the past franchising was used almost exclusively to expand.

However, the favorable projected return on investment has increased emphasis on company-owned shops.

That doesn't sound like any training program to me.

Getting back to my automobiles. If I wander a little, it is because I have tried to push my mind faster than it is capable of going, but let's get back to the General Motors 5-year agreement and the things we find to be objectionable in that agreement.

One I pointed out was the fraud element. Others are the dealer would be required to enter into the business of renting and leasing of cars at GM's discretion. Dealers would participate in all GM promotions. It says that in definite terms, that dealers maintain certain facility standards. The reason for the facility standards are simple: It is not that that dealer could adequately represent General Motors. It is that he cannot take in a competitive import line to compete with their lines. It is limiting competition.

Now there was quite an uproar by General Motors dealers, but quite an uproar by General Motors dealers usually consists of a whisper some place in the back room because of the fear of the power of General Motors.

So General Motors felt that maybe they should do something about it, and at the National Automobile Dealers Convention, an organization which represents the largest segment of franchise new car dealers and is not represented at these hearings for reasons of their own, which I'm not privy to or totally privy to, at their annual convention the gentleman that ascended to the presidency is John Pohanka, who owns an Oldsmobile agency in this area.

John went screaming, "My God," just before the convention, "look what you have done." They came out with a five-page letter of explanation of the franchise agreement, and I will make a copy of this available to you.

I will make a copy to the committee for its record. It explained their franchise agreements.

Senator Moss. We will place it in the record when we receive a copy.

Mr. COHEN. It states for little fraud we won't do anything. They say we won't make you buy the program if we feel it is not applicable. The agreement compels the dealer at GM's discretion to go

into rental and leasing of cars in competition at some times with giants like Avis and Hertz, whom they subsidize.

So we have here a gift to John Pohanka, and I wrote a letter to John telling him to beware of Greeks bearing strange gifts, and this is indeed a very, very strange gift.

Reference was made yesterday to the dealer day in court act, and I wonder if looking back at the clock, because I'm ashamed that I don't own a watch——

Senator Moss. You have 7 or 8 minutes.

Mr. COHEN. I want to give you a couple questions to ask. But the dealer day in court act was a hope for car dealers. When that legislation was enacted by this Congress, not this current Congress, but by our representatives, we felt they had finally become cognizant of the problems of little people.

We are not very bright, I will admit. We don't know this fine legal language and we are not very well equipped in this lobbying business. And there is something in the good faith act that gives a strange definition to bad faith. Bad faith is only an act of coercion. If I shoot you, it is not a crime. If I threaten to shoot you and then shoot you, it is a crime. The proofs necessary for the plaintiff through the good faith act emasculated the bill, destroyed it, demolished it, and we have so much bad law on the books that I'm afraid to go near a court with a good faith action.

We have heard a lot about franchises wanting a part of what the franchisor owns. Rest assured, I covet nothing that John Riccardo, the president of Chrysler or any officer or stockholder of Chrysler Corp. has.

My only request is that they should not covet anything I own. If I produce something of my own labor, admire my production. If I fail this free enterprise system has a price for failure. It is called bankruptcy.

I'm willing to pay that price and I'm willing to compete in this marketplace, but for crying out loud, give me the opportunity. I would like to close by referring to two portions of section 4 of the bill, and I guess you know by now that our organization supports this legislation.

Senator Moss. I gathered that.

Mr. COHEN. There are current laws in 23 States that do offer some franchise protection. Some are even stronger than the legislation you are proposing. I would hope that the passage of this law would not preempt that State legislation. But the route of going State by State is impossible. If you think they lobby down here, on the State level they are murder.

And you mention the study by the FTC, an agency who has many people I respect. You notice I said "people."

In section 4, reference is made to a proposed study by the FTC. A 1939 report of the FTC on GM found that through their Motors Holding division, GM was effectively dominating the retail market in competition with their own dealers. I cover this in my statement.

As of now, some 36 years later, the situation still exists. The FTC appears to be burdened with more than they are capable of handling at the present time.

Any additional task would be of very questionable value. I want to thank you and your staff for the opportunity to present my testimony.

If you have any questions in the next 2½ minutes, shoot.

Senator Moss. Thank you, Mr. Cohen. That was an excellent presentation.

You are a very articulate man and I understand why Cohen's has built a good business there. I don't think it will be a burden on your son should he want to take over.

Mr. Reese, we are glad to have you. I don't know if you want to make a comment here.

Mr. Reese. I would like to.

I was struck by the testimony of Mr. August Bequai and Mr. Cohen could take up the rest of the afternoon by telling you all of the trips he has made to Government agencies and furnished them with similar information, only to have them shake their heads, take it under advisement, and accomplish absolutely nothing.

It is a sad reflex on our democracy when this information is furnished to them, voluntarily, and they listen patiently and politely and while they don't flatly refuse to do anything, there are no results that ever come from it.

I only wish this committee could avail upon Mr. Cohen at a future time to provide them with this information. I am sure it will startle you. It will be a revelation, and you will perhaps find it difficult to believe some of the things that have happened to him in these various trips down here which must run into a great deal, and the net effect is to accomplish nothing except provide the Government with the information to no avail.

Thank you, sir.

Senator Moss. Thank you for making that statement.

That does give us some concern. Besides the obligation to legislate, we have the oversight function in the Congress. We should be exercising that to look at governmental departments if they are indeed not carrying out the mandate that they have by reason of the legislation.

We will look into that, dig in as much as we can. We may want to have a time when Mr. Cohen can have all day and doesn't have to be his son on the bench waiting to win the game in the last 5 minutes.

I certainly do appreciate your articulate presentation of this matter. You brought us back to what I was trying to find out from some of the earlier witnesses, whether or not this thing is so rigged in the differential of power that we have to do something.

Of course, the early witnesses felt it was not unbalanced and you have presented a point of view that it is very much unbalanced. Yours deals with automobiles primarily. But it seems to me that we have witnessed such a disparity of power there that it amounts to control.

Mr. Cohen. I agree.

Senator Moss. If it is control, then that is something we ought to break, if indeed we believe in a free enterprise system.

I find a lot of people give lip service to free enterprise, but when it comes to applying it, they are not so anxious we keep it free and open. I got my bells and we have finished.

Thank you very much.
[The statement follows:]

STATEMENT OF INDEPENDENT DEALERS COMMITTEE DEDICATED TO ACTION

The concentration of economic power in the United States stands as major threat to the continuation of the free enterprise system. New entry in major industrial enterprises has effectively been eliminated. To further aggravate the situation conglomerates have appeared on the scene, and after absorbing smaller successful ventures, have moved in on large publicly held corporations.

The American dream of entering into business has all but been eliminated. If there is one area where a glimmer of light still exists it is in the field of franchising.

Franchising falls into two categories. The initial category would be in a field represented by such products as automobiles. Here a group of manufacturers desired to distribute their product by establishing independent merchants who would stock product, offer after market services, including warranty, maintain a sufficient supply of parts, and independently promote the sale of product through advertising so as to insure a retail market for such products.

The second, and comparatively recent franchising concept, is represented by such entries as McDonalds, Burger King, Dunkin Donuts, Carvels, etc. In these arrangements an idea man without sufficient financial wherewith all in the formulative stages, has promoted a marketing concept. The trademark instead of representing a product per se, represents a method of collectively, through franchising, of promoting a product idea.

In both instances a major contribution to the success of the franchisor is supplied by the franchisee. In return the franchisee has been led to believe that he is an independent businessman and will share in all the rewards as his efforts make possible. There is no question as to the interdependency of franchisor-franchisee in a continual successful relationship.

Franchisors have tended to play down franchisee's contribution. Old trademark law clouds the issue by only recognizing the rights of such trademarks. New law has not been promulgated so as to take into consideration facts that have emerged since the original trademark laws were enacted. The bill before this committee today appears to be the first glimmer of light in this important area.

As representatives of franchised new car dealers I.D.C.D.A. will present the views of only the first category of franchises. We would hope that the position of fast food and service franchisees will be presented by representatives of these franchises so as to shed light on the problems relating to them.

New car dealers employ literally millions of people in carrying out the duties of their franchise. From the ranks of these come future independent businessmen in auto agencies, repair shops, gas stations and other related ventures too numerous to describe. These citizens of our country will contribute to the growth of a concept that has made this Republic more industrially productive than any other nation in the world. To put it into one succinct-phrase Americans are working fools. We spend more time collectively enriching mankind than any other people. This is accomplished through the American Dream, be on business and be your own boss.

Auto franchises have offered such opportunities to millions since their inception. What has been gained by the franchisors? Allow us to list but a few: (1) A national distribution system for the merchandising of product: (2) Relief from supplying and supervising personnel to accomplish marketing and servicing; (3) Relief from negotiating thousands of organized labor contracts throughout the fifty states; (4) Controlled non-negotiable prices at wholesale for their products; (5) Assistance in promoting through dealer paid advertising (in addition to their own) of products they sell; (6) A buffer between manufacturer and consumer to handle problems created by products they produce; (7) The payment by franchises of substantial financing cost for inventory in the field (all vehicles are paid in full to the manufacturer before he swings open the gates); (8) Billions of dollars in insurance costs assumed by the franchises; (9) The use of billions of dollars withheld from dealers

in what is termed as dealer holdback for a period of one year[1]; (10) Retail license cost and compliance with municipal and states laws as they relate to retailing.

These are but ten examples of literally hundreds of benefits that accrue to the Automotive manufacturer through the franchise system.

In the past, when legislation attempting to accomplish some of the goals of S. 2335 has been proposed, auto manufacturers have stated that dealers did not pay fees for the franchise. That the product represented by the Trademark was the only thing of value being offered and therefore dealers were not responsible for the success that they achieved. That the franchise was a privilege with sole rights to grant or continue such relationship the exclusive right of the franchisor. The listing of the ten benefits to the franchisor represents the highest franchise fee paid by any group of franchises in the nation.

The question now arises why are franchisees calling on the congress to forge new ground and offer to millions of Americans equal protection under law? Abuse of power is the straightforward answer. Auto manufacturers have been guilty of callous and wanton disregard for the rights of others.

A prime example of the previous statement is the just recently signed five year dealer agreement as presented to its dealers by the General Motors Corp. A dealer with his entire lifes efforts and material rewards faced loss of both on this sign or else document. The or else was to go out of business and retrieve maybe ten cents on every dollar of true assets. The five year term is so designed as to intimidate and subjugate each and every GM franchisee.

Ford Motor Company displayed similar arrogance when they incorporated in their agreement that the franchise renewal with many terms changed, was being signed with the full will and accord of the franchisee.

Chrysler Corporation when introducing foreign entries notified their dealers that they were eliminating a clause in the dealer agreement which granted the dealer the right to distribute such products. When called to their attention that this was a violation of the agreement they pointed to a never before used clause which in essence stated if we do similar injustices to all, the action is perfectly legal. The true reason for taking this action by Chrysler was to remove the just rights of some franchisees and then reward those chosen few.

AMC the smallest manufacturer, who should really know better, has displayed similar disregard for human rights. Each and every time they achieve the slightest success they flex their muscles and use mal distribution of product as a tool to eliminate those they no longer desire.

There could be little credence to any document on the need for new legislation without a few concrete examples of the abuse of power and disregard for human decency by franchisors.

The Chrysler franchise agreement sets a sales performance standard which automatically grants Chrysler the right to cancel a franchise agreement of at least fifty percent of its franchisees at all times. Robert Lutz doing business under the name of "Swift Dodge" in Kansas City, Missouri found himself in just this situation. He was terminated for failure to meet minimum sales responsibility.

Chrysler's formula takes the amount of vehicles that all domestic makes register in a given area. It then divides the number of Chrysler vehicles registered in a similar area and comes up with their percentage of the market. Through some inexact science they come forth with an individual dealer responsibility and through this method more than fifty percent of their dealers are currently in violation of their sales agreement.

Mr. Lutz was in a market in which Chrysler controlled distribution and sales through directly owned factory branches. These branches delivered the majority of Chrysler registered vehicles. They functioned at extremely high financial losses and received preferential scheduling on hot models and acted as dumping grounds for unwanted merchandise. This committee need only

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[1] Auto manufacturers withhold 2 or 2½ percent of dealer discount and pay this on a yearly basis. GM and Ford withhold 2% of the entire invoice including accessories. Chrysler withholds 2½% of the base price of the vehicle excluding accessories. In some instances of hardship Chrysler will release these monies on a quarterly basis. GM will not. During the last GM strike dealers in financial straits requesting their withheld funds received a flat refusal but were offered the right to borrow against their own money from GMAC at prevailing GMAC interest rates.

examine the preceding five 10K reports filed with the S.E.C. by Chrysler Corp. to substantiate the extremely heavy financial losses sustained by Chrysler's wholly owned retail outo dealerships.

Robert Lutz although not extremely profitable maintained profits in most years under this untenable situation of his manufacturer competing in the marketplace with him without regard to retail profits. This case has been in the Federal Courts for almost two years and as time goes on Lutz's remedy under law will be lost by a financial dwarf facing even this weakened financial giant.

Chrysler has argued that their former Dealer Enterprise Division renamed Market Investment Development is meant only to allow new entry into the franchise system to qualified individuals without financial resources. Allow them to tell Mr. Aratari of Rochester, New York this fairy tale.

Mr. Aratari was a highly successful used car manager for a well established Buick dealership in Rochester. One day he was approached by a Chrysler Dealer Enterprise specialist and asked how would he like to be a dealer. There are few individuals, as stated at the outset of this document, who do not desire such an opportunity. The proposition offered the opportunity with a minimum investment of thirty-five thousand dollars.

The proposed location for the dealership was an already established dealership in which Chrysler Corp. no longer desired to continue the current dealer. They were having difficulty convincing the operator to close so they offered to find him a customer with a proposition that could not be refused. Joseph Aratari became the unsuspecting dupe in this plot.

He could not turn his back on this great American Dream to be his own boss. Aratari put up his thirty-five thousand and Chrysler proceeded on the buy out. They arranged the buy out terms by which Mr. Aratari would enter business. All the prices to be paid for by the new Corporation were set by them. Used cars were purchased while snow covered; parts at full book value although many were obsolete.

The agreement between a DE or MID operator states that Chrysler will control all voting stock of the named Corporation, and that two of the three Board of Directors will be Chrysler employees. Further the operator investment in case of any loss is the first to go and that he can be dismissed after his total investment is wiped out.

In the case of Aratari due to the aforementioned prices paid for assets his investment was lost before he worked at the dealership his first day. On the insistence of the Dealer Enterprise Division, used cars were written down in value two months after Aratari became a dealer; parts shortly thereafter.

Even under these unjust conditions Aratari worked at becoming a successful dealer. He trained salesmen, promoted product, followed the dictates under the guide of expert advice of the Dealer Enterprise Division. As a former sucessful manager he questioned certain moves (the sacrifice of profits for volume) but went along on the personal assurance of the Branch Manager of DE that he was highly regarded in Detroit and even shown another dealership which they would buy and would relocate his present dealership.

Aratari did become apprehensive on his lack of profitability. He expressed this time and time again only to be reassured that the volume he was moving was the name of the game and his rewards would follow.

At the end of model year 1961 Chrysler Corp. was burdened with excess inventory of 1961 vehicles. They had already secured the announcement supply of 1962 orders from Aratari. One week later they came in to inform him that he would be shipped an additional amount of 1961 Dodge cars. He balked stating that he was already over inventoried on 1961 cars and had already ordered a considerable amount of 1962 vehicles. After he refused to bend he was told to accept them whether he liked it or not. He rejected this argument.

After that it was all down hill. He was no longer Detroit's fair haired boy; he was criticized, threatened, harassed and otherwise abused. The new location he was promised was secured but he never was considered. Finally he was terminated for not meeting minimum sales responsibility.

Aratari secured an attorney. For some reason, not made clear, the attorneys for Aratari permitted the Statute of Limitations to run out on a Federal action.

After going to a new legal firm of a public minded lawyer, Aratari did file an action in State court. His action prevailed and a jury awarded him ap-

proximately $102,000. Because of the protracted litigation and the cost of such actions, it is greatly doubted whether the judgment helped Aratari recover his initial $35,000 loss.

These cases graphically illustrate that current remedy under law is not sufficient to protect the rights of small businesses, namely franchisees, against the giant Oligopolist. The right to continue in business while litigating is totally essential so as to allow a franchise to sustain a legal action. Unless irrefutable proof that material damage would occur to the more dominant power, the franchisor in this case, the agreement should be continued until such time as the courts are able to make a full and proper disposition of any action. The recognition of the comparative size of the adviseries in any such action must be acknowledged and the usual standards for injunctive relief must be expanded so as to bring law and justice in balance.[2] We would like to see this more clearly spelled out in S. 2335.

A further need for the proposed legislation can be found in the following illustrationn. GM presented a new five year agreement to their dealers sixty days before the expiration of the preceding agreement. The terms were in no way open to negotiation. It was presented on a take it or leave it basis. What were some of the new changes?

1. Dealers would be required to enter into the rental and leasing of cars at GM's discretion.
2. Dealers would participate in all GM promotions.
3. Dealers would be responsible for any employee's fraudulent misconduct whether he was aware of it or not.
4. That certain facility standard would be maintained. (This was to keep dealers from taking on competitive lines, an evasion of the law on exclusive dealings.)

These are but four of many changes and variations. GM answered their dealer critics by stating that it was in reality the same agreement somewhat tightened in language. Sales people put out the line that this was a document of the legal department and financial people. They were setting up the good guy/bad guy technique. There is only one Corporation responsible for this oppressive document and it includes everybody from Chairman Murphy down.

Simultaneously with the N.A.D.A. (National Automobile Dealers Association) convention General Motors released a letter to their dealers explaining a few of the more restrictive changes in their franchise agreement. This gift to the ascendancy of John Pohanka, a GM dealer, as President of N.A.D.A. was hailed by the forementioned organization as a major accomplishment on their behalf with strong legal standing in a court of law. Legal counsel for I.D.C.D.A. regards the letter as having little or no legal standing. To begin with in no way does it rescind any of the oppressive terms or are they modified in any fashion through explanation.

GM Dealers across the land were given little choice as to their destiny. Either they risk losing sizable investment, obtained through working long almost unbelievable hours, or they follow the more prudent path of signing.

I.D.C.D.A. supports the proposed legislation but asks that some reconsideration be given in the Title IV portion.

There are current laws in some twenty-three states that offer some protection to auto dealers and other franchisees. If the current legislation were to pre-empt that legislation, it would limit the value of S. 2335.

Under uniform code this would void many state licensing laws. In some way this should be avoided.

Further in Section 4 reference is made to a proposed study by the Federal Trade Commission. A 1939 report of the FTC on General Motors found that through their Motors Holding Division GM was effectively dominating the retail market in competition with their retail dealers. As of now, some thirty-six years later, this situation still exists.

The FTC appears to be burdened with more than they are capable of handling at the present time. Any additional task would be of very questionable value.

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[2] Judge Sylvester Ryan in Semmes vs. Ford Motor Co. did in a written opinion express this view.

We appreciate the opportunity of appearing today and further appreciate the effort of this sub-committee in responding to this urgent need of franchisees. If there are any question as to our testimony, we would be glad to respond.

[The following information was subsequently received for the record:]

CHEVROLET MOTOR DIVISION,
GENERAL MOTORS CORP.,
February 2, 1976.

To All Dealers for Whom Chevrolet Has Business Management Responsibility:

A few short months ago, Chevrolet and its dealers executed new Dealer Sales and Service Agreements effective for a 5-year period beginning November 1, 1975. In the weeks that followed, certain questions were asked about the Dealer Agreement.

In the Productivity Meeting held in your Zone on January 20, my filmed remarks included a brief discussion with the past and present National Dealer Council Presidents, Van Gates of South Bend, Indiana, and Warren McEleney, Clinton, Iowa, covering certain aspects of the new Dealer Agreement. In the Chevrolet National Dealer Council meetings during that week, the meaning of certain provisions of the new Dealer Agreement were thoroughly reviewed. In the near future, you will receive copies of these minutes which will set forth our discussion of these provisions.

As you are well aware, General Motors has made considerable investment to meet consumer needs in this critical time and the immediate future. This is being done to enable General Motors and its dealer organization to fulfill, better than ever before, the transportation requirements of the public. We are mindful that General Motors dealers are likewise investing in the future and share our common purpose. To accomplish our common objective, it is imperative that General Motors continue to respond to the rapidly changing demands and needs of the motoring public. It is equally important that we have strong dealers with similar capabilities.

When we drafted the 1975 Agreement, we had in mind not only the necessity of fostering the growth of General Motors Corporation but also the need to continue to build and foster a strong and lasting dealer organization. The Dealer Agreement is a marketing tool which provides the means of not only accomplishing these mutual objectives but also protecting and enhancing our respective investments. For example, the succession provisions in the new Agreement set forth the means by which dealer operators and owners may protect the investments they have made in their dealerships and the means by which to provide protection for their families.

In our discussions with dealers, the desirability of a booklet in layman's terms, of the successor provisions became apparent. The attached booklet may be referred to with respect to personal estate planning and explains these provisions and contains examples as to how the provisions operate. If you have questions about succession after you have matched your intentions in this respect against succession documents you may have already executed, consult your Zone Representative for assistance.

In addition, some questions have been raised with respect to certain other provisions of the 1975 Dealer Sales and Service Agreement. Some of these questions deal with provisions that have been in prior Agreements as well as in the current Agreement. We would like to take this opportunity to address those questions of primary concern and set forth the policies that will guide General Motors with respect to how it intends to apply these provisions.

What is General Motors intent with respect to provisions in the Agreement concerning a dealer's participation in advertising and promotional programs?

It is not the intent that a dealer has to participate in each and every advertising and promotional program offered; and the Agreement does not so state. The intent is that a dealer participate to the extent necessary to fulfill its obligations under the Agreement. The availability of these programs is just one element in assisting dealers to provide satisfactory sales and service performance and if a dealer does have unsatisfactory sales or service performance, one cause could be the lack of advertising and promotional programs. These programs are intended for use only where appropriate and only

in line with the normal operations of the dealership, e.g., it would be inappropriate for a dealer that "wholesales" most of its used cars to participate in extensive used car advertising and promotional programs.

What is General Motors intent with respect to dealers participating in leasing and/or rental business?

The Agreement indicates that as additional opportunities are apparent, the dealer should engage in the rental and leasing business. This is simply a matter of common sense. If the opportunity is there and this opportunity is being seized by competitors, it would appear that as a matter of good business sense General Motors dealers would likewise choose to participate in this segment of business activity if it will enhance the dealership operating profit.

What is General Motors intent with respect to termination on the basis of misrepresentation, submission of false or fraudulent application or claim, or on the basis of a dispute among dealer principals?

The preamble to the section of the Agreement which enumerates the foregoing bases for termination explains that these are the types of acts or events which are so contrary to the spirit, nature, purpose or objectives of the Agreement as to warrant its termination. This language clearly sets forth the standard by which the enumerated acts or events if they occur will be measured. Namely, that the aforementioned acts or events will, when they are so contrary to the spirit, nature, purpose or objectives of the Agreement, warrant its termination.

A slight or insignificant deviation resulting from an honest mistake would not result in termination under these provisions of the Agreement.

Although not incorporated in the Agreement, General Motors internal procedures provide that no terminations under this section may occur until the circumstances in the particular situation are discussed with the dealer and are thoroughly reviewed by Divisional Field and Central Office Sales Management as well as Corporate Management.

Does General Motors have the right to terminate the Agreement because of fraud by a dealer employe even though the dealer principal was unaware of the practice?

Both the new and previous Agreement recognize (a) the right of the Divisions to terminate the Agreement because of fraud, as well as (b) the fact that the dealer principals are responsible for the acts of their employes. No change has occurred between the old and new Agreement in this concept. Fraud by its nature in most cases is a conscious wrong doing or occurs when a party negligently permits a certain conduct to continue. Under normal business conditions, efficient management procedures should guard against such activities, i.e., good accounting and operating procedures should uncover such practices.

With respect to an employer being responsible for the acts of his employe, such liability has existed, of course, since the early common law. The reference to this principle with more specificity is merely to reiterate this responsibility with greater emphasis.

A slight or insignificant deviation resulting from an honest mistake would not warrant termination.

The act or event must be so contrary to the spirit, nature, purpose or objectives of the Agreement as to warrant its termination.

What were the reasons for modifying the provisions in the Agreement dealing with the death or incapacity of a dealer principal?

(*a*) The 1970 Agreement could be terminated due to the incapacity of any person named in Paragraph Third. It was felt that this was an unnecessary, and too encompassing a provision because some Dealer Owners are not active in the management of the Dealer entity. Here our intent was to be more practical and use criteria tied to the management of the dealership and, accordingly, the 1975 Agreement may be terminated upon the incapacity of the Dealer Operator, and not upon the incapacity of a Dealer Owner.

(*b*) The 1970 Agreement provided that the Agreement may be terminated in the event the Division determines that any person named in Paragraph Third is totally and permanently incapacitated. It was believed that this terminology could be improved by applying a more clear and objective standard: a standard that fully recognized the significance of the personal service concept. Accordingly, the terms "totally and permanently" were deleted. In-

stead, the criteria under the new Agreement are tied directly to the operating management of the dealership and provide for termination if the Dealer Operator is so physically or mentally incapacitated as to be unable to actively exercise full managerial authority for the operating management of the Dealer.

Here again, no termination will occur without a review by Divisional Field and Central Office Sales Management as well as Corporate Management. The effective date of any such termination is not less than three months after notice to the Dealer, and to facilitate on orderly transition, the Agreement provides for a further deferment if requested by the Dealer.

Does General Motors approve or disapprove the addition of a new line of cars at a General Motors dealership?

The response to this question is set forth in Mr. Estes' letter to all General Motors Dealers dated July 21, 1975 wherein it was stated in part:

"There are no provisions in General Motors Dealer Agreements, and there is no General Motors policy or practice, to prohibit a General Motors dealer from handling competitive products. A dealer has the right to sell and distribute other products, and Divisional representatives should neither question nor interfere with that right. Whether the profit return to be expected by handling other lines justifies the additional investment required is an economic question which the dealer must answer and which determines the dealer's decision on this subject—not any policy of General Motors.

At the same time, a dealer handling another line of cars or trucks must have and maintain adequate resources and capacity in capital, facilities, manpower and management to discharge the sales, parts, and service responsibilities under our Dealer Agreement."

Do any of the provisions of the Agreement place it in direct conflict with state legislation?

Neither the Dealer Agreement nor any of its related documents are in conflict with state laws, but rather provide for the application of such state laws where appropriate. The Agreement specifically stipulates that whenever a provision contravenes applicable State or Federal law, the law will prevail.

What was General Motors intent in including provisions in the Agreement obligating dealers to disclose if an item installed in a new General Motors vehicle is not manufactured by General Motors and that General Motors does not warrant such item?

These provisions are in line with the full disclosure concept of consumer protection requirements encompassed under the federally enacted Magnuson-Moss Act. The provisions in the Agreement recognize the intent, both expressed and implied, within the Act of disclosing what the warranty on a given product covers and what it does not cover. This new requirement is in keeping with the continuing efforts on the part of both General Motors and dealers to remain sensitive to consumer interest.

Chevrolet is proud of its franchise dealer organization, and rightly so; however, a franchise system is only as good as the aggregate of all the franchise holders. It should be apparent from our answers to the above questions that it was our intent to write a Dealer Agreement which would assure that the Chevrolet dealer organization will continue as the standard of the industry. Both Chevrolet and the Chevrolet dealer organization have an immense job to do to continue successfully in this extremely competitive business. As a team, we will move forward to make the most of the great opportunities of the future.

Very truly yours,

R. E. Cook,
General Sales Manager.

Senator Moss. We are now in recess.

[Whereupon, the committee was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

SPEAR BEVERAGE CO.,
Portland, Oreg., March 22, 1976.

Hon. WARREN G. MAGNUSON,
Chairman,
Senate Commerce Committee.

DEAR SIR: This statement is sent to you with the fervent hope that there will be something in it that will assist your committee in making the type of decisions that will insure the survival of small business in this country.

Our company had been a Hamm's wholesaler since 1959 enjoying good times, enduring lean times and working with three separate owners through these years. When news of the Hamm's purchase by Olympia was announced, I was elated as this seemed to mark the end of fiscal and marketing problems that had plagued the brand for years. Further, Olympia was oriented to the Pacific Northwest, cognizant of our specific problems and seemed at the time to be the perfect company to restore the Hamm's label to its former position of prominence in the brewing industry.

On March 13, 1975 two Olympia representatives spent most of the day at my warehouse and they seemed to be impressed with the operation making special note of our A.D.P. department which is fairly sophisticated for a company of our size. I feel that these people were sincere and honestly felt that their observations and reports would be heeded by their superiors at Olympia. In any event, I made several important fiscal committments that had been pending because of the favorable response of those representatives and my confidence in a future that looked promising now that a viable company was in control of my main brand of beer.

On April 12, Hamm's distributors in several states in the Northwest were terminated en-masse. My letter started, "Gentlemen"; it was not even addressed to me personally.

That is the background; now I would like to submit a few points of interest:

1. On an annualized basis that letter to "Gentlemen" containing "effective immediately" took $1,300,000 in gross annual sales or $300,000 gross annual profit from my company. That gross dollar volume represented 40% of my total beer business at that time. I immediately looked for other brands to replace this lost business and was able to buy a lesser selling brand although at considerable expense. This new label made up only about 40% of our lost sales so at summer's end I had no alternative but to let go 3 route drivers, and later 2 warehousemen and 2 over the road drivers. Thus most capital investment and expense dollars spent in anticipation of a resurgence in business has largely been wasted. For instance, even now I have three trucks valued at $45,000 standing idle. Ten Hamm's trucks had to be re-painted at an average cost of $600 each. I have had to sell a small branch operation because it was hopelessly unprofitable without the Hamm's and another branch is in the same situation with little hope of relief in the near future.

2. It has been brought to my attention that some say Hamm's distributors lost nothing because the brewery would have gone out of business anyway. Not so. While it is true that the brewery could not have survived, it is not true that no one was interested in purchasing the label. After all, Burgermeister was purchased by the Pabst Brewing Company and there is no doubt in my mind that a still viable brand such as Hamm's was at that time, could not have sold to someone other than Olympia, but remember that at the time, the Olympia Brewing Company was by far the most appropriate and logical purchaser in the eyes of the Hamm's principals.

3. I could go on but want to make only one more point. Any supplier has the right to expect maximum efficiency and sales effort from its' distributor. Any supplier therefore has the right to criticize and make suggestions as to how their distributor can increase sales and marketing penetration and I wouldn't have it any other way. I am not looking for a free ride or a fran-

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chise cast in bronze for all eternity regardless of the job my company does. But I ask you Mr. Chairman, how can my small company or any other around this country, invest in inventory, make capital investments, stake our reputation on a product in an industry that is very personalized when we do business in an environment that allows immediate termination without compensation.

Sir, thousands of us ask—no, plead for your help in passing legislation that will provide some protection from imperious and arbitrary acts on the part of our suppliers. If such help is not forthcoming, and indeed this savage and unfeeling act of Olympia is allowed to stand, would you please tell me what my business is worth if any supplier can terminate me "effective immediately".

Most Sincerely,

PHILIP J. SPEAR,
President.

INTERNATIONAL FRANCHISE ASSOCIATION,
Washington, D.C., March 23, 1976.

Hon. WARREN G. MAGNUSON,
U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: On March 9, 10 and 11, the House Consumer Protection and Finance Subcommittee conducted hearing on H.R. 8349, the "Franchising Practices Reform Act" which is virtually identical to S. 2335, the "Fairness in Franchising Act" which you have co-sponsored. Because these bills are of critical importance to the members of the International Franchise Association (I.F.A.), which opposes the bills, I would like to briefly explain to you the results of those three days of hearings and relate to you the comments of some of the agencies and organizations that have written the House Subcommittee concerning the bill. Enclosed is a directory of franchising companies that make up I.F.A. membership.

I would particularly call to your attention the fact that every agency of the Federal Government which either appeared or submitted a statement for the record, has opposed the bill. This is especially noteworthy in that these agencies have been charged by the Congress with the responsibility of protecting free competition and the consumer.

The Federal Trade Commission appeared before the Subcommittee, represented by Acting Chairman Paul Rand Dixon. The Commission criticized the broad definition of the term "franchise," and said that even with a more restricted definition, "* * * we believe that it may be particularly difficult to legislate a uniform solution to the problems in the franchise termination area due to the many conflicting interests, ambiguous terms and varieties of business situations involved therein."

Mr. Dixon singled out the bill's apparent requirement for perpetual franchise agreements and noted, "it would probably create inefficiencies in the market place more costly than any likely benefit." After raising the possibility of legislatively imposing a minimum term for all franchise agreements, Mr. Dixon admonished, "any selection of a specific time period would be arbitrary. For instance five years might be too long for some franchises and too short for others to provide a reasonable time in which the franchisee could recoup his investment."

The Acting Chairman also attacked as "speculative" the bill's requirement that franchisees be compensated for lost good will when their franchises are terminated or not renewed.

A letter from the Antitrust Division of the Justice Department to Chairman Harley O. Staggers warns that the bill "would raise significant competitive problems. Moreover, we have some doubts as to the likely effectiveness of the Bill in redressing problems of unequal bargaining power between franchisors and franchisees. These problems are exacerbated by the vague standards employed by the legislation, which would encourage litigation whenever a franchise is terminated or not renewed."

The bill would create substantial cost to the economy, the letter continued. "To the extent that the bill may * * * lead to the retention of incompetent

or inefficient dealers, it can interfere with the efficiency of distribution and lead to higher costs for consumers."

"The Bill may even have the effect of operating against the interests of franchisees in general by reducing a franchisor's willingness to appoint franchisees. A franchisor who is aware of the costs and difficulties of terminating franchises under this legislation might be reluctant to make future arrangements."

The Department of Commerce opposes the bill as "an unnecessary intrusion by Government into the business relationships of franchisors and franchisees" which have the "undesired effect of restricting the grant of franchises."

In particular, the Commerce Department examined the provisions requiring 90 days notice to cancel, terminate or fail to renew a franchise in all but two situations. "In our judgment," the letter reads, "there is not any viable method of legislating in an advance notice requirement of any specific duration without creating inequities either for the franchisor or the franchisee." The Department also criticized as unfair and highly discriminatory those provisions of the bill which shift the burden of proof to the franchisor and require him to pay the court costs and attorney's fees of a successful franchise litigant.

Government agencies were not the only opponents of the bill. So too were groups such as the United States Trademark Association, the New York Patent Law Society, the U.S. Chamber of Commerce and the Foodservice and Lodging Institute. Of course the bill is also opposed as unnecessary and unworkable by the International Franchise Association. And it was opposed by franchisees who thought it contrary to their best inerests. From the record you will find that the witnesses from the private sector who testified before the Subcommittee in favor of the bill all belonged to the National Franchisee Association Coalition. During a full afternoon of hearings, they were frequently urged by the Committee members present to describe the franchisor abuses that made the legislation necessary. The only alleged abuses they could identify were isolated examples which were either violations of existing contract law or the Federal antitrust laws. Remedies were already available.

The tenor of the proponents argument was most clearly manifested by the Chairman of the N.F.A.C., Mr. Richard Frankel. He told the Committee that with an investment of $25,000 in 1959, he became a McDonald's franchisee, that today he owns 24 McDonald's franchises, has a net worth of $2.5 million, and that he supports the legislation because of, in his own words, "greed." Mr. Frankel did not feel threatened with termination of his franchises, he wanted Congress to enact a law that would gurantee to him that he would only have to pay 1959 prices for new franchises granted him 20 years later in 1979.

In conclusion, the record reveals a lack of need for legislation in the area of franchise termination and renewal, the absence of abusive practices by franchisors, and a proposal which is detrimental to franchisor and franchisee. It would inhibit competition and present consumers with a lower quality of goods and services. And it would deprive many people with marginal financial resources, but promising ability, the opportunity to become a franchise owner.

I am confident that as you prepare for hearings on S. 2335 that you will fairly consider the evidence which has already been presented, and that you will evaluate your support of S. 2335 in light of that evidence. We think that this measure has been thoroughly discredited, and we would welcome the opportunity to meet with you at your convenience to discuss the bill and franchising.

Sincerely yours,

JERRY H. OPACK,
President.

JERRICO, INC.,
Lexington, Ky., March 29, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: Because of the significant adverse impact S. 2335 will have on many aspects of franchising undertaken by our company, we are

corresponding with you to voice our concerns regarding S. 2335 and the detrimental impact it would have upon our business if enacted.

For your information, Jerrico, Inc. has been in the food service business since 1946. Jerrico is concerned not only with franchising but with food service as a profession, a management orientation that underlies Jerrico, Inc.'s entire corporate philosophy. Jerrico has both company-owned and franchised Jerry's Restaurants which may be described as a coffee shop format offering full-service family dining. In addition, Long John Silver's, Inc., a wholly-owned subsidiary of Jerrico, Inc., has both company-owned and franchised Long John Silver's Seafood Shoppes which offer a variety of seafood menu items at economical prices. Jerrico, Inc. and Long John Silver's, Inc. are currently operating in approximately 34 states.

We have many serious concerns about the impact which S. 2335 will have upon our operations in general and franchising, in particular. The bill would prevent franchisors from terminating franchisees after the original contract has expired, except under extraordinary circumstances. By requiring this new and unprecedented type of commercial relationship, the bill will have the effect of reducing competition and will unfairly penalize both the franchisor and the franchisee.

The bill should be rejected for a number of legitimate, business and legal reasons which we will attempt to summarize. No evidence of abuses in the franchising industry exist which require or call for the harsh and punitive remedies as set forth in the bill. Even if certain abuses do exist as caused by a very few irresponsible franchisors, these abuses are already subject to adequate existing law, if appropriately enforced, such as state statutes, contract law and antitrust law.

Even assuming that certain abuses exist (usually found in "dealer" arrangements) which would indicate a need for federal legislation, those practices are isolated in a very few industries. We would suggest that those practices should be corrected by legislation dealing with only those industries. Many states, as well as Congress, have taken this more responsible course of action (e.g. the Automobile Dealer's Day in Court Act and petroleum legislation which has passed the Senate). S. 2335 proports to treat all franchising alike, which ignores the total lack of abuses in the vast majority of franchised industries. The bill would lump together short-term and long-term arrangements, products and services, and a wide range of other quite different forms of business relationships. Franchising takes many varied forms and deals with a wide range of services and products and, in our view, cannot be dealt with in a bill which ignores these and other most important facts.

In addition, the bill would make it difficult, if not impossible, for the responsible franchisor to terminate a franchisee, even if the franchisee is engaged in practices which are in direct violation of their franchise agreements. Such a provision will prove dangerous and damaging to the franchising system which has proven so successful, and will likely prove detrimental in many cases to the consuming public. The bill is detrimental not only to the responsible franchisor but also to innocent franchisees whose personal franchise investment is at stake.

The bill as drafted would require a franchisor to enter into a new agreement with the franchisee upon the termination of the original term, without any regard whatsoever to the length of the original term or the profits which the franchisee may already have earned. Such a requirement which neither party had bargained for could even be mandated to be on far different terms than those which the franchisor is now offering and would have the effect of creating two different and inconsistent marketing systems. Such a disparate effect would be contrary to the original intent and desires of the parties and likely contrary to the dictates of good business judgment. Such a requirement is without precedent in any other commercial relationships of which we are aware, and would be imposed upon the franchisor under this bill unless the franchisor was successful in persuading a court that it should be relieved of such a burden.

From a legal viewpoint, the bill will raise a number of legal questions and court tests. A number of recent court decisions cast doubt upon the constitutionality of many of the provisions of the bill. These questionable provisions include its apparent retroactivity and its classification of one form of business

as the object of discriminatory legislation. Further, the bill would require a court to interpret the vague provisions of the bill in a business rather than legal context. For example, what is an "essential" or "reasonable" provision of a franchise agreement? To place such a requirement of interpretation on the courts will most likely result in a wide range of varying interpretations in different courts.

We are amazed and seriously concerned with the disparate treatment to be afforded the franchisor and franchisee under such a bill. The most classic example of this disparity is clearly seen in the provision which would allow a franchisee who brings suit against a franchisor and loses, to possibly be awarded costs and attorney's fees. We are unaware of such special treatment available in any other area of our judicial system. Further, when such a suit is initiated, the burden of proof would shift from the franchisee plaintiff to the franchisor defendant, resulting in an unjustified shifting of the risks, costs and burdens of litigation. In the areas above mentioned and others, the bill is clearly and fundamentally inequitable and constitutes a marked departure from all other forms of commercial relationships.

As you may be aware, the most widely accepted and most effective form of protection which can be afforded to franchisees to avoid overreaching by franchisors is the requirement of full, fair and timely disclosure by the franchisor to a prospective franchisee. This logical and more responsible approach has been adopted by at least eleven states and is being currently considered by others. This approach incorporates the use of a Uniform Franchise Offering Circular which continues to be refined and improved by the various state regulatory agencies. The disclosure approach has also been adopted by the Federal Trade Commission by its trade regulation rule as originally promulgated in 1971. This rule has been the subject of extensive public hearings and comments and has been repromulgated in 1974. As we are sure you aware, the Commission has not yet formally adopted the rule. We submit that it is certainly inappropriate and inconsistent for Congress to now venture forth with an entirely different approach when the principal method of regulation (delayed only by the inaction of the FTC), has not yet had an opportunity to be proven as adequate.

In summary, responsible franchising represents one of the few remaining real opportunities for thousands of small businessmen to retain a large measure of independence while greatly enhancing their prospects of business success. If seriously detrimental legislation in the nature of S. 2335 is enacted, many responsible franchisors will be forced to discontinue franchising as a practical method of distribution and growth. Rather, those franchisors will expand through company-owned stores and choose to remain vertically integrated. As a direct result of such legislation, a proven and rare opportunity for small businessmen will very quickly disappear to the ultimate detriment of our economy, our system of free enterprise and the consuming public, all of which currently benefit from the range of choices which the franchising system now offers.

We respectfully request that these observations be given serious consideration as you and other members of Congress attempt to responsibly evaluate the need for federal legislation in the franchising area. If legislation is ultimately found to be needed, we submit that S. 2335 is certainly not the appropriate vehicle for such legislation.

Sincerely,

CURTIS L. WILSON,
Counsel.

PAYLESS CAR RENTAL SYSTEM,
Spokane, Wash., March 29, 1976.

Re Senate Version of Mikva Bill S. 2335.

Hon. WARREN G. MAGNUSON,
U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: As a businessman from your state of Washington, we question the above proposal which would substantially eliminate one

party's right to choose those with whom he will conduct business. To deny franchisors the right to terminate franchisees which are operating in violation of the agreement not only has a terrible effect upon the relationship of the violating franchisee and franchisor, but can ultimately kill the system.

A company, such as ours, who has no company store, or huge assets to fall back on, would go out of business if legislation such as Mikva's was passed, taking away from us our right to protect ourselves and that of our associates.

We recommend that this bill be rejected.

Sincerely,

L. E. NETTERSTROM,
President.

HILTON INNS, INC.,
Beverly Hills, Calif., March 29, 1976.

Hon. WARREN G. MAGNUSON,
U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: Hilton Inns, Inc. wishes to express its strong opposition to the enactment of the proposed franchising legislation, as embodied in S. 2335, entitled Franchising Practices Reform Act, introduced by Senator Moss of Utah.

It is the conviction of Hilton Inns, Inc. that S. 2335, the Moss Bill, as it applies to our hotel franchise operaton, could result in substantial curtailment of Hilton's present franchising program, as well as the programs of all other nationally recognized companies. We feel the act is premature in that adequate remedies exist under present law, and any inadequacies under existing laws will be dealt with under the eminent Federal Trade Commission Franchising Regulations and the expanded nature and scope of state legislation. Further, the enactment of the Moss Bill imposes severe and unconscionable financial penalties wholly disproportionate to the supposed problems with which it is dealing.

We are advised by our attorneys that equally serious, the Bill is clearly defective on constitutional grounds by reason of the extremely vague and ambiguous standards.

Our specific comments are as follows:

1. The Bill places the franchisor in the unfortunate position of allowing the franchise to recover court costs and attorneys fees from the franchisor even though the franchisee loses the case, and yet on the other hand allowing such an award in the event the franchisee is successful. This reflects a biased and inequitable attitude, and the result could only encourage constant litigation by franchisee at the expense of the franchisor.

2. Section 7(d), by placing the burden of proof on the franchisor to prove that it has not violated the Act, reverses the normal rule of evidence and creates a presumption of guilt which the franchisor must overcome even though the claim is without justification.

3. The traveling public or consumer is adversely effected by certain provisions of the Bill, and could suffer substantially since standards are so vague and the penalties for violation are so stringent a franchisor could not terminate or refuse to renew, even though standards are reduced, rules are not followed, and price gouging prevails. Therefore, quality and standards would deteriorate and the consumer would be provided with standards of service and a product so inferior that complaints would increase a hundred fold.

4. Since a substantial amount of good will of a franchise is created by the franchisor's name, the requirement that on termination, the franchisee be compensated for good will (which is not defined) is unfair and prejudicial.

5. Franchisor would not be able to protect other franchisees who are operating satisfactorily from an inferior franchisee who might jeopardize the credibility of the franchisor's name and, in turn, jeopardize all other franchisees bearing the same name.

6. The Bill would curtail future franchising by the franchisor and small business could not have the benefit of a brand name and proven operating expertise and efficiencies.

7. When a franchisor does have "good cause" to terminate a franchisee, thirty days should be sufficient time and not ninety days as stated in the Bill.

Hilton is of the opinion that legislation on this subject should be directed against the specific industries who are abusing the rights of the franchisees and not against franchising in general.

Respectfully submitted,

GREGORY R. DILLON,
Executive Vice President.

SERVICEMASTER INDUSTRIES INC.,
Downers Grove, Ill., March 30, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: Hearings were recently conducted on the House version (H.R. 8349) of the Moss Bill, S. 2335. Most of the provisions of H.R. 8349 are identical to S. 2335. Of particular significance to you is that all government agencies testifying opposed the bill: the Federal Trade Commission, the Antitrust Division of the Justice Department, and the Department of Commerce. The main reason is that the bill is unneeded and unworkable.

I believe that passage of S. 2335 would severely stunt the growth of franchising as a proven business form in an economy looking for help. I know our company would seriously consider limiting expansion to company-owned branches were we subjected to a law which makes compliance so costly and difficult.

Our Company's objectives require, among other things, that we pursue excellence. To deny franchisors the right to terminate franchisees operating in violation of their license would have a serious and detrimental effect on the quality and standards of services performed under our service marks to the harm of our Company's reputation, our conforming licensees and the consuming public.

We strongly recommend that this bill be rejected.

Sincerely,

C. D. GUSTAFSON,
Secretary and Counsel.

RADIO SHACK FRANCHISE INTERNATIONAL,
DEALER DIVISION,
Fort Worth, Tex., March 30, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: This is to advise of my company's objection to subject bill. Were such a bill enacted, those of us who have employed the franchise method to serve certain categories or markets would be forced to consider further verticle expansion through company units. In our particular case, this would deprive about 1,000 independent businessmen in every state from associating themselves with our company through proven and profitable marketing techniques.

I submit that forced renewal or withdrawal from the market would deprive my company of "due process". We enjoy a most harmonious relationship with over 1260 "Authorized Sales Centers". Yet as numerous as they are, they constitute less than 7% of our gross revenue. We feel our association with our dealers is a mutually profitable by-product resulting from multi-million dollar investments in our 2400 plus company units. Any legislation enacted that would deny a franchisor the right to correct a selection error can only serve to injure those competent, hard working dealers who live within the letter and spirit of our Agreement.

At a time when our country should concern itself with more effective utilization of available capital, S. 2335 would do more than its share to curtail growth. The ultimate loser would be the consumer who, because of the anti-competitive nature of the bill, would be forced to deal with the merchants who may be both disinterested and incompetent.

Very truly yours,

R. R. LYNCH,
Vice President.

WRANGLER WRANCH FRANCHISING SYSTEMS, INC.,
Greensboro, N.C., March 30, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR: It has come to my attention that S. 2335, "Fairness in Franchising Act", will be the subject of hearings by the Senate Committee on Commerce in the near future. I feel compelled to express my opposition to it as totally disruptive to the franchising industry.

As President of Wrangler Wranch Franchising Systems, Inc., a wholly owned subsidiary of Blue Bell, Inc., I have had the opportunity to observe franchising in the retail apparel area for some time and consequently feel that this Bill is a perfect example of the concept of overkill. In order to correct the abuses by a few franchisors, this legislation will disrupt the entire franchising industry, the vast majority of which deals fairly and equitably with their franchisees.

The Bill is absolutely one-sided in favor of franchisee and is so vague as to make efforts at compliance extremely difficult. Franchisors will find it almost impossible to terminate a franchise. To do so, franchisors will be burdened with proving that "good cause" exists, a term defined only in the vaguest terms. Additionally, in every legal proceeding brought by a franchisee against a franchisor, this Bill creates a presumption that the franchisor acted unfairly. Finally, the Bill allows franchisees who prevail in law suits to collect court costs including attorneys' fees from the franchisors, but does not make similar provisions for successful franchisors.

I feel that franchisees are far better protected by legislation and rules requiring full disclosure by the franchisor to prospective franchisees. I am certain that S. 2335 will prove extremely detrimental to the franchising industry and therefore strongly request that you oppose its passage.

Respectfully yours,

E. F. LUCAS, Jr.,
President.

THE NEW YORK PATENT LAW ASSOCIATION,
New York, N.Y., March 31, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: The New York Patent Law Association is a professional organization with a membership of about 1,200 patent and trademark lawyers, comprising most of the practicing patent and trademark lawyers in New York City and many in the surrounding New York, New Jersey and Connecticut areas.

We are writing to set forth our views on S. 2335, which we understand is the subject of hearings before your Committee.

We have several objections to S. 2335. First, insofar as it conflicts with the trademark law, as codified in the Lanham Act, 15 U.S.C. § 1051 et seq., it does not serve the public interest.

Most franchise relationships involve the licensing of a trademark or service mark. The function of any trademark or service mark is to identify the source of sponsorship of goods or services and to distinguish them from those of others. The trademark or service mark is the means by which the public is able to select the goods or services it wants. The trademark law does permit a trademark to be used by one other than its owner, but only so long as the owner exercises control over the nature and quality of the others' goods or services. In this way, the goods or services still meet the public's expectation.

S. 2335 could prevent a franchisor from exercising effective quality control over use of his mark. For example, the franchisor will be unable for ninety days to stop a franchisee from selling substandard goods and for 48 hours to stop a franchisee from selling goods posing an imminent danger to public safety. Public deception could result insofar as the goods or services sold

under the franchisor's mark met neither the franchisor's quality standards nor the public's expectations. Moreover, such failure to exercise quality control could result in an abandonment of the franchisor's mark (15 U.S.C. § 1127).

Our second objection to S. 2335 arises from its coverage of franchises and distributorships in every type of business as well as some trademark licenses which would not normally be considered to be franchises. There does not appear to be any evidence of the existence of substantial inequities to all such franchisees, distributees and licensees which are not covered by existing law and require legislative amendment of the underlying agreements.

We are concerned as well with other aspects of S. 2335, including its suggestion that franchisees acquire goodwill in the trademarks or service marks of franchisors (contrary to 15 U.S.C. § 1055), its shifting of the burden of proof, its vague terminology and its apparent one-sidedness.

We shall be happy to supply you with a detailed memorandum on these points if desired.

For the reasons set out above, we urge rejection of S. 2335.

Respectfully submitted,

L. P. BROOKS,
President.

THE UNITED STATES TRADEMARK ASSOCIATION,
New York, N.Y., March 31, 1976.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee of Senate Commerce Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: The United States Trademark Association, on behalf of its membership as shown in the attached roster, wishes to record its opposition to the trademark aspects of the bill identified as S. 2335 (Moss), which we understand is scheduled for hearings before your Subcommittee.

The United States Trademark Association, now almost a century old, has participated actively in the development of federal legislation pertaining to trademarks. For example, it was instrumental in the shaping and enactment of the Lanham Act, the basic Federal Law dealing with the use, licensing, registration and protection of trademarks, and of amendments to the Act. It also screens bills and other topics which may adversely affect, or conflict with the provisions of the Lanham Act. We believe that the Moss Bill will adversely affect trademarks and, therefore, we urge that it be disapproved.

While the Moss Bill appears to be primarily concerned with the relationship between franchisors and franchisees, such a relationship, as indicated in the Moss Bill, revolves in most instances around the licensing of a trademark or service mark. Because of the provisions in the Moss Bill with respect to conditions for termination of an agreement between a franchisor and a franchisee, the Moss Bill has an adverse effect on existing trademark law as it relates to the protection of the public.

Specifically, because of imprecise language used in the definition of "good cause" as a basis for termination of the agreement, the definition is subject to various interpretations. As a result it is not clear that the agreement can be terminated as a result of the inability of the franchisee to meet quality standards established by the franchisor. Further, the 90-day period of time provided for notice of such termination permits the franchisee to continue its substandard activities without the necessary control by the franchisor.

A trademark or service mark is adopted by a manufacturer or franchisor to identify his goods or services and distinguishes them from those of others. Under the Lanham Act, a mark may be used legitimately by another, such as a franchisee, so long as the owner continues to exercise supervision and control over the nature and quality of the goods or services.

It is our opinion that the Moss Bill fails to protect the public from confusion, mistake or deception since it interferes with the ability of the franchisor to supervise and control the nature and quality of the goods or services by requiring a franchisor to maintain or renew a franchise agreement with a franchisee who is selling goods or rendering services which may not meet the

franchisor's quality standards and thus, may not meet the public expectation of such goods or services. This is a situation which the present trademark law prevents.

We are convinced that this Bill will only result in a deception upon the public and ask that it be disapproved by your Committee. The United States Trademark Association would welcome the opportunity to amplify these views or to appear before the Subcommittee.

We trust these statements will be made part of the record.

Respectfully submitted,

WILLIAM HEDELUND,
President.

MANPOWER,
Milwaukee, Wis., March 31, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate Commerce Committee,
Russell Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: On April 7 and 8 your Committee will conduct hearings on S. 2335 introduced by Senator Moss and six co-sponsors, including yourself.

Manpower, Inc., the world's largest temporary help service company and a pioneer in the franchise system of doing business, stands opposed to the passage of this legislation because of the significant adverse impact this legislation would have on the way of doing business that offers perhaps the last opportunity for entrepreneurship to the small businessman.

The proposed legislation requires harsh and punitive remedies to cure abuses not proved to exist ignoring the fact that existing laws at Federal and State levels can adequately deal with alleged abuses.

Alleged abuses in some industries would be dealt with by this sweeping legislation aimed at all of franchising, thus penalizing all for the alleged sins of a few.

The proposed legislation would make it difficult or impossible to terminate franchises even where the public welfare would best be served by termination and otherwise seriously interferes with the right of private contract that should be preserved.

The proposed legislation is so full of legal deficiencies as to cast severe doubt upon the constitutionality of many of its provisions.

Last but not least, the Federal Trade Commission has long been interested in the protection of franchises and has approached the problem from the standpoint of requiring full and fair disclosure prior to the onset of the franchise relationship. The franchising industry currently awaits formal adoption of the FTC rule and respectfully submits that Congress should not, at this point, further complicate the picture until such time as the FTC rule has been promulgated and its results have been determined.

Sincerely,

WALTER G. KOZLOWSKI,
General Counsel.

JELLYSTONE CAMPGROUNDS LTD.,
Sturgeon Bay, Wis., March 31, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate Commerce Committee,
Russell Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: I am writing to you about the Fairness in Franchising Act S. 2335 scheduled for hearings on April 7 and 8. I am President of a relatively small company directly involved in the franchising of deluxe, high amenity campgrounds throughout the United States. All of our units are franchisee owned and operated.

I want to express to you my sincere concern for the adverse effect that I feel the Fairness in Franchising Act S. 2335 can have on franchising in general and, more specifically, the long range viability of my company.

I oppose this bill for the following reasons:

If there are abuses, and little evidence has been submitted thus far to support such a contention, I believe they are isolated to a few specific industries, some of which fall outside the true definition of franchising, in my opinion, even though they call themselves "franchisors," such as oil company arrangements and recreational vehicle dealers.

Adequate legislation now exists to redress most of the abuses that have thus far been brought forward in testimony before the Consumer Protection and Finance Subcommittee of the House Interstate and Foreign Commerce Committee.

I consider this bill as an unnecessary intrusion by Government into the business relationship of franchisors and franchisees. Not all franchisees are responsible businessmen and no amount of legislation is going to change that fact. Yet in most instances, a bad franchisee does have a direct adverse effect on the franchise system as a whole and more specifically the individual investments of many other viable and successful franchisees within the system. There is just cause for the termination and/or non-renewal of some franchise arrangements and in many instances ninety (90) days is too long a period to take positive action to protect the collective interests of the system and other franchisees.

Reputable franchisors like ourselves welcome reasonable legislation that protects our collective interests and strengthens the viability of franchising in general. However it should be rocognized that most franchisors do not deal from strength but rather depend on the basics of our economic system to survive and sell new franchises, that is a reputation of fair contract dealings and the creation of a demand for our products. You cannot legislate these principal factors of a basic business relationship. The very essence of the franchisor/franchisee relationship dictates that no franchisor can continuously abuse its franchisees and expect to sell new franchises and/or maintain the viability of its existing franchise organization for very long.

The bill as written is unfair and highly discriminating on those provisions that shift the burden of proof to the franchisor and require him to pay the court costs and attorney's fees of a successful franchisee litigant, and may require him to pay those costs for an unsuccessful franchisee.

Language such as "a failure by the franchisee involved to comply substantially, without reasonable excuse or justification," and "such franchisor has good cause for such failure to" etc. are ambiguous and destines every failure to renew or cancellation to litigation.

I strongly encourage your careful evaluation of this legislation.

CHARLES C. CHOUINARD,
President.

ATTORNEY AT LAW,
Carol Stream, Ill., March 31, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: I have taken the time to read the subject bill which has been proposed called the "Fairness in Franchising Act." This bill is coming up for hearing before the Senate Committee on Commerce on April 7 and 8.

Mr. Moss, in his comments at the time the bill was introduced, expressed the value of and need for the franchising system of distribution. He stated, "Such agreements and relationships are beneficial to the economy. They enhance commerce, and they promote competition * * *" The value of franchising has become widely recognized. Because of the importance to the economy of franchising, I feel compelled to object to the bill because its effect will be not to enhance the system, but to injure it. This is not the effect intended by the drafters of this legislation.

Remedies for unjust enrichment and breach of contract have long received redress under common law actions. The remedies proposed in the subject bill do not "assure fair dealing," but place the franchisor in the place of being liable until he proves himself free from liability—just the reverse of the American system of justice.

The franchising system of distribution is so diverse and covers so many different products and services, that where the bill might correct a so called inequity in one area, it will surely create inequities in others. Complete equality of bargaining power is not attainable. Disparity is not an evil to be corrected—only abuse of that disparity. Courts have and will continue to provide remedies where there is abuse.

I encourage you to thoughtfully consider the effect this bill will have if enacted.

I also urge you to reject S. 2335 as unneeded and unworkable legislation.

Sincerely,

E. L. OLSEN.

CONVENIENT FOOD MART, INC.,
Chicago, Ill., April 1, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: Please accept this letter as a vehement protest against bill S. 2335 (Fairness in Franchising Act) introduced by Senator Moss. The bill, in brief, is unfair, unjustified, and anti-competitive.

We feel very strongly that a few misguided lawmakers who obviously have failed to do their homework and therefore lack the expertise and special knowledge needed to fairly evaluate the proposed legislation—have erroneously concluded that all franchising is alike and that certain remedies are needed to bring about a balance between franchisors and franchisees which is labeled "fairness".

Hogwash!

The states have ample power to legislate in these matters and some have elected to do so, while others have rejected legislative proposals of similar thought. Federal intervention is both unnecessary and inappropriate.

Our learned lawmakers who know how to make use of their helmets (thinking caps) will turn their attention to worthwhile skirmishes in which to engage; God knows there are enough areas (some of which will produce banner headlines when solutions are proposed) in both domestic and foreign affairs in which to lend strength and energy.

We hope you can be identified with the latter!

Sincerely yours,

WM. R. SANDBERG,
Executive Vice President and Franchise Director.

SERVICEMASTER INDUSTRIES INC.,
Downers Grove, Ill., April 1, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: As a member of the legal staff of ServiceMaster Industries Inc. I would like to voice strong opposition to the proposed "Fairness in Franchising Act" (S. 2335) and encourage rejection of said bill.

ServiceMaster franchises several different types of cleaning businesses and has over 1500 franchises operating worldwide. Having had considerable experience with the franchise relationship over the past 25 years, we feel that the proposed bill is objectionable for several reasons.

First, the scope and magnitude of alleged abuses in franchising does not warrant such harsh legislation. As was apparent in the recent hearings on the comparable House Bill (H.R. 8349), abuses in franchising are anything but widespread. Franchisees who testified in favor of the bill were hard-pressed to cite even one instance of actual abuse that would be cured or prevented by the passage of such a bill. Mr. Moss and his cosponsors see a "need to study the franchising situation in the United States today, and to develop appropriate remedies where the need exists." It is evident from the

House hearings that a need does not exist for the passage of a bill such as S. 2335. Flagrant abuse, for the most part, is limited to a few industries which could and should be dealt with individually. Many problems and alleged abuses are simply breach of contract, and are covered by existing Contract Law. Others constitute violation of Antitrust Laws or the FTC Act. There is adequate existing law to deal with most alleged abuses. Those which are isolated in specific industries should be dealt with individually. It would be a mistake to pass legislation which would cover all franchise relationships when the contracts, types of businesses and problems vary so widely.

Another highly objectionable provision of S. 2335 is forced renewal of the franchise agreement. This provision is so unflexible that the agreement would become virtually perpetual under the law. The ServiceMaster agreement provides for renewal of the contract and, almost without exception, we renew each agreement upon expiration. However, we feel entitled to the right to make these business decisions and resent Congress's unprecedented and unjustified attempt to interfere in this commercial relationship. This forced renewal provision could prove to be anticompetitive and damaging to other franchisees as well as to the franchisor.

As a franchisor, we favor full and fair disclosure. Our policy has always been to make all the facts available to the prospective franchisee. We encourage him to talk to other franchisees, to obtain as much information as possible about our company and the business he is considering buying. To this end, we support disclosure legislation and have anticipated the adoption of the FTC rule which might provide for uniform federal disclosure laws. However, we resent Congress's attempt to regulate this business relationship once it has been established. Certainly disclosure regulation should be fully enacted and tested before Congress intervenes with a totally different type of regulation.

Perhaps the most tragic consequences of the passage of a bill such as S. 2335 is that it would severely stunt the growth of franchising as an effective business form in our economy. As stated in Section 2(a)(2) of the proposed bill, Congress has found the Franchise relationship to be "beneficial to the economy, the enhancement of commerce, and the promotion of competition"; yet they propose a bill which would virtually destroy this relationship. I know that ServiceMaster would seriously consider limiting expansion to company-owned branches, perhaps ceasing franchising altogether, in preference to being subjected to a law which makes compliance so costly and so difficult. New companies or companies considering franchising for the first time would likely decide against such an expansion method in light of legal problems which they would inevitably encounter. There is much for the franchisor, the franchisee and the economy to gain through this particular commercial relationship. Certainly government regulation of franchising through passage of S. 2335 would be to the ultimate detriment of society; the bill would eventually eliminate franchising as we know it today. We strongly recommend that this bill be rejected.

Sincerely,

LANA S. FIFE,
Paralegal Assistant.

MID-AMERICA NEWSPAPER CARRIERS ASSOCIATION,
April 4, 1976.

Hon. FRANK E. MOSS,
Chairman, Senate Subcommittee on Consumers,
Senate Office Building, Washington, D.C.

DEAR SENATOR FRANK MOSS: It is our understanding that your subcommittee will hold hearings on a bill known as "Fairness in Franchising Act".

The Mid-America Newspaper Dealers Association would like to take this opportunity to inform your subcommittee as to the situation of the franchise newsdealers in the metropolitan area of Kansas City, Mo. and their fast changing relationship with the publisher, the Kansas City Star Company.

In 1947, a hearing was held before the National Labor Relations Board for the purpose of determining the status of the dealers. The dealers were declared independent contractors and not employees because of the direct testimony given by members of the circulation department representing the Kansas City Star

Company. They testified to the fact that the dealers owned and operated their routes without any personal supervision from the publisher. They also testified that the dealers bought and sold their routes for large sums of money through banks and other lending institutions and the publisher did not interfere in such transactions. The publisher also recognized the right of survivorship. We refer you to the Kansas City Star Company brief before the National Labor Relations Board (colored pages 6, 8, 23, 40, 57, 58, and 59).

The Albrecht decision handed down in 1968 by the U.S. Supreme Court declared that the independent newspaper dealers, not the publisher, had the sole right to set the retail price of the newspaper. The Kansas City Star Company ignored the Albrecht decision March 4, 1968, and raised the subscription price on September 1, 1968. It was not until June 1, 1972 that the dealers here began to set the retail price of the newspaper on an individual basis. Until then, the retail price had always been dictated by the Kansas City Star Company.

Having lost control of setting the retail price, the publisher began certain types of intimidations, harassments and fear tactics against the dealers in an attempt to regain control of the retail price. For instance, in August of 1972, the publisher began to run surveys on the front page of the newspapers. The publisher asked the dealers subscribers if they had any gripes about their dealers delivery service. The result of the surveys was in favor of the dealers; howver, the publisher proceeded to use the results of the surveys to threaten termination of twelve dealers. The 12 dealers asked to see the results of the surveys so that they could correct any problems pertaining to their service. The publisher refused to disclose the survey data. Instead, the officials of the circulation department would only give verbal answers to questions from the dealers. The officials would say that the percentage of the subscribers responding to the surveys disclosed poor service on the part of the dealer. They would not disclose any figures. The surveys and threat of termination ceased when the publisher learned that the dealers were prepared to go to court.

In December of 1973, a franchise dealer passed away. The survivor contacted the circulation department in January of 1974 to enter into a standard form contract with the publisher. For the first time and contrary to their testimony before the N.L.R.B. the publisher attempted to strip the survivor of the vested property right in the route. The publisher offered the survivor an option contract upon learning that all of the dealers were prepared to go to court in order to protect their rights of survivorship. Eventually the publisher allowed the survivor to sell the route.

In April of 1974, the Kansas City Star Company notified the dealers of a change in the wholesale rates which would necessitate entering into a new contract. The publisher was changing the rate structure from a fixed amount to a percentage of whatever the dealers charged their subscribers. The dealers opposed the new percentage contract because it would place them in a bad position whenever there was a need to raise the subscription price to their subscriber. In some cases under the percentage contract the dealers would have to double any increase in order to give the company their share. The dealers inquired the reason for the percentage contract. The publisher's answer: we will never be caught again under a government price freeze whereby the small independent dealers could raise their subscription prices and we would be unable to share in such increases.

The dealers were informed that the deadline for signing the percentage contract would be made May 25, 1974 or the publisher would cease to do business with them. Unbeknown to the dealers, the company was preparing to notify the dealers of a change in their policy. On May 24, 1974 all dealers received a letter notifying them of this change. The change: in the event the company desires to change the method of delivery there would be no obligation to the dealers because The Star in no way recognizes a continuing property right in any independent carrier contract. In other words, the company would not be under any monetary obligation to the dealers for loss of their business as a result of a distribution change by the company. The Star has been aware, through the years, that routes have been selling between $25,000.00 to $160,000.00. They also know that a system change would force the majority of the dealers into bankruptcy let alone the economic effect it would have on banks and other lending institutions. The company also stated that they no longer would accept assignments to the contract pertaining to survivorship as had

been done in the past. Also, the company would no longer accept assignments from banks on the buying and selling of routes. The publisher knew full well that when the news of this policy change reached the banks that it would create a depressed market in the fair value of the dealers businesses.

In Jauary of 1975, as a result of the Star's policy change, the attorney for the dealers association has filed antitrust litigation against the Kansas City Star Company in federal court.

Historically, since the creation of routes and re-affirmed as late as June of 1974, the publisher has maintained that it has the right to terminate any route on four (4) days notice for any reason or no reason.

Because of the unjust tactics by The Kansas City Star Company with regard to the dealers, it is imperative that we convince you and your subcommittee of the need for legislation as provided in the "Fairness in Franchising Act" and the urgency of its passage by the full congress.

Thank you, we remain

Sincerely yours,

RALPH REAGAN,
President.
HOWARD J. WHALEN,
Secretary.

Enclosure.

THE KANSAS CITY STAR,
THE KANSAS CITY TIMES,
Kansas City, Mo., May 24, 1974.

DEAR INDEPENDENT CONTRACT CARRIER: For many years The Kansas City Star Company has sold newspapers published by it to independent contractors for resale and delivery by them. Recently, uncertainty seems to have developed as to the Star's position when an independent contract carrier dies or desires to terminate his contract and have the Star enter a new contract with another person designated by him.

Generally, the Star feels the independent contractor system has proven its superiority over other delivery techniques and the Star chooses to continue this system to serve our circulation requirements so long as in our opinion it provides satisfactory home delivery of our newspapers. The Star enters into a personal service contract with an independent contractor to sell newspapers at wholesale for the independent contractor's resale and delivery as provided in the contract. The carrier is not an employee of the Star but rather is an independent contractor who undertakes to resell and deliver the newspapers purchased by him in a prompt and satisfactory manner. This personal responsibility for proper performance is a vital part of the circulation process and is essential to the contractual relationship. Therefore, in the event of a carrier's death or a carrier's desire to terminate his services under the contract, the Star must find the person suggested as a new independent contractor for the particular route to be satisfactory to the Star. In this regard, the Star has in the past and chooses at present to observe the following practices:

1. Upon termination of a contract by reason of the death of an independent contract carrier, the Star will enter into a contract with a prospective carrier designated by the personal representative of the deceased carrier, provided there is no interruption in service, if paper bills are current, if the Star approves the credit standing of the prospective carrier, and if in the Star's judgment the prospective carrier is qualified to satisfactorily perform under a new contract.

2. If an independent contract carrier wishes to terminate service under the contract, the Star will enter into a new contract with a prospective carrier designated by the terminating carrier, provided there is no interruption of service, if paper bills are current, if the Star approves of the credit standing of the prospective carrier and if in the Star's judgment the prospective carrier is qualified to satisfactorily perform under a new contract.

The Star has no involvement or interest whatsoever in any arrangements between an independent contract carrier or his personal representative and a prospective carrier and by following the practices stated in paragraphs 1 and 2 above for the convenience of the contract carriers, the Star in no way recognizes a continuing property right in any independent carrier contract. While it is certainly not now anticipated, it should be recognized that in the future the Star can and may choose to modify or change its circulation system

or practices without liability to independent contract carriers. This statement is explanatory of the Star's present policy and does not alter or amend any contract provision. The provisions of each individual contract, present or future, shall be determinative of the relationship between the Star and each independent contract carrier.

Very truly yours,

JOHN W. WHITE,
Circulation Manager.

KENTUCKY BEER WHOLESALERS ASSOCIATION,
Lexington, Ky., April 5, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: The Kentucky Beer Wholesalers Association, representing the wholesale beer distributors in the Commonwealth of Kentucky, wish to go on record as endorsing S. 2335. This bill would give protection to beer wholesalers from unjust termination of their franchises which has been prevalent in our industry in the past.

We wish to impress upon the committee the need for reform of franchising practices in our industry.

We request that the above statement endorsing S. 2335 be entered in the hearing record.

Sincerely,

ROBERT R. RUSSELL,
Executive Secretary.

UNITED STATES SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C., April 5, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Commerce Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed is a copy of a letter from Mr. Milton R. Bergseth and Mr. Richard D. Bergseth of Bergseth Brothers Company, Inc. of Fargo, North Dakota.

I would appreciate your inclusion of the letter from my constituents in your hearing record on S. 2335. It is my understanding that the Senate Commerce Committee will begin hearings on April 7 on this legislation, and I am sure that members of the Committee will benefit greatly from the experience of and thoughts expressed by the Bergseth brothers' concern.

Thank you for your assistance.

With kind regards, I am

Sincerely,

QUENTIN N. BURDICK.

Enclosure.

Fargo, N. Dak., March 18, 1976.
BERSETH BROS. CO., INC.,

Hon. QUENTIN N. BURDICK,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR SENATOR BURDICK: It has come to our attention that Senator Moss (Utah) has introduced a proposal entitled "Fairness in Franchising", S. 2335. This bill is apparently a companion version of the "Franchising Practices Reform Act", H.R. 8349, introduced earlier by Rep. Abner J. Mikva (Illinois).

The objective of these bills is to provide the small businessman protection from unjust terminations and trade practices.

Although our relationships with our suppliers have been most amicable, it is none the less true that small businessmen generally, including wholesale beer distributors, are highly vulnerable to blunt and arbitrary termination, sometimes with little or no notice, and without cause or consideration.

A very real and recent example of this type of action is the widespread termination of Hamms distributors by the Olympia Brewing Co. when the latter acquired the Hamms Brewery.

We strongly recommend that you join with Senator Moss in sponsoring this legislation.

Sincerely yours,

MILTON R. BERGSETH.
RICHARD D. BERGSETH.

THE SOUTHLAND CORPORATION,
Dallas, Tex., April 5, 1976.

Senator WARREN G. MAGNUSON,
Chairman, Senate Commerce Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: I am writing you in opposition to S. 2335 and request that this letter be placed on the record in your committee hearings. I recently testified before the Consumer Protection and Finance Subcommittee of the House Committee on Interstate and Foreign Commerce in opposition to H.R. 8349, which is virtually identical to the captioned bill.

By way of introduction, I am Chairman of the International Franchise Association, having served on its board for 7 years and having been an active member almost since its inception over 16 years ago. I first became involved with franchising in 1956 as one of the founders of Speedee Mart, Inc., a small chain of franchised convenience stores in San Diego, California. In 1964, Speedee Mart sold to The Southland Corporation, and since I have been Franchise Manager of Southland which is headquartered in Dallas, Texas and is known primarily for its over 5,500 7–Eleven convenience stores in 38 states and the District of Columbia. Speedee Mart was Southland's first experience with franchising. Now there are 2,188 7–Eleven stores in 21 states and the District of Columbia franchised to individual owners. In addition, Southland has six U.S. area licensees that operate or subfranchise to individuals 158 stores in 10 states. We believe Southland's growth, coupled with the success of the vast majority of 7–Eleven franchisees, is proof that franchising today remains a viable form of distribution for the franchisor, the individual franchisee and the consumer.

As background for my remarks on the Fairness in Franchising Act, let me briefly outline what a 7–Eleven store is and what the 7–Eleven franchise to an individual covers. 7–Eleven stores are extended hour, miniature supermarkets providing over 3,000 items of groceries, take-out foods and beverages, non-food merchandise, specialty items and incidental services. In the 7–Eleven franchise program for individual stores, Southland selects and trains qualified applicants. Southland leases to the franchisee a ready to operate 7–Eleven store, which has been fully equipped and stocked, for a term of 15 years (or the remainder of the lease terms on leased locations). The company grants the franchisee a license to use the 7–Eleven System and trademark and will loan a portion of the necessary working capital for the franchisee's investment in the inventory in the store. The Company also provides sales and marketing advice, advertising and bookkeeping services. Southland's investment in a 7-Eleven store now averages about $148,000, $110,000 for the land and building and $37,000 for the equipment. Typically, inventory averages about $20,000 at cost and the company emphasizes optimum inventory levels to maximize sales while minimizing pilferage and the amount of financing required by the franchisee. The company receives a cash payment from each franchisee of $5,000 for training and store set up and a minimum investment of $3,000 toward the inventory. The company also shares in the gross profit of the store as the continuing charge for the license, lease and services from which the company bears building, utility and equipment costs as well as property taxes. From the franchisee's share of the gross profits of the store, the franchisee bears all other operating expenses as well as personal property taxes on the inventory.

Southland has always supported full disclosure of the franchise relationship to prospective franchisees. However, we are concerned by the ambiguous and onerous provisions of the Act, which impose unwarranted burdens and penal-

ties on all franchisors (although there are many varied franchise arrangements) far out weighing any need for additional legislation which may have been demonstrated in a very few segments of franchising. These troublesome provisions range from vagueness and omissions, to duplication of existing statutory or common law remedies, to conflicts with existing trademark statutes, to serious questions of constitutionality, to discouraging commercial arbitration, to an unprecedented shifting of the burden of proof so the franchisor must establish non-violation, to serious constraints on amicable settlement of normal disputes. Since most of these are largely legal in nature, I will limit my comments to the provisions of the Act which relate to termination. They, in my opinion, will be grave impediments to the continuation of frnachising as a viable form of business.

Involuntary termination of a franchise is not taken lightly by Southland. The qualifications and training of franchisees is very costly for the company. In addition, Southland, if any profit is to be made from franchised stores, realizes its return by sharing in the gross profits generated by an ongoing successful operation. Each termination is, therefore, a serious matter to the company. We also recognize it is serious and traumatic to the individual franchisee and has even broader implications to other franchisees, not to mention the potential legal exposure of Southland for wrongful termination under existing statutes and common law. Of the 470 7–Eleven franchises which terminated during 1975, only 9 were involuntary. Most of the remarkably low 23% turnover among 7-Eleven franchisees is the result of the decision by a franchisee to retire or relocate—and regrettably we have found no way to prevent good franchisees from doing so. In fact, the ability of 7–Eleven franchisees—who have no capital risk for land, building and equipment and the option to cause Southland to purchase their inventory at cost—is, we believe, a significant advantage to individual businessmen. In addition, since Southland has long believed that a full understanding of the consequences of the franchise relationship is necessary to a successful franchise, the 7–Eleven franchise agreement itself specifies in detail those failures by the franchisee which may result in termination relating to financial exposure of Southland and to those matters which our experience has proven are necessary for the operation of a 7–Eleven store to be successful for the franchisee and for the company.

Under the Act, a continuing franchisor may terminate (except for bankruptcy or imminent public danger) only for good cause and after 90 days notice, and the franchisor has the burden in any subsequent litigation of proving compliance with the Act. The problems created by the Act seem obvious to me.

Good cause covers only failure of the franchisee to substantially comply, without reasonable excuse or justification, with essential and reasonable provisions of the franchise agreement or bad-faith conduct by the franchisee. This takes away the business experience of the franchisor and the rights of both the franchisor and franchisee to contractually agree to what standards are essential and reasonable, subjecting these determinations to varying and costly court interpretation.

Also, where a 7–Eleven franchisee has made only the minimum $3,000 investment in a $20,000 inventory, 90 days notice of termination is too long. It is an unreasonable business risk for Southland. With average annual store sales of $265,000, in 90 days a franchisee is able to (and I can cite you many instances where they have) pocket sales receipts from merchandise purchased with money borrowed from Southland—an exposure of $60,000. These few bad franchisees—unlike franchisor companies—are not able financially to subsequently respond in damages for breach of contract. In addition, they can destroy sales and build up inventory levels irreparably damaging the 7–Eleven image to the detriment of all other franchisees.

I urge the Committee to give serious consideration before adopting new and unprecedented limitations on commercial relationships and to recognize the legitimate needs of franchisors to protect their individual franchise systems. I suggest that the Act should cure only actual problems, not unnecessarily curb a total system of distribution which, in the aggregate, is a very important segment of our economy. No good will come to franchisees from an Act which dissuades companies from franchising. No useful purpose will be served by an Act which adds to the inflation presently concerning consumers.

I will be happy to meet with you or your representatives at any time to discuss these comments, and, of course, to answer any questions you might

have or to provide any desired additional information concerning the impact of the provisions of the Act on the 7–Eleven franchise system.

Very truly yours,

PALMER WASLIEN.

POSTAL INSTANT PRESS,
Los Angeles, Calif., April 5, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SIR: As one of the family of franchise companies throughout the United States, we have had an opportunity to examine S. 2335 and would like to urge that you carefully consider the equities involved in its context. There exist, certainly, some inequities in the business community with which legal advocates wrestle daily: This bill is not an answer. This bill is a challenge to see if franchising can survive in its wake.

Two items stand out dramatically: a five year period within which a franchise company must not do business in a territory previously occupied by a franchise owner who has been terminated—and a ninety day notice prior to terminating a franchise owner regardless of the reasons involved.

We respectfully urge that you acknowledge the legitimacy of the franchise system which has helped our economy to grow in leaps and bounds: S. 2335 could be instrumental in inhibiting that growth and the future of our economy.

Respectfully,

IRA N. NOTTONSON,
Vice President.

FIRESTONE,
Akron, Ohio, April 5, 1976.

SENATE COMMITTEE ON COMMERCE,
New Senate Office Building,
Washington, D.C.

GENTLEMEN: The above Bill to provide new remedies for franchisees is presently before your Committee. While I do not doubt the legitimacy of many of the complaints that have given impetus to this legislation, I am of the opinion that, if passed in its present form, the Bill will adversely affect efficient and fair forms of business relationships thereby having a detrimental effect on the independent entrepreneurs operating the businesses and the public served by them. This is true because the Bill's present definition of "franchise" unnecessarily includes a large number of traditional manufacturer-dealer relationships that have functioned fairly and efficiently for many years under existing laws.

Senator Moss, in his comments introducing Senate Bill No. 2335, indicated that it was directed at a "relatively new method" of business relationship that usually involves several of the following:

(a) A uniform and standardized method of doing business;
(b) A trade or service mark;
(c) A territory in which the franchisee operates;
(d) An initial payment for the franchise or periodic royalties; and
(e) A system of sublicensing of franchises.

The Senator further pointed out that in this new nature of the franchise method of distribution there is unequal bargaining power between the parties and that current statutory or common law is not adequate to protect the franchisee against unjust enrichment, overreaching or unfair termination by the franchisor. Given these assumptions by the Bill's sponsors, it appears clear that the tire manufacturer-dealer relationship, and many similar arrangements in other industries, were not intended to be treated as franchises under the legislation.

First, rather than being new, the independent tire dealer has existed in this country since the founding of the tire industry, and it wasn't until after the Second World War that any other method of independent distribution (includ-

ing private brands and sales through oil companies) became significant. Nor is this situation limited to tires. Since the Industrial Revolution distribution through independent dealers has been the primary method used by manufacturers of durable goods in supplying ultimate consumers. By contrast, "package" franchising is a recent development and does not normally involve manufacturers, but purveyors of proprietary rights, ideas and fancy names, often backed by limited capital and depending almost entirely upon the sale of future expectations rather than past performance.

Second, the tire manufacturer-dealer relationship is not a uniform and standardized method of doing business, and such uniformity and standardization that may exist are more often than not either superficial or required by current price discrimination and trade practice laws. In actuality, almost every relationship between a tire manufacturer and an independent dealer is, to the extent permitted by law, unique: one dealer may choose to sell predominantly passenger tires, another truck and another off-the-highway; some may choose to carry only one brand but a vast majority carry two or more; credit arrangements and other business dealings are individually negotiated and tailored to the dealer's capabilities and needs; some dealers have multiple locations and sell at both wholesale and retail, others operate only a single retail location; and one may choose to have limited brand identification and another to have his location so well identified as to be indistinguishable from a manufacturer's store.

Third, while the tire manufacturer-dealer arrangement does involve trade and service marks, they are, at best, only incidental to the relationship. Unlike some package franchises, where the only real value is often the trade name, to my knowledge, no charge or royalty of any kind is made for the use of a tire manufacturer's trademark. Further, any Firestone tire dealer, whether or not a direct dealer, may purchase Firestone brand tires from other sources and advertise that he has Firestone tires for sale. By contrast, it would be impossible for a hamburger stand to advertise that it had McDonald's hamburgers for sale unless it was a licensed franchisee or for a McDonald's stand to carry the Burger King "Whopper" as well.

Fourth, the exclusive territory concept has no application in tire distribution. While Firestone desires to maximize our distribution through an effective independent dealer organization, dealers are not assigned exclusive territories nor given any assurance that other Firestone distribution, direct or indirect, will be absent from their areas. Even if we chose to go through the motions of making such representation, it would be meaningless since Firestone brand tires are available to the competitors of our independent dealers through many independent channels and thus, every dealer and store must actively compete for Firestone customers. Similarly, while direct Firestone dealers are able to sign up associate dealers for Firestone tires if they so desire, they are given no exclusive territory in which to do so as is the case with many franchise operations and "pyramiding" has no real meaning in the industry.

Fifth, no initial payment of a franchise fee or periodic royalty is made by any Firestone dealer. To the contrary, Firestone often finds itself in the position of having to give initial financial assistance to encourage the independent tire dealer to take on Firestone. Except for the dealer's proportionate share of the cost of some co-op advertising and advertising materials, the only amounts paid to Firestone by the dealer are for products purchased for resale, and Firestone's profit from a dealer's operation is realized solely from the sale of tires and other Firestone products and not from payment for the use of the Firestone name or any Firestone services.

Sixth, the legislative assumption of unequal bargaining power is inapplicable to the tire manufacturer-dealer relationship. Many of our dealers have been in business for years and are financially sound and experienced businessmen. Even new tire dealers are far different than the husband and wife with a small nest egg but no business experience that may respond to franchise ads in The Wall Street Journal. Most new tire dealers have either worked for other tire dealers or have been employees of a tire manufacturer and are fully aware of the risks and benefits associated with the business. While it may be advantageous to some franchisors who endeavor to make money on the franchise itself to sign up naive and inexperienced persons, Firestone can

only realize a profit if its dealers are competent businessmen with adequate business, financial and legal advice.

Seventh, an additional major difference between the two types of relationships is the amount and type of investment required. There are all levels of entrance into the tire business, from renting a closed service station for a few dollars per month to a six-bay, turn-key tire center, and the dealer, through his own plans and objectives, determines the amount of capital necessary. This contrasts to modern franchising where often a very substantial amount of initial investment is required by the franchisee even before the doors are opened. Perhaps even more important than the amount of capital is the fact that the investment in a tire dealership is readily transferable. Every year hundreds of tire dealers switch from one tire manufacturer's brand to another with little more involved than a change of signs and inventories. This very real competition for existing dealers works to the dealer's, not the manufacturer's advantage, and militates against any assumption of unfair dealing or overreaching in the relationship.

Eighth, one criticism of package franchising and the source of much litigation has been the contractual or implied requirement that the franchisee buy substantial associated products, ingredients or services from the franchisor. Such requirements have never existed in traditional tire manufacturer-dealer relationships. While some machinery, equipment and related products are available for purchase at competitive prices, we basically sell tires and the dealer is free to buy anything else he needs anywhere he desires. Nor are there any arbitrary standards that tie the dealer to the manufacturer, as is evidenced by the wide variety among our dealers with respect to location, store appearance and business practices.

Having, I believe, demonstrated that the tire manufacturer-dealer relationship is not within the scope of the arrangements at which Senate Bill No. 2335 is directed, let me comment briefly on why its inclusion under the Bill is, given the realities of the marketplace, unfair to the tire dealer and ultimately the consumer, the very persons the legislation is intended to protect.

I am confident that any tire manufacturer, rather than risk the financial consequences and possible punitive damages inherent in an "after the fact" determination by a court or jury that a termination was not for "good business reasons", will normally follow the course of terminating few dealers and signing up even fewer. Having been deprived, at least in its opinion, of many of the benefits of distribution through independent dealers, the manufacturer will be forced to expand its own controlled distribution, or sell a larger percentage of its output through large tire brokers, oil companies, or other mass marketers. The independent tire dealer, rather than having his rights protected, will see the value of his dealership continually diminished by more and more locations selling the manufacturer's brand.

A strong, independent dealer organization benefits the dealer by assuring him of a value to his dealership, and benefits the consumer by providing reliable locations for the availability of the manufacturer's products and warranty service. Time has proven the value of the arrangement, and existing law has provided more than adequate protection to the parties. Without conducting any type of survey, I venture to say that the vast majority of independent dealers of tires, and most other products as well, are far more concerned about the proliferation of competitive outlets and about the burden and expense of excessive government paperwork and interferences than they are about the possibility of unfair termination by their suppliers.

In summary, Senate Bill No. 2335 should be amended to apply specifically to the new franchising arrangements that gave rise to it initially, and to exclude the tire manufacturer-dealer and similar traditional relationships. Since the most common aspect of "new franchising" is a charge, in one form or other, for the franchise, I suggest that the definition of franchise be amended to cover only those arrangements that require an initial payment in excess of a stated amount or a periodic royalty or similar charge in excess of a stated amount annually. With respect to almost all other manufacturer-dealer arrangements, we believe there is no need for further legislation.

Sincerely,

JOHN F. FLOBERG.

SERVICEMASTER INDUSTRIES INC.,
Downers Grove, Ill., April 5, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Bldg., Washington, D.C.

DEAR MR. MAGNUSON: When I reviewed the proposed Franchised Practices Reform Act, I was shocked to think that this kind of injustice could possibly be dealt to the free enterprise system by those in Congress who would seek to perpetuate the growth of the system that men gave their lives to establish two hundred years ago. We believe that the proposed bill will destroy the system in which our franchisees have invested their lives.

As responsible leaders of our government, I would urge you to consider the adverse effect of this bill on the established franchisee.

We want to prune from our industry those who would violate the rights of an individual, but what has been proposed will destroy the system.

Sincerely yours,

K. T. WESSNER,
President.

COX, LANGFORD & BROWN,
Washington, D.C., April 5, 1976.

Hon. FRANK E. MOSS,
U.S. Senate, Rayburn Senate Office Building,
Washington, D.C.

DEAR TED: As you may recall, I am Special Counsel for the Consumer Electronics Group of the Electronic Industries Association, which represents manufacturers of consumer electronic products such as television and radio receivers, phonographs, tape recorders and audio products.

We urgently request that in development of legislation on franchising, the definition of franchise be confined to situations where there is a major amount of control of the franchisee by the franchisor so as to avoid coverage in the definition and the legislation of normal manufacturer-distributor, manufacturer-retailer and distributor-retailer relationships.

Typical commercial relations between television manufacturers and distributors often involve a situation where the operation of the distributor's business is substantially associated with the manufacturer's trademark, service mark, trade name, advertising or other commercial symbol designating the manufacturer.

Unlike the situation in a true franchising relationship, a manufacturer of consumer electronic equipment generally exercises very little control over the normal business operations of its distributors. Although a distributor may ask a manufacturer for advice on various business matters, he is not in any way obligated to accept the advice.

We urge that the definition of "franchise" be narrowed to exclude situations which in common parlance and business usage have not been considered to be franchising relationships.

Best wishes,

Sincerely,

J. EDWARD DAY.

MAINE BEER AND WINE WHOLESALERS ASSOCIATION,
Bangor, Maine, April 6, 1976.

Senator WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: The Maine Beer and Wine Wholesalers Association of Maine strongly urge your support of Senator Frank Moss's bill "The Fairness in Franchising", S. 2335, which is before your Committee for hearing.

Spokesmen for the Federal Trade Commission have described the termination clauses in many franchising agreements as "A loaded gun pointed at the customers head and threatening his economic life and well being, should he

make a wrong move . . . In some instances, it can become a powerful weapon when employed by a dominant franchisor against dependent franchisees to enforce compliance of a franchisors demands, irrespective of whether these demands are reasonable or legal, or unreasonable and illegal". Maine beer wholesalers are confident that this bill will receive the support of Maine's Senators Hathaway and Muskie and are sure that your Committee will give this bill a full and fair hearing.

The Maine Beer and Wine Wholesalers Association would be most appreciative if this letter could be included in the hearing record on this bill.

Sincerely,

KENNETH P. MACLEOD,
Executive Secretary.

GOODENOUGH, SMITH & MAY,
ATTORNEYS AND COUNSELLORS,
Bloomfield Hills, Mich., April 6, 1976.

Hon. WARREN MAGNUSON,
Chairman, Senate Commerce Committee,
U.S. Senate, Russell Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: We represent Ziebart International Corporation and we would like to comment on S. 2335 for which your committee will be conducting hearings.

Ziebart International Corporation is based in Troy, Michigan and licenses some 275 independent dealers in the United States and a like amount in foreign countries. These dealers operating pursuant to ten-year contracts provide the public with what we believe is the highest quality rustproofing services currently available to car and truck owners.

Ziebart has been developing dealers since 1962 and is currently doing about six million dollars in sales to its dealers each year. A number of Ziebart dealers also own automobile franchises and conduct businesses and have assets substantially in excess of Ziebart. Thus, in numerous situations the economic disparity between the parties favors the franchisees.

In analyzing the proposed bill you should attempt to gauge the effect upon franchisors, franchisees and the consuming public. The effect on franchisors would be clearly and emphatically negative resulting in a substantial contraction at all levels of commerce.

The effect on the public of the passage of this bill is also going to be negative. The policing efforts of franchisors upon their franchisees in an attempt to maintain quality requirements will be substantially weakened. Further, the franchisee knowing that he has a perpetual monopoly in the product or service will have lessened incentive to serve the public in his area.

Only the franchisee will delight in the windfall which he has received without bargain or work. But even the franchisee will recognize that the value of his franchise will erode commencing upon passage of the act. This will occur because the name and service provided the public will decline in value because of unpoliced dealers providing lesser quality and service to the public. Franchisees are aware of this for franchisors are continually being asked by their dealers to terminate or correct certain dealers whose product and services are not up to the standard requested by the franchisor and attained by the complaining dealer.

We hope as more information becomes available to you you will reconsider your sponsorship of S. 2335.

Very truly yours,

RICHARD H. MAY.

BURGER CHEF SYSTEMS, INC.,
White Plains, N.Y., April 6, 1976.

Hon. WARREN G. MAGNUSON,
Chairman,
U.S. Senate, Russell Senate Office Bldg., Washington, D.C.

DEAR SENATOR MAGNUSON: We have been advised that the Senate Committee on Commerce has scheduled hearings on franchise termination and renewal

legislation (S.2335). We wish to express our deep concern over the possible impact of the passage of this legislation.

The preamble of the bill indicates that its intent is to protect against certain ills which may develop in the franchisor/franchisee relationship. We feel that the proposed legislation transcends its intended purpose and could have a crippling affect on our ability to operate effectively as a business enterprise. I have indicated below a number of objections which we have with the proposed legislation:

(1) The legislation requires "good cause" or "legitimate business reasons" in order to cancel a franchise. In our business, the fast-food business, critical matters such as sanitation, cooking to required specifications of wholesomeness, and meeting the particular quality specifications of the franchisor would be subject to judicial review if repeated violations resulted in cancellation of a franchise. The typically protracted judicial process would allow a franchisee, who may be seriously crippling the consumer image and trademark value of the franchise, and in addition, may be jeopardizing the public by serving unwholesome food, to linger on for a considerable period. Because franchisor-owned and operated restaurants are usually grouped for purposes of management control and advertising economy, other franchisees in the non-conforming franchisee's area will suffer from the negative consumer impact that he generates. Far from benefiting franchisees, the most successful of whom support and encourage strict adherence to the standards of wholesomeness and quality, this legislation threatens their business enterprises.

(2) It should be noted that considerable legislation exists which deals with the concerns set forth in the preamble of the bill. Some of the practices have been proscribed by various federal or state antitrust laws dealing with anti-competitive business practices. In addition, the Federal Trade Commission is presently considering a trade regulation rule which requires disclosure regarding the financial structure of the franchisor and other information which would be relevant and useful to a prospective franchisee. This is also the approach adopted by eleven states who have participated in the development of a Uniform Franchise Offering Circular. It seems questionable for Congress to initiate a totally different approach when the principal method of regulation at the state and federal level has not had an adequate opportunity to demonstrate its efficacy.

(3) Should certain industries suffer from a proliferation of questionable business practices, it would seem more appropriate to regulate them with appropriately devised laws. Precedence for this exists among the various statutes enacted or being considered in Congress; for example, the Automobile Dealers Day in Court Act and the petroleum legislation which has passed the Senate. S.2335 lumps together all franchising relationships, short and long term, products and services, and a considerably diverse variety of other business associations. We would propose that the "rifle" approach to these problems has been proven preferable to the 'shotgun' approach which may damage considerably more than merely the problems at which the law is aimed.

(4) S.2335 appears to create a serious imbalance between the right of franchisors and those of franchisees. Both Sections 5 and 6 regarding notice, cancellation and termination of the franchise relationship place serious burdens on the franchisor while no corresponding responsibility or obligation is visited upon the franchise. Section 6(b) even requires a franchisor who fails to renew a franchise at the end of its legitimate, mutually agreed upon contractual term to pay the franchisee reasonable compensation for the value of the franchise business, including goodwill. No such corresponding burden is placed on a franchisee who abandons his business during the franchise term to the resultant economic detriment of the franchisor. It should be borne in mind that a significant portion of the "goodwill" for which a former franchisee would be compensated derives from the use of the franchisor's trademarks, and from the reputation for quality developed and maintained at considerable expense to the franchisor over many years and in many locations.

Further, Section 7 directs that costs of litigation including actual and punitive damages, attorney and witness fees be paid by the franchisor should the franchisee prevail. No such correlary exists when the franchisee is unsuccessful in his suit or the franchisor successful in pursuing his rights under the law.

(5) Finally, the proposed law attempts to regulate the contractual agreements of independent businessmen attempting to operate in the spirit of the free enterprise system. It seems quite unnecessary in 1976, with the variety of regulations which are placed on anticompetitive business practices by various federal laws, to introduce new legislation which abrogates private contractual agreements. Should a franchisor and franchisee agree that twenty years is an appropriate term for their business arrangement and set a price on the value of such a term and agree that neither shall be bound beyond that term to the duties and responsibility of the agreement, it seems not only unnecessary but an unreasonable interference with the rights of both parties to prohibit the franchisor from allowing the agreement to expire at the end of its agreed-upon term. In Section 2 (b) of S.2335, the bill states that its intent is to simulate "fair dealing" and "equitable franchise agreements", an objective hardly furthered by this interference with the rights of businessmen to make otherwise legitimate contractual arrangements.

I hope you can appreciate our great concern over the impact of this legislation on our business. We feel it unnecessary in view of the other legislation which presently controls our enterprise and which, in the vast majority of cases, results in business relationships favorable to us and our franchisees. We strongly encourage you to reject S.2335 and allow the free market economy to operate in an informed fashion through the Uniform Franchise Offering Circular that is presently required in many states, and soon likely to be a Federal Trade Regulation Rule.

I appreciate the opportunity to present our opinion. If we can be of future service, please do not hesitate to contact me.

Very truly yours,

THOMAS D. MCCANN,
Vice President-Administration.

AMERICAN RETAIL FEDERATION,
Washington, D.C., April 6, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Commerce Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR CHAIRMAN MAGNUSON: The American Retail Federation would like to take this opportunity to comment on S. 2335, the "Fairness in Franchising Act."

The American Retail Federation is composed of 50 state retail associations, 31 national retail associations (lists of which have been attached for your information), and many large and small corporate retail members. Several of our national retail associations have commented on the bill. Through its membership, the American Retail Federation represents an industry that has over one and a half million retail establishments and employs over twelve million people.

Our members are affected by the legislation. A necesssity for this type of legislation should be established by those interests seeking the legislation. At this time, no repeated abuses in the present system have been documented. The Federation's members, after much consideration, have determined that no need for this type of legislation has been demonstrated.

Another point of concern is the broadness of the bill. Many of our members lease departments in their retail stores which in no way involves a franchise. However, definitions which are loosely drawn and totally inclusive such as those in S. 2335 could be interpreted to cover this type of relationship. The definitions should be more precise with the extent of the bill's coverage narrowly defined. As the acting Chairman of the Federal Trade Commission, Paul Rand Dixon stated in his testimony before the Consumer Subcommittee of the House Interstate and Foreign Commerce Committee, on March 11, 1976, that this type of legislation ". . . might have a far greater impact than desired."

The proposed legislation would interfere with the contractual relationship between two parties by restricting and/or dictating the terms of contract renewal or termination. This type of intervention by the government should be

avoided. Furthermore even if a need should be established, the legislation should be carefully and tightly drafted so as to avoid unnecessary and unduly burdening parties not under the legislation.

Sincerely,

LLOYD HACKLER,
President.

EDWIN K. WILLIAMS & CO.,
Santa Barbara, Calif., April 6, 1976.

Hon. WARREN G. MAGNUSON,
U.S. Senate, Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: In the past five years, the increased amount of legislation which has been imposed upon franchisors has caused our small company tremendous hardship through additional legal costs and other requirements which have been imposed by many of the states.

To comply with the laws in these states, we are required to rigidly adhere to the stringent requirements of the commissioners. Audited financial statements for mid-fiscal years, full disclosure of all business related activities and costly changes to a substantial amount of our materials, agreements and policies have all been imposed.

Our company has been in business since 1935, and our revenue from franchising amounts to less than one million dollars annually. From this income, we sustain a heavy cost of maintaining a quality service organization with assistance and training to each of our 265 franchisees and over 1,500 of their employees.

In the past three years, we have sustained legal costs of over $500,000 which were directly connected with protecting our franchisees and complying with the legal restrictions imposed upon us.

Senate Bill 2335 would impose further hardship upon our small company. Though we believe adequate protection for franchisees is one of the intents of a franchise relationship, the basic agreement between the franchisor and franchisee is adequate from both sides to protect these interests.

All this bill will do is to further crowd the courts with unnecessary cases. Since the burden of proof lies with the franchisor, it could cause us legal expenses which could seriously damage the interests of the majority of the franchisees. We would be unable to sustain the main effort of assistance to our franchisees and further damage the services performed for the clients of our franchisees.

Most litigation will be brought by ex-franchisees whose attorneys are willing to take the case on contingency. We are left with no recourse under the law for the loss of time, legal expenses or other related costs connected with defending ourselves.

English jurisprudence makes the irresponsible plaintiff responsible for his own legal costs and those of the successful defendant. Not so in our Federal Courts.

We urge your voting against S. 2335 as a completely unfair and unjust piece of legislation which could be detrimental to many small firms like ours and certainly to the taxpayer who will suffer because of the number of new cases which will certainly choke the Federal Courts.

Sincerely,

MRS. E. K. WILLIAMS,
President.

WHITE HEN PANTRY,
Elmhurst, Ill., April 7, 1976.

Mr. WARREN G. MAGNUSON,
U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: This letter is written with regard to certain proposed legislation entitled "Fairness in Franchising Act" (S. 2335) which is, or shortly will be, the subject of hearings before the Senate Committee on Commerce.

For your information, Jewel Companies, Inc., a diversified retailer, includes within its business the franchising of more than 200 convenience food stores under the name "White Hen Pantry".

We have particular concern with this legislation because, while attempting to offer a solution to potential franchise termination and renewal abuses, it disregards the reasonable interest of the franchisor in the franchise relationship. We also feel that this proposed legislation fails to consider the inherent obligation of franchisors to protect the mutual best interest of their franchisees at large, which may be in conflict in such matters.

It is our sincere belief that certain types of business ventures can best be operated by a local owner who knows his customers and marketing area. In that regard, franchising generally has broadened the potential for local ownership to a point where it now represents a significant opportunity for anyone interested in a small business operation. It is reported, in fact, that franchised businesses now account for more than one-third of all retail sales nationally. However, the franchising concept cannot continue to thrive unless there exists an inducement to franchisors sufficient to justify the significant investment and other business risks involved.

It is not our intent to challenge the right of any person to be fairly treated. But we must question any proposal which would substantially eliminate one party's right to choose those with whom he will conduct business unless the most compelling evidence exists in support of such a proposal.

We would suggest that a comprehensive study be immediately initiated to clearly determine what abuses exist in the broad spectrum of franchising nationally. In this regard we specifically believe that a cooperative effect of all concerned government agencies and representative franchisees and franchisors be the vehicle for such a study. Only then can we fairly determine the propriety of a law as restrictive as that now proposed.

Respectfully submitted,

JO H. ARMSTRONG,
President.

CONSOLIDATED FRANCHISE ASSOCIATION,
Kansas City, Mo., April 8, 1976.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on Consumers, Senate Commerce Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR MOSS: I have delivered to your subcommittee the following documents for your consideration with respect to S. 2335, to wit:

1. Statements of (a) James D. Cerajewski, President of CFA, (b) Mark J. Klein, General Counsel of CFA, and (c) Richard F. Bolinger, Jr., Former Dunkin' Donuts franchisee.

2. Separate binder of exhibits to statements of James D. Cerajewski and Mark J. Klein.

We do not request that the entire binder of exhibits be printed in the record of the hearings, only Exhibt Nos. 2 and 3. These two documents present information supplemented to the statements that we feel is relevant, and additional copies have, in fact, been attached to Mr. Gerajeyski's statement. The purpose of the other documents is solely to substantiate the statements themselves. They will provide the subcommittee and staff a means of checking the source of much of the information contained in the statements. Thank you for your consideration of this request.

Respectfully yours,

MARK J. KLEIN,
General Counsel.

MICHIGAN BEER AND WINE WHOLESALERS ASSOCIATION,
Lansing, Mich., April 9, 1976.

Senator WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: I understand that there is a strong possibility that hearings may be scheduled on S. 2335, the "Fairness in Franchising" bill before your Committee.

Speaking on behalf of the entire membership of the Michigan Beer and Wine Wholesalers Association, I would like to indicate to you at this time our strong support of this measure.

Beer wholesalers, as relatively small businessmen, are often exposed to critical relationships with their suppliers, and without the support of a reasonable franchise arrangement, they ofttimes find themselves cancelled with little or no notice, and subjected to possible loss of their business, or at least serious damage thereto.

Your favorable consideration to this request will be appreciated.

Very truly yours,

RAE W. DEHNCKE,
Executive Vice President.

SCHWINN BICYCLE CO.,
Chicago, Ill., April 9, 1976.

Hon. WARREN G. MAGNUSON,
U.S. Senate, Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: I am writing you concerning this Bill which I understand you have cosponsored and which I understand is now pending before the Senate Commerce Committee. Our Company is opposed to this legislative proposal because we believe it is an unnecessary and unwarranted interference in the relationship between Schwinn Bicycle Company and our 1700 independent Schwinn retailers.

Enclosed is a copy of the testimony I gave on March 10th before the House Subcommittee on Consumer Protection & Finance Committee on Interstate and Foreign Commerce, in opposition to the companion Bill in the House introduced by Congressman Mikva.

We urge you to give particular attention to the fact that the definition in this proposed legislation is so broad that it would encompass many kinds of product distribution arrangements like Schwinn which are not the usual kind of franchising. Indeed, if enacted, this legislation would create serious interference with the distribution of literally thousands of trademarked products which involve the payment of no franchise fee whatsoever or any royalties.

We urge you to vote against S. 2335.

Yours very truly,

RAY BURCH,
Senior Vice President, Marketing.

Enclosure.

STATEMENT OF RAY BURCH, SENIOR VICE PRESIDENT, MARKETING, SCHWINN BICYCLE CO.

My name is Ray Burch. I am Senior Vice-President of Marketing for the Schwinn Bicycle Company in Chicago and I appear on behalf of Schwinn. Schwinn is a family owned business founded in 1895. We manufacture high-quality bicycles which are sold to consumers through approximately 1,700 independently owned authorized Schwinn retail dealers located throughout the country.

At the outset, let me state that Schwinn, being a member of the International Franchise Association, supports the IFA position on HR 8349 as set forth at this hearing. My statement is intended to supplement that presentation.

We believe the proposed restrictions on franchise terminations are, first of all, entirely unnecessary and uncalled for by the conditions that actually exist today in most, if not all, of the many varieties of franchising. This committee

should recognize in its deliberations that the vast majority of nearly half a million franchisees are happy and successful. The complainers are exceptions to that general condition in the world of franchising and should be so recognized. And there is no way to legislate complete happiness for everyone.

Second, the definition of franchising in HR 8349 omits the condition that there be a franchise fee and therefore is entirely too broad and all inclusive of many kinds of businesses. This legislation would cover not only the complete business format type of franchising, which is what most people understand the word "franchise" to mean, but it would also attempt to regulate the relationship between thousands of manufacturers of tradename products and the many more thousands upon thousands of retailer whose names are listed in the Yellow Pages everywhere as sellers of those products.

The proposed restrictions on terminations, as well as the enforced renewal of agreements and "buy out" provisions, are totally unrealistic and inapplicable in this type of product franchise business relationship, as can be demonstrated by the following brief explanation of Schwinn's method of selling Schwinn bicycles.

Schwinn's franchise program is a very simple form of product franchising, utilizing a brief one-page Schwinn Dealer Franchise Agreement. A copy of that agreement is attached to this statement as Exhibit A. Under the terms of this agreement Schwinn does not charge a franchise fee or royalty of any kind. Schwinn merely appoints a retailer as its authorized dealer at a specified address.

Schwinn agrees to supply Schwinn products to the dealer and to help the dealer in creating a market for those products through advertising and merchandising support. Schwinn Dealers agree to make a bonafide effort to sell and service Schwinn products and to provide warranty service to their customers.

In short, the Schwinn Dealer Franchise Agreement is nothing more than a simple buy/sell agreement between Schwinn as a manufacturer and independently owned retailers. Schwinn's income is derived from the sale of Schwinn bicycles and related products to its authorized dealers at bonafide wholesale prices.

Virtually all Schwinn Dealers sell other merchandise, including other brands of bicycles and bicycle products, in addition to the Schwinn line. Under this type of selling agreement, retailers are free to come and go, and to take on other lines of merchandise, in which case they may elect to keep Schwinn or they may choose to drop the Schwinn line. If they decide to drop the Schwinn line, they may or may not give notice. They may simply stop buying Schwinn merchandise without giving notice, and become an inactive account.

In such cases Schwinn may not realize for a period of weeks or even months that a dealer has stopped buying Schwinn products. When it does become evident that a dealer is no longer actively representing our product, there is an immediate need to terminate the inactive account and appoint a new dealer to service Schwinn consumers in the abandoned market. A delay of 90 days to give notice to a dealer who has already quit without giving notice makes no sense and imposes an unfair burden on the manufacturer as well as the consumers in a vacated market. The type of termination I have just described is not a rarity or merely one isolated instance, particularly in the type of product franchising Schwinn uses. Such terminations are common and, with very few exceptions, non-controversial. In over 23 years of franchising, no Schwinn Dealer has ever brought suit against Schwinn to challenge termination of a franchise.

Schwinn was sued by the U. S. Justice Department in a civil anti-trust action, in which Schwinn's dealer franchise program was thoroughly investigated and upheld under the "rule of reason" (see 237 F. Supp. 323 (N. D. Ill. E. D. 1965); reversed in part 388 U.S. 365 (1967); 291 F. Supp. 514 (N. D. Ill. E.D. 1968)). In that litigation evidence was presented which analyzed the reasons for over 7,000 terminations of Schwinn franchises during a ten-year period from 1952 to 1961. That evidence may be helpful to this committee by providing a broader perspective of the typical causes of franchise terminations.

As will be noted from the results of that analysis summarized below, over 80% of all terminations were by dealer option. Of the remaining 19%, the reasons clearly left little basis for challenge, and none was challenged. The summary results follow:

ANALYSIS OF SCHWINN FRANCHISE TERMINATIONS[1]—DECEMBER 1952–DECEMBER 1961

Reason	Percent	Number of terminations
Dealer inactive	32.1	2,254
Dealer went out of business	23.3	1,642
Dealer dropped bicycles	7.4	517
Dealer failed to renew franchise	7.1	497
Dealer sold out to new owner	5.5	386
Dealer requested termination	3.0	208
Dealer moved to new location	2.2	254
Total dealer option	80.6	5,658
Unsatisfactory sales (less than 10 bicycles per year)	11.5	807
Poor credit experience	2.8	196
Unsatisfactory sales (less than 25 bicycles per year)	2.7	187
Unsatisfactory sales (less than 50 bicycles per year)	.6	42
Inadequate display, no stock, inadequate sales effort	.9	64
All other, miscellaneous	.9	64
Total Schwinn option	19.4	1,360
Total terminations	100.0	7,018

[1] Source: Defendant's exhibit 257A in U.S. vs. Schwinn (237 F. Supp. 323). See exhibit B attached.

During a more recent period, from October 1974 through February 1976, a similar analysis showed the following reasons for termination of Schwinn franchises:

ANALYSIS OF SCHWINN FRANCHISE TERMINATIONS—OCTOBER 1974 THROUGH FEBRUARY 1976

Reason	Percent	Number of terminations
Dealer option—various reasons	55.4	41
Dealer moved to new address	5.4	4
Total dealer option	60.8	45
Poor credit experience	28.4	21
Unsatisfactory sales	10.8	8
Total Schwinn option	39.2	29
Total terminations	100.0	74

Source: Schwinn Bicycle Co. franchise records.

As these figures indicate, franchise terminations simply are not a problem or a form of "franchise abuse" in Schwinn distribution. With literally hundreds of brands of bicycles readily available in the marketplace, every Schwinn dealer has many options to change brands whenever he chooses—as do many thousands of retailers of other products who have the same freedom to select the brands of trademark products they sell.

If the seller defaults on his contractual obligations, the retailer has a cause of action to seek relief under laws which already exist. But neither party is required by law to continue or to renew a relationship which has ceased to be simply a buy/sell relationship involving the purchase of goods by a retailer at bonafide wholesale prices without any royalty or franchise fee.

The sponsors of this bill have called attention to the benefits of the franchise method of distribution, at least in a general sort of way. Before leaving the subject of Schwinn distribution, let me call the committee's attention to a summary of Schwinn sales figures which illustrates the benefits of selective distribution in product franchising—see Exhibit C. These figures show that although the total number of Schwinn Dealers was reduced from 1960 to 1974, total Schwinn sales increased substantially during the same period, even before the so-called "Bike Boom" began in 1971. And sales per dealer increased even more remarkably as individual dealers became stronger competitors in the marketplace, as shown below. Stronger dealers not only enhance the vigor of competition but they also provide consumers with better selections of merchandise and better service.

SCHWINN BICYCLE SALES 1960–74

[By units and approximate retail dollar volume]

Dealers	Total Bicycles	Total Average	Average retail price	Approximate total retail dollar sales	Average
5,087	429,076	84	NA	NA	NA
3,236	826,059	255	$ 51.05	$ 42,170,312	$13,032
1,895	889,706	470	69.28	61,638,832	32,527
1,704	1,142,960	671	81.51	93,162,670	54,673
1,635	1,427,933	873	87.69	125,215,445	76,584
1,580	1,532,681	970	93.63	143,504,922	90,826
1,605	1,449,392	903	106.74	154,708,102	96,391

Source: Schwinn sales records. See exhibit C.

Let me turn now to the subject of complaints about the alleged abuses of franchising which are invariably cited as proof of the need for franchise regulation. It has been my experience that there is a great deal of misunderstanding, not only about how many complaints are being received, but also about the nature and validity of those complaints, as well as the very real question of how many and what kinds of complaints can be helped by legislation.

In 1972 the Federal Trade Commission conducted public hearings in connection with a proposed trade regulation rule on franchising, which incidentally is still pending at the Commission. At the opening of those hearings testimony was given by an administrative assistant representing a member of Congress who stated "The records of this Commission show that there have been a substantial number of complaints. . . . These abuses are too many in number to go unheeded" (FTC Hearing Transcript, pages eight and nine). These complaints were said to be contained in the FTC Public Record.

In an effort to determine more precisely the nature of franchise complaints being registered with government agencies, I personally reviewed every one of the 246 purported complaints of franchisees and others who claimed to have been the victims of abuses as contained in the FTC Public Record at that time. I made a summary of those 246 so-called franchise complaints, and this summary was submitted to the Federal Trade Commission by the International Franchise Association on April 20, 1972. One copy of that complete report totaling 283 pages is submitted to this committee with this statement. (See Exhibit D1). A copy of the cover letter dated April 20, 1972 from Mr. Jerry H. Opack, Executive Vice President of the International Franchise Association, summarizing the results of that study is attached to all copies of this statement as Exhibit D2.

To my knowledge, this is the most comprehensive collection and analysis of case history data ever assembled detailing specific franchise complaints. It was collected from regional FTC offices, Better Business Bureau offices, the Justice Department, state agencies, chambers of commerce, members of Congress and various other sources, including attorneys and individuals known to have been involved in franchise litigation. Of the total of 246 purported complaints, 66 are not complaints at all, but rather are comments on the FTC's proposed rule on franchising.

The most significant result of this study is the discovery that over two-thirds of the so-called "franchise complaints" in this FTC file do not relate to "franchising" at all—or to any variation of franchising. Instead, the records are bulging with a long list of fraud and other abuses committed by hit-and-run swindlers who use—and continue to use—deceptive blind ads to peddle vending machines, rack jobber deals, phoney "distributorship", pyramid schemes and other nefarious offerings.

Analysis of all the complaints show that there are only 55 complaints that could be found to relate to franchising. For the most part the records available indicate that the majority of these involve ordinary business problems and disputes. Some complaints have been included in this category simply because they claim to be "franchise complaints" and there is insufficient information to classify them otherwise. Most of the charges made in all of these complaints are entirely unverified, being only "one side of the story."

This is not to say that they should be dismissed as unimportant but only that in their present state and without more thorough investigation they do not constitute reliable evidence of widespread wrongdoing or unfair practices by true franchisors. However, the most significant fact is that not a single one of these complaints would be covered by HR 8349. That is to say, not a single one of these complaints involves a termination or refusal to renew a franchise. Rather, they involve such matters as alleged misrepresentation and fraud, no profitability, operating problems, franchisor bankruptcy, and the like. A list of the types of complaints involved in these 55 franchise complaints is contained in the summary attached to this statement as Exhibit D2. The total number of complaints is truly miniscule in comparison with the total of 457,693 franchisees in existence in 1976[1] and in any event would not be covered by HR 8349.

It is obvious that HR 8349 is aimed at vices present only in certain industries. In fact, the only specific reference to abuses made by Congressman Mikva when he introduced the Bill is a reference to a survey of gasoline filling station dealers. I submit that you should not "burn down the barn to kill the rat" by unreasonable, needless and anti-competitive regulation of the vast majority of franchise industries that present no problem.

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[1] Franchising in the Economy 1974–1976 U. S. Department of Commerce publication.

EXHIBIT A

FACTORY USE ONLY
Franchise Registration No.
Original Expiration Date
By

Schwinn®

Dealer Franchise Agreement

This AGREEMENT, made at Chicago, Illinois, this _____ day of _____ 19___ between Schwinn Bicycle Company with its principal place of business in the City of Chicago (hereinafter called "Schwinn") and

Dealer Name _____

Street Address _____

City _____ County _____ State _____ Zip _____

(hereinafter called "Dealer")

WITNESSETH that the parties hereto, in consideration of the mutual covenants and agreements hereinafter set forth, do agree with each other as follows: SCHWINN hereby appoints Dealer as its authorized dealer for Schwinn Products at the address shown above:

1. SCHWINN WILL:

a. Offer the Dealer a market with an established potential and a limited number of authorized Schwinn Dealers, based upon Schwinn's careful market analysis;
b. Give the Dealer vigorous, sustained advertising support;
c. Make available advertising, display, and promotional material at low cost to the Dealer;
d. Offer the Schwinn Guarantee against defective material or workmanship on all Schwinn products sold and put in normal use.

2. DEALER WILL:

a. Maintain satisfactory annual sales of Schwinn bicycles, estimated at _____ per year.
b. Display on Dealer's floor at all times (with position equal to and as prominent as that of any competitive bicycle) an adequate stock of new Schwinn bicycles;
c. Advertise the Schwinn line and at all times promote the sale of Schwinn products to the best of Dealer's ability;
d. Properly display and explain the Schwinn factory guarantee to all purchasers buying Schwinn bicycles;
e. Provide adequate service for Schwinn bicycles he sells, using only Schwinn factory parts and accessories in servicing Schwinn products, unless owner specifically requests other parts be used;
f. Maintain satisfactory credit relations with Schwinn;
g. Not use the name "Schwinn" except in the manner authorized by Schwinn and will forthwith discontinue any use on termination of the franchise.

3. DEALER AND SCHWINN MUTUALLY AGREE:

a. This franchise shall remain in effect until the original expiration date shown above, and shall automatically be renewed from year to year thereafter, unless terminated by notice to Schwinn by Dealer prior to any anniversary date, provided that this franchise or any provision thereof may be forthwith cancelled by Schwinn at any time by written notice mailed to Dealer at the above address;
b. In the event of termination of the franchise, Schwinn has the option of repurchasing any unsold Schwinn products or any unused advertising matter, at the price paid for them by the Dealer;
c. This Franchise is issued by Schwinn by reason of the confidence it has in the Dealer, is personal in nature, and is non-assignable and non-transferable;
d. Nothing contained herein shall be construed in any manner to appoint Dealer an agent for Schwinn.

SCHWINN BICYCLE COMPANY (Manufacturer)
1856 N. Kostner Avenue, Chicago, Illinois 60639

Dealer's Signature _____

Business Name _____ Signed _____

Signed _____ Date _____ Title _____
(Salesman)

Dealer's present inventory of Schwinn bicycles _____ Last year's sales of Schwinn bicycles _____

Estimated sales of all makes of new bicycles _____ Bicycle repair service Yes ☐ No ☐

Note: Franchise must be completely filled in. All three copies must be signed in ink by dealer and salesman, then sent to factory.

FACTORY COPY

6-1-69

In the United States District Court
Defendants' Exhibit 257A

EXHIBIT B

ANALYSIS OF SCHWINN FRANCHISE TERMINATIONS...

DECEMBER 1952....DECEMBER 1961

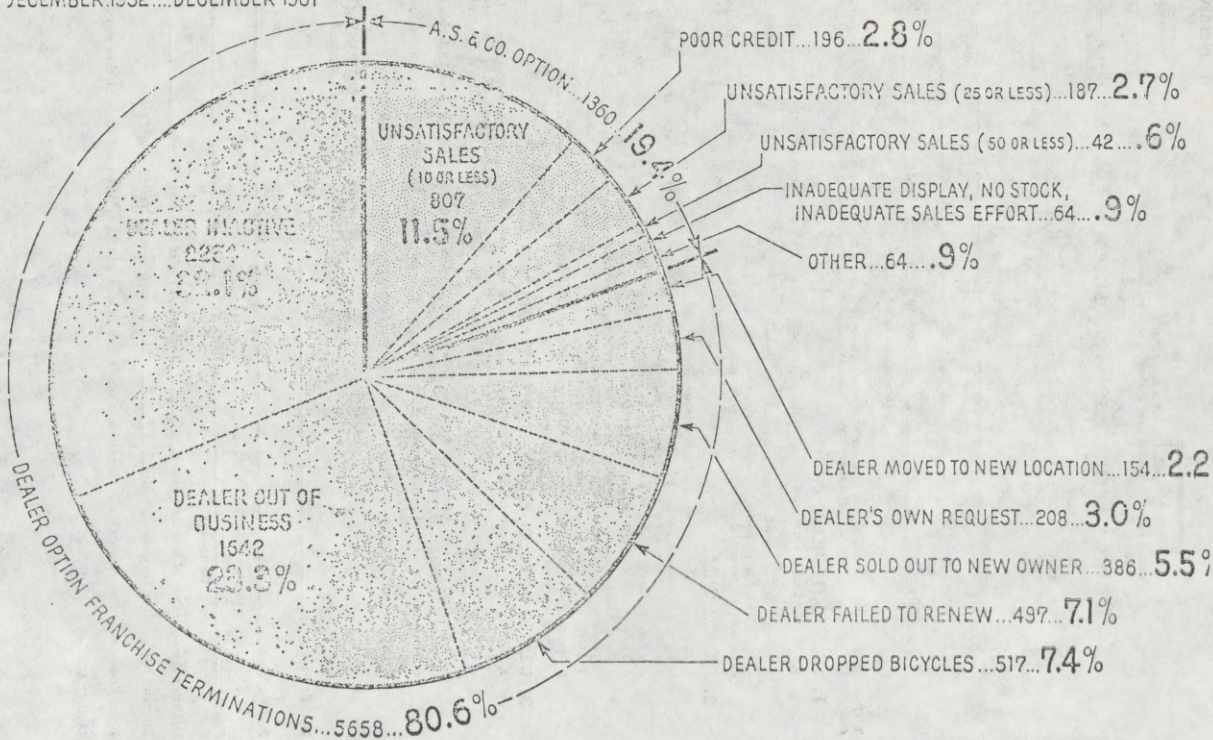

Exhibit C

RETAIL SALES OF SCHWINN BICYCLES BY DEALER CLASSIFICATION—1960–74

Year	1000+units annual sale			500–999 units annual sales			0–499 units annual sales			Total			Average retail price	Approximate total retail dollar sales	Average
	Dealers	Bicycles	Average	Dealers	Bicycles	Average	Dealers	Bicycles	Average	Dealers	Bicycles	Average			
1960	16	21, 341	1, 334	93	63, 025	678	4, 978	344, 710	69	5, 087	429, 076	84	NA	NA	NA
1965	122	164, 815	1, 351	381	245, 547	644	2, 733	415, 697	152	3, 236	826, 059	255	$51. 05	$42, 170, 312	$13, 032
1970	254	411, 521	1, 620	381	258, 151	677	1, 260	220, 034	175	1, 895	889, 706	470	69. 28	61, 638, 832	32, 527
1971	406	721, 570	1, 777	368	254, 530	692	930	166, 860	179	1, 704	1, 142, 960	671	81. 51	93, 162, 670	54, 673
1972	524	1, 001, 222	1, 911	386	273, 177	708	725	153, 534	212	1, 635	1, 427, 933	873	87. 69	125, 215, 445	76, 584
1973	571	1, 098, 870	1, 924	406	290, 640	716	603	143, 171	237	1, 580	1, 532, 681	970	93. 63	143, 504, 922	90, 826
1974	532	989, 495	1, 860	413	303, 457	735	660	156, 440	237	1, 605	1, 449, 392	903	106. 74	154, 708, 102	96, 391

[1] Total bicycle unit sales as shown exclude sales to employees, advertising and promotional sales and nondealer shipments.

[2] Weighted average of suggested retail prices of all models. Increases reflect shift in model mix to greater ratio of 10-speed models of higher value, plus inflationary trend of material and labor costs.

Exhibit D

INTERNATIONAL FRANCHISE ASSOCIATION,
Washington, D.C., April 20, 1972.

Re Analysis of "Franchise Complaints" in FTC Public Record regarding Proposed Trade Regulation Rule on Franchising.

MR. WILLIAM D. DIXON,
Assistant Director, Division of Rules and Guides, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C.

DEAR MR. DIXON: This report is submitted on behalf of the International Franchise Association to assist the Commission's study of franchising in three ways:

1. To more accurately identify and classify the specific kinds of business opportunity abuses now occuring in the marketplace, as evidenced by actual case histories taken from "complaints" in the public record of the Commission's proceeding on the proposed franchise rule.

2. To distinguish between:

(a) Alleged abuses, including fraud, by non-franchisors, masquerading as franchisors, and

(b) Alleged abuses by franchisors—particularly those abuses which would be reached by the proposed rule, and

116 NONFRANCHISE COMPLAINTS

The most significant result of this study is the discovery that over two-thirds of the so-called "franchise complaints" in this FTC file do not relate to "franchising" at all—or to any variation of franchising. Instead, the records are bulging with a long list of fraud and other abuses committed by hit-and-run swindlers who use—and continue to use—deceptive blind ads to peddle vending machines, rack jobber deals, phoney "distributorships", pyramid schemes and other nefarious offerings.

While some of these "come-on" ads appear under the "Franchises" heading in the classified sections of leading Sunday newspapers everywhere, most are found under "Business Opportunities." It is shocking to find that some of the same advertisers identified in this FTC file as alleged swindlers are still running the same kind of "come-on" ads. It is also discouraging to see the great number of blind ads accepted by leading newspapers where potential investors are invited to write to a box number, or to "call a Mr. X" at a phone number, or at a hotel. Although some such offers are no doubt legitimate, the FTC files contain numerous complaints alleging that deposits or "front money" were paid in hotel meetings to representatives who "disappeared", or that money was paid for machines, racks or merchandise never delivered. Such ads continue to appear in newspapers every Sunday—see "Business Opportunity Ads" tab.

FRANCHISE OR NON-FRANCHISE?

It is understandable that many people may be deceived or confused about what is franchising, and what is not franchising—especially when the already complex nature of franchising is further complicated by non-franchisors masquerading as "franchisors." (See speech by M. A. Caliandro of the Better Business Bureau in Appendix.) The opening paragraphs of the FTC's Background Paper on the Proposed Franchise Rule discuss the problems of defining "franchising" and reach the conclusion that:

"Basically, franchising should be viewed as a method of distribution in which the franchisor *licenses his trademark* to a licensee, i.e., a franchisee who conducts his business in accordance with the franchisor's uniform business format." (Emphasis added.)

(c) Ordinary business problems and disputes between franchisors and franchisees which are beyond the scope of the proposed rule, and;

3. To recommend remedies which will directly apply to the most prevalent abuses now occurring without burdening the Commission and responsible franchisors with depressing regulations and a mass of administrative detail which would very likely be evaded by the "fringe element", in any case.

CONTENTS

This report contains a one-page summary sheet for each of the 246 sets of documents (over 2100 pages) filed in Category (4) from January 26 through March 3, 1972. (Category (4) contains letters and documents solicited and obtained from, or in behalf of, purported franchisees and other persons who claim to have been the victims of abuses associated with a variety of business opportunities.) These summary sheets have been grouped in four classifications as shown on the index tabs ("Miscellaneous". "Comments". "55 Franchise Complaints" and "116 Non-Franchise Complaints"). More detailed breakdowns of two of these categories "55 Franchise Complaints" and "116 Non-Franchise Complaints", are listed on their respective tab dividers.

These summary sheets, and the documents they describe, to our knowledge provide the most comprehensive collection and analysis of case history data ever assembled detailing specific "franchise complaints." They have been collected from regional FTC offices, Better Business Bureau offices, Justice Department, state agencies, chambers of commerce, members of Congress and various other sources, including attorneys and individuals known to have been involved in franchise litigation. Only a relatively small number of complaints were received by FTC in Washington without solicitation, and some documents relate to cases in which civil or criminal complaints have already been filed. Sixty-six of the 246 documents relate primarily to comments and opinions about the Proposed Rule rather than detailing specific complaints, as did the vast majority of the 1747 pages of testimony taken during twelve days of hearings.

It is the use of a trademark which almost invariably distinguishes true franchising from spurious "franchising." Granting the use of a trademark or service mark for a fee or royalty is indeed the essence of the franchise relationship. This is recognized by the definition of "franchise" in the California Investment Law, the International Franchise Association's "Model Bill", and by most other state laws to regulate franchising. (Granting the use of a trademark without a fee or royalty for merchandising purposes also may be called a "franchise", although such arrangements usually are more accurately identified as "authorized" dealerships or distributorships, and do not possess the inherent risk of loss or injury to the investing public.)

It is clear that few if any of these "116 Non-Franchise Complaints" relate to true franchise relationships for several reasons. First, no trademark or service mark is involved—and indeed, based on the FTC complaint files, it is common practice for shady operators to change company names as often as they change hats. Second, the complaints show there is no "series of . . . transactions", no "continuing commercial relationship," nor does the "franchisor continue to exert any control. . . ." On the contrary, the typical swindler collects the deposit or "front money" and either disappears or refuses to respond to investor inquiries—this situation is illustrated over and over again in the file of complaints.

While it might appear to be a simple remedy to broaden the definition of "franchise" to cover sellers of vending machines, rack jobber routes, "distributorships", pyramid deals and other schemes described in this file of complaints, such a solution would suffer from at least two defects. First, the rule would have to be so broad as to encompass virtually every kind of distributor arrangement and would therefore be virtually unmanageable and, second, the fraudulent recruiters would no doubt switch to "Help Wanted" ads or other evasions, and would continue to violate laws, regulations, and business ethics by one means or another just as they are doing today.

55 FRANCHISE COMPLAINTS

With respect to the "55 Franchise Complaints," it is suggested that the Commission staff may find it worthwhile to investigate each of these cases in more depth. For the most part, the records available indicate that the majority of these involve ordinary business problems and disputes, a good many of which are being litigated to determine whether the franchisee is justified in his complaint. Some complaints have been included in this category simply because they claim to be "franchise complaints" and there is insufficient information to classify them otherwise. Most of the charges made in all of these complaints are entirely unverified, being only "one side of the story."

This is not to say they should be dismissed as unimportant, but only that in their present state, and without more thorough investigation, they do not constitute reliable evidence of widespread wrong-doing or unfair practices by true franchisors. Even assuming one third of them may prove to be both justified and also covered by the Proposed Rule, which probably is a generous estimate, they would make up less than twenty actual franchise complaints—a modest number indeed in relation to some 500,000 franchisees now estimated to be in business. Such a figure provides scant support for the assertion made at the opening of the hearings that "The records of this Commission show that there have been a substantial number of complaints. . . . These abuses are too many in number to go unheeded." (Transcript, pages 8 and 9)

REMEDIES THAT "ZERO IN"

As counsel and witnesses for the International Franchise Association testified during the hearings, IFA supports remedies designed to stop abuses by the "fringe element of promoters" which not only defraud the public but also damage the reputation of ethical franchisors. But at the same time, the Commission was urged to be selective and to propose remedies which would "zero in" on actual abuses, rather than to use a "shot-gun" approach. During the hearings, however, few if any witnesses had any clear understanding of what kinds of abuses were represented "in the files of this Commission". Indeed, the second witness, a lawyer, was frank to say,

"In other words, I simply don't know what is the problem on misrepresentation or fraud which is what I assume these disclosure requirements are aimed at, that prompts them to be such a sweeping type of regulation." (Transcript page 34.)

Now that "the problem of misrepresentation or fraud" has been more clearly identified in the Commission's files, appropriate remedies might include the following:

1. A crack-down on the flood of blind Business Opportunity or similar "come-on" ads to stop those that are found to be deceptive or have the capacity to deceive.

2. A request from FTC to States' Attorneys General to conduct local investigations of such ads and to press for enactment of legislation to prohibit blind or deceptive ads, and to provide adequate penalties if not already in effect.

3. More vigorous enforcement of anti-fraud statutes at both federal and local levels, including mail fraud, with criminal prosecutions where warranted.

4. A systematic exchange of information about suspect offerings and investigations between all local enforcement agencies, Better Business Bureau offices, FTC regional offices and FTC headquarters.

5. If sufficient need can be shown on the basis of true franchise abuses, promulgation of a disclosure rule similar to the IFA model bill and the California Franchise Investment Law, perhaps with appropriate exemptions (such as those adopted elsewhere, for established responsible franchise companies and for "authorized dealership" arrangements not involving a franchise fee).

6. If there appears to be sufficient need for a special trade regulation rule for gasoline service stations, as suggested by various witnesses during the hearings, representatives of the petroleum industry should be consulted to develop a reasonable, workable rule for that industry. This is far more reasonable and sensible than blanketing all no-franchise-fee marketers by having an overly broad definition of "franchise" merely for the purpose of bringing service stations under the rule.

7. In general, existing laws against deceptive advertising, misrepresentation and fraud by non-franchisors should be vigorously enforced—rather than attempting to eliminate these practices by imposing upon franchisors added burdensome regulations using a contrived definition broad enough to cover non-franchise offerings.

CONCLUSION

Based on the evidence of record in the trade regulation rule proceeding, it is apparent that unfair and deceptive practices do occur in the promotion and sale of a variety of business opportunities. It is also apparent that only a small percentage of recorded complaints and alleged abuses relate to true franchising. And, even these are unverified.

The Commission has authority under existing law to take enforcement action against the kind of promotional and sales practices which have been demonstrated to exist, and we urge that such action be taken. On the other hand, the proposed rule will be ineffective to a large extent in eliminating present abuses, while casting an enormous burden on ethical and fair-dealing business. The proposed approach to abusive practices should be changed and directed to squarely meet the real problems of the market place.

It is respectfully requested that the foregoing, with attachments, be included in the record of proceedings for the proposed trade regulation rule concerning franchising. We would be pleased to discuss this submission with you and to provide the Commission with any further information it may deem useful and desirable.

Sincerely yours,

JERRY H. OPACK,
Executive Vice President.

MEINEKE DISCOUNT MUFFLER SHOPS, INC.,
Bellaire, Tex., April 9, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, U.S. Senate
Russell Senate Office Building, Washington, D.C.

DEAR SIR: I have been in franchising for almost fifteen years as a franchisee, an employee of a franchisor and a franchisor.

It is my judgment that remedies presently exist to provide the protection that this Bill attempts to provide.

I question its sponsor's motives. I believe it was introduced as a direct result of a sensational exposé in the Chicago Tribune without sufficient study.

The Bill places the investment of thousands of small businessmen and women in danger by removing from them the trademark protection necessary to provide for equity growth from the danger of irresponsible actions by unscrupulous members of their own organization.

The Bill would remove from franchisors the ability to protect their names and marks as well as the public interest against unscrupulous irresponsible actions of franchisees.

As examples—a hamburger franchisee decides that in addition to the prescribed menu, he wants to sell fish. Since fish is not a part of the regular menu, the franchisor has no standard with regard to the freshness of the fish to be served. Upon inspection by the franchisor, it is discovered that the franchisee is running the risk of selling bad or contaminated fish, and the franchisor directs the franchisee to stop selling fish or to take necessary safeguards. The franchisee refuses.

If the franchisor reports his franchisee to the authorities, a risk is run that the press will discover the situation and expose the story to the public, thereby causing all other franchisees serious financial harm. The franchisor must have a speedy recourse to terminate for good cause. Present due process can provide both parties with a quick hearing where a danger to health and safety of the public exists.

A franchisor in the automotive after market discovers that a dealer is charging for work and not performing the service or selling a service that a customer does not need. This example is like the first but in a different industry. A franchise company must have the right to protect all the other franchisees in the chain. This Bill removes that right and is therefore not in the interests of the franchisees or the public.

It is essential to distinguish between termination and nonrenewal.

If it is the intent of this committee to provide legislation to protect the small investor, then it should direct its efforts against those specific franchises that have:

1. Short term duration with frequent renewal clauses.
2. Additional license fee (as differentiated from continual royalty fee) for renewal.

If these two examples are eliminated from all franchise or license agreements, most of the legitimate complaints of the franchisees will be eliminated with regard to unfair termination. If #1 is eliminated, it will force the two parties

to work out solutions to disagreements and will remove the threat of arbitrary non-renewal on the part of the franchisor, make all license agreements a minimum of ten years and spell out the basis of renewal. If #2 is eliminated, the franchisor will not be able to unfairly participate in the equity that the franchisee has built up through the years and will remove a major cause of complaint.

In conclusion, the present Bill would do nothing to eliminate the problems and would so weaken the franchise company's ability to protect its "mark" as to render the value of that "mark" meaningless.

Very truly yours,

HAROLD NEDELL,
Executive Vice President.

KOWALSKI DISTRIBUTING CO., INC.,
Manistee, Mich., April 10, 1976.

Senator WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce, Dirksen Senate Office Bldg., Washington, D.C.

DEAR SENATOR MAGNUSON: Reference is made to Senate bill No. 2335, "Fairness in Franchising".

Legislation to enact this bill is of utmost importance to our business and future.

It is requested that every effort be expended to have this bill entered in the hearing record.

Your favorable consideration will be sincerely appreciated.

Very truly yours,

ERVIN A. KOWALSKI,
President.

SISSETON, S. DAK., *April 11, 1976.*

CHAIRMAN,
Senate Committee on Commerce,
Washington, D.C.

DEAR MR. CHAIRMAN: I am a resident of Sisseton, South Dakota. Since 1947, I have been in the business of distributing beer in northeastern South Dakota. My family's involvement in the beer business goes back to approximately 1934 when, with the repeal of Prohibition imminent, my father traveled to the Hamm's brewery in St. Paul, Minnesota and agreed with Hamm's executives to distribute Hamm's beer in Sisseton and neighboring towns as soon as it became legal to do so. When Prohibition ended, my father hired a local drayman to deliver beer. He later bought a pickup truck, which he emblazoned with the Hamm's emblem. With the help of his own children, usually myself, he introduced Hamm's beer to northeastern South Dakota.

After returning from naval service in World War II, I purchased the Hamm's distributorship from my father. In those days many retail establishments sold only one brand of beer. I made repeated calls on all retail business establishments in northeastern South Dakota in an attempt to get Hamm's beer in as many outlets as possible. At the time my current supplier of Hamm's brand beer attempted to terminate me, Hamm's was being sold in every retail establishment in northeastern South Dakota.

During my 28 years as a Hamm's distributor, I have made substantial and continuous investments, in excess of $150,000, in fixed plant, equipment, real estate, vehicles and other assets necessary to properly carry on my duties as a Hamm's distributor.

My duties as a distributor of Hamm's brand beers have included taking all reasonable steps to insure the quality of the Hamm's product, including, but not limited to, rotation of Hamm's beer in my warehouse, on my trucks, and at the point of sale. I have always attempted to market a full line of Hamm's packages, and have provided regular deliveries of Hamm's beer to all retailers in northeastern South Dakota. I have maintained adequate inventory levels in a clean and efficient warehouse. I have trained and maintained a sales and

delivery force. I have installed, at substantial cost to myself Hamm's advertising in all, or nearly all, of the retail accounts in northeastern South Dakota. I have maintained a record-keeping system for recording orders, deliveries and other pertinent matters helpful in the marketing of Hamm's. I have attended numerous Hamm's sales, service and related meetings and training sessions.

Just four months prior to being terminated, I received a bonus from my supplier of Hamm's brand beers in excess of $1,000 for exceeding, by 32%, the sales quota for Hamm's draft beer established by Hamm's for my territory. This performance resulted in Hamm's congratulations to myself and an award of a bonus in excess of $1,000.

As a distributor of Hamm's brand beers, I have expended considerable sums over the years for advertising the Hamm's brand in newspapers, on billboards, on my trucks, and on my employees' uniforms. I have purchased additional promotional materials such as coolers, glasses, matches, jackets and t-shirts for resale at or near cost in order to promote the sale of Hamm's products in my territory and to create the goodwill associated with Hamm's brand names.

During the past 28 years, my promotion, distribution, service, and investment, as well as my involvement in public affairs, have brought Hamm's from an unknown and unsold quantity in northeastern South Dakota to complete market availability and recognition. In northeastern South Dakota, the names Dady and Hamm's have become mutually identified, thereby creating goodwill of considerable value to both Hamm's and myself.

On February 28, 1975, I received a memorandum from Leopold Schmidt addressed "To All Hamm's Wholesalers" stating that the Olympia Brewing Company had entered into an agreement with Theodore Hamm Company to purchase its St. Paul Brewery and the Hamm's brand, with the sale to be closed March 1, 1975. The memorandum also stated that Olympia was in the process of evaluating the extent to which current Hamm's wholesalers fit into its marketing and distribution philosophies, and that Olympia hoped to be able to discuss this subject with me "at an early date." At no time since receiving this memorandum has any representative of Olympia Brewing Company contacted me to discuss marketing practices and philosophies.

On April 12, 1975, I received a memorandum from Leopold Schmidt addressed to "Gentlemen" stating simply that "we have concluded that Olympia can better serve your market through another distributor" and that, effective immediately, my distributorship was terminated. This termination, without notice and without good cause, was not accompanied by any offer to compensate me in any way for the loss of my Hamm's distributorship. In fact, Olympia has stated (in letters to its newly appointed distributors) that there is no value attached to a Hamm's distributorship and that it may be terminated for any reason at any time.

Throughout my 28 years in dealing with successive suppliers of Hamm's brand beers, it has always been my impression that I could not be terminated so long as I performed capably. If this is not the law, it should be! To allow a brewer to appropriate the efforts of hundreds of small businessmen like myself without compensation is to return to Nottingham Forest, but with a new twist—robbing from the poor to pay the rich! "Freedom of contract" as applied to relationships between brewers and beer distributors really means freedom for the brewers to take what they want from their distributors. To allow brewers this power is to eliminate the individual distributor as an independent businessman, to be replaced by pawns of the breweries. This will adversely affect not only the hundreds of distribution level competitors already terminated, but also consumers of beer everywhere, who will suffer from the reduction and, in some cases, elimination of competition at the distribution level.

Respectfully submitted,

J. A. DADY,
Beer Distributor.

BURGER KING CORP.,
Miami, Fla., April 12, 1976.

Re Senate Bill 2335

Hon. WARREN MAGNUSON,
Chairman, U.S. Senate,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: The enclosed letter requires no explanation and is being forwarded to you with the knowledge and consent of our franchisee.

We do not pretend that Mr. Wessel's opinion is necessarily representative of all of our franchisees. It is only sent to you because it illustrates that there are franchisees who have prospered and enjoy the franchising experience that exists at Burger King.

We hope that you will find this letter persuasive and assist you in the decisions you must make regarding the subject legislation.

Sincerely,

J. THOMAS BROWN,
Senior Vice President.

Enclosure.

WESFAM RESTAURANTS, INC.,
FRANCHISE OF BURGER KING,
Huntsville, Ala., April 6, 1976.

Mr. J. THOMAS BROWN,
Senior Vice President, Burger King Corp.,
Biscayne Annex, Miami, Fla.

DEAR JACK: Please excuse the delay in answering your letter of March 1, but March was a very busy month and I was away a good deal.

I have read through the Mikva Bill (HR 8349) and can only comment on it against the background of my own nearly 10 years experience as a franchisee.

During this period I have not suffered from any inequities nor felt that adequate remedies were not available to me should the balance of power be misused. The intent of the bill is a puzzle to me since franchising has successfully existed in this country since its inception, and in recent years has realized unprecedented growth and contributed immensely to the benefit of the American public. Surely there are presently on the books sufficient laws to protect the parties involved from abuse.

Oddly enough, in the period of my experience with franchising, I have become aware of more abuses of the franchisor by the franchisee than the reverse.

I believe the proposed bill I have seen is far too objectionable throughout to warrant taking the time to challenge in any specific area.

My understanding of the franchisor—franchisee relationship is such that a reasonable balance of power should reside with the franchisor. In most cases I know, of, this power has not been misused by the large and successful companies and I for one would not want to see our company weakened by a bill written to correct abuses caused by a minority.

Indeed, the strength and future of my own franchise is dependent on the company retaining its rightful authority and using it as it deems necessary for the benefit of the many franchisees who willingly agreed to and comply with the provisions of the agreement.

Abusive franchisors are sowing the seeds of their own destruction and legislation that would hinder the control any franchisor must exercise would only weaken a major aspect of the American free enterprise system that has brought so much to the public and the silent, successful majority of franchisees.

If there is any effective way I can register opposition to this bill, please advise.

Very truly yours,

JOHN F. WESSEL.

COLORADO BEER DISTRIBUTORS ASSOCIATION,
Denver, Colo., April 12, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce,
Dirksen Senate Office Bldg., Washington, D.C.

DEAR SENATOR MAGNUSON: The purpose of this letter is to throw the support of the Colorado Beer Distributors Association, of which I am President, behind your efforts to secure passage of S 2335 or similar legislation. We understand this is known as the Fairness in Franchising Act.

We agree with Senator Moss' remarks on this subject when he said, "Franchising relationships are beneficial to the economy and to competition because they provide a means for combining centralized planning, direction and standard setting with local decision-making, initiative and capital formation in a way that appears as effective or more effective than commercial arrangements based on principal-agent relationships.

". . . However, the law has not evolved sufficiently to insure against overreaching unjust enrichment and unjustifiable terminations. Traditional legal doctrine too often permits inequities and fails to provide sufficient remedies for conduct that should be characterized as wrong-doing . . ."

We feel that the time has come for this type of legislation which would afford beer wholesalers and thousands of other small businessmen protection from unjust terminations and trade practices. We are asking that you include this letter in the hearing record.

Thank you for your efforts on the above bill.

Sincerely,

WILLIAM R. SPENCER,
President.

ROBINETTE DISTRIBUTOR CO.,
Adrian, Mich., April 13, 1976.

Senator WARREN G. MAGNUSON,
Chairman, Senate Committee of Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: This is to inform you that as a wholesale beer and wine distributor, I am in favor of S. 2335, the "Fairness in Franchising" bill. Please support the enactment of this vitally needed corrective legislation and enter my letter into the hearing record.

Thank you for your consideration.

Sincerely,

HERBERT L. MILLS, Jr.

AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION,
Reston, Va., April 21, 1976.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Commerce Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The American Newspaper Publishers Association submits these comments for inclusion in the record of hearings by your subcommittee on S 2335, the "Fairness in Franchising Act."

ANPA is the national trade association of daily newspapers with a membership of more than 1160 newspapers representing more than 90 percent of the total daily and Sunday newspaper circulation in the United States. In addition, ANPA represents several nondaily newspapers.

We are joined in this statement by the National Newspaper Association which is a trade association representing more than 5500 weekly and 950 small city daily newspapers throughout the United States with a total circulation of more than 40 million.

ANPA and NNA are addressing this legislation because it appears that the term "franchise" is defined so broadly in S 2335 that it could include the relationship between a newspaper and the independent contractors who distribute the newspaper in those cases where such distribution systems exist.

We do not agree that such an arrangement between a newspaper and its local distributor represents a "franchise" in the sense that the term is commonly used. There are 1756 daily newspapers in the country and more than 7500 nondaily newspapers. The product each one sells is a uniquely local product distributed, almost exclusively, in a small geographical area surrounding the site of publication. There is no national newspaper "franchisor" marketing one identical product across the country, or even across a large region, through a system of franchise agreements.

This legislation treats all arrangements between businesses and their distributors alike, without regard to differences in products and services and, apparently, without regard to any record of abuses. When extended to the newspaper business, however, such excessively restrictive legislation as S 2335 raises a question of a possible intrusion on the free press' right to disseminate the news.

In addition to these concerns, ANPA and NNA believe S 2335 is unfair and punitive to free-enterprise business. By virtually taking away the right of a newspaper to terminate an agreement with a distributor and by instituting

what amounts to a "forced renewal" provision, the legislation represents an extraordinary intrusion by government on a private business' right to conduct its business.

This right of an American newspaper to conduct its business in regard to distribution would be severely disrupted by S 2335. One major reason for this is the vague and imprecise definition of the term "good cause" which would have to be proven in order for the publisher to terminate whatever arrangement he had with the distributor. We conclude that the only real beneficiaries of this bill would be lawyers, as a deluge of court cases can be expected to ensue as parties attempt to determine what is meant by such terms as "comply substantially," "reasonable excuse," "essential and reasonable requirement"—all in the definition of "good cause."

Just as troublesome are the requirements which would have to be met under the "failure to renew' section of the bill.

Under the language of this bill, even the lazy, inefficient distributor would be virtually guaranteed a safe fiefdom. It would be difficult, if not impossible, for the owner of a newspaper to exercise his authority and responsibility to ensure that his business is as efficient and productive as possible.

Another deleterious effect of these restrictions would be the freezing of existing distribution methods, thereby thwarting progress and preventing development of new and better methods for the distribution of newspapers. Such a result clearly would not be beneficial to the American public which is uniquely served by a free press.

The inherent bias in S 2335 also is evidenced by inclusion of such provisions as the one which automatically places the burden of proof on the franchisor in a suit brought by a franchisee.

More than just an effort to get a better break from the business for which he is working, more even than trying to get equal status with the owner of the business, S 2335 seeks to place the distributor above the owner or owners or stockholders of the business by granting the distributor all of the security and none of the risks or pressure to perform borne by the owner.

Proponents of this legislation have tried to give the impression that somehow this bill would benefit the public. One proponent who appeared before the Consumer Subcommittee April 7 testified that certain newspaper publishers unsuccessfully sought an exemption from the antitrust laws to permit them to engage in "vertical price-fixing." What the proponent did not explain is that the exemption (in legislation to repeal the authority for state fair trade laws) was to help hold down the price of a newspaper to the reader. Contrary to the impression we believe was left by the incomplete testimony of the proponent of S 2335, the exemption would have benefited the newspaper-reading public by protecting it from indiscriminate price hikes by distributors.

Finally, ANPA and NNA believe that, like much protective legislation, this bill ultimately would work to the detriment of the proponents. By raising such unacceptable and unworkable barriers to the conduct of business, S 2335 would discourage businesses from entering into such agreements in the future. Likewise, it would encourage a company which now has such business relationships to end them at the earliest possible opportunity. Thus one more avenue for an individual to become an independent businessman at a minimal investment would be closed, and jobs would be lost—even abolished.

ANPA and NNA appreciate the opportunity to express our views on this matter.

Sincerely,

JERRY W. FRIEDHEIM,
General Manager.

COLLINS FOODS INTERNATIONAL, INC.,
Los Angeles, Calif., April 21, 1976.

Hon. JOHN V. TUNNEY,
U.S. Senate,
1415 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR TUNNEY: I am writing to you because of my deep concern over two bills now in the Congress of the United States. The first in the House of Representatives, HR 8349, and the second, before the Committee on Commerce,

Senate Bill 2335, have as their objective the regulation of relationships between franchisors and franchisees. Both bills primarily deal with the right of franchisors to terminate or fail to renew franchise agreements.

As Chairman of the Board of Collins Foods International, Inc., a New York Stock Exchange corporation operating both as a *franchisee* and as a *franchisor* of over 500 restaurants in California and throughout the United States, I am in a very unique position to realistically view the franchisee/franchisor relationships. Understanding both sides of the franchise form of doing business allows me, I believe, to fairly asses the implications of these bills. My strong personal feeling is that the passage of these bill would seriously and irrevocably damage the essential characteristics of the relationship between a franchisor and a franchisee. These bills, if enacted, would so seriously interfere with the franchisor's ability to protect the value of his trade names for both his own purposes and for those of his franchisees that the franchising form of business would probably, in time, cease to exist as a viable business concept. Because the franchising form of business has been a keystone for the success of the small businessman and one which has provided real "entrepreneurial" opportunities for a lot of people, it would be a great loss to our balanced business environment and economy to see it become less viable.

On behalf of myself and my associates here at Collins Foods, I strongly urge you to rigorously oppose this legislation.

Respectfully yours,

JAMES A. COLLINS,
Chairman of the Board,
Chief Executive Officer.

BASKIN-ROBBINS ICE CREAM,
Burbank, Calif., April 23, 1976.

COUNSEL TO THE SUBCOMMITTEE ON CONSUMER AFFAIRS,
Committee on Commerce, Senate Office Building,
U.S. Senate, Washington, D.C.

DEAR SIRS: This letter is submitted to you with regard to the part of the statement of Mr. Jerome R. Waldie, presented by him at the hearings of your Subcommittee on April 7, 1976, in which he stated, among other things, that he is appearing on behalf of a coalition of franchisee associations which includes an organization which he referred to as "National B/R Storeowners Association (Baskin-Robbins)".

To avoid any erroneous inferences from Mr. Waldie's statement, we desire to point out that the group which calls itself National Baskin-Robbins Storeowners Association has not announced the number of its actual members and in our estimation, comprises only an insignificant percentage of Baskin-Robbins store owners. The antagonism toward Baskin-Robbins and other views expressed by that group are not shared by the vast majority of Baskin-Robbins store owners. That group, therefore, or Mr. Waldie, has no standing to act as spokesman for Baskin-Robbins store owners.

Baskin-Robbins has no disagreement with the objective of assuring "fair dealing in franchising," which is stated as one of the objectives of S. 2335. We are thoroughly aware of the fact that, in addition to the franchisor's investment and assumption of liabilities, franchisees have investments of capital in their franchised businesses and are entitled to protection against a franchisor who would misuse its position to appropriate its franchisee's investment to itself.

We disagree with features of the bill which are prejudicially one-sided. Although the bill speaks of an intent to provide certain remedies to franchisors and franchisees to assure fair dealing, it imposes obligations and liabilities only on franchisors. In effect, the bill would encroach on the franchisor's trademark rights, would take away the right to enter into franchise contracts with limited duration, would impair the ability of franchisors to operate viable franchise systems, and would cause franchisors to change terms of franchise arrangement which have been to the benefit of franchisees.

The provisions of the bill which would compel franchisors (but not franchisees) to renew all franchises forever and ever, would turn a franchise agreement into a relationship which is indissoluble by the franchisor except on proof by the franchisor of the existence of "good cause" (as vaguely defined in the

bill) to the satisfaction of a court or arbitration board, or at the price of payment to the franchisee of an amount which was not part of the bargain at the grant of the franchise and which is not ascertainable by any appropriate standards. The outlook of incurring protracted and costly litigation if it should become necessary to decline renewal of a franchise following expiration of its contract term, cannot be but a disincentive to granting of franchises. Such built-in additional costs of doing business as franchisors will ultimately be borne by all franchisees.

The factors to be considered in fair dealing with franchisees and non-renewal must include the interests of the great majority of franchisees who seek to conduct their business in accordance with the letter and spirit of the franchise business which they joined by their choice and in which they, too, invested capital.

We submit that we must have the right to decline renewal of a franchise when the franchisee operates his store in a substandard manner and thereby negatively impacts on the name and good will of Baskin-Robbins and other franchisees who look to Baskin-Robbins for protection of their franchises.

Respectfully yours,

ROBERT J. HUDECEK,
President and Chief Executive Officer.

NATHAN'S FAMOUS INC.,
New York, N.Y., April 23, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: We would like to take this opportunity to introduce ourselves to you. Nathan's Famous, Inc., in this year of our country's bicentennial, is celebrating its 60th birthday. Perhaps in the overall complex of our business society, a 60th birthday is an outstanding beacon to be noticed.

This company was founded on the fibers which are the same as those which run through our country. The moral fibers of ethicacy and the basic entrepreneurial spirit has made this nation great and we would hope that we could express our opinion to you so that you may consider same in your deliberation of the proposed legislation hearings on S. 2335, the "Fairness in Franchising Act".

In our opinion, this legislation should not be approved in its present form. We will not attempt in this letter to give you all our objections, but rather point out some of the highlights.

The franchise system of distribution which, from an historical point of view is relatively new in our capitalistic system, and like all new things probably in its development has seen abuses arise. Upon examination of said abuses, we feel that it could be documented that the abuses were in the minority and that present state legislation with reference to disclosure and the various regulations of the Federal Trade Commission will more than adequately eliminate the minority abuses.

Whether we are speaking of a franchisor or a franchisee, it seems to us that any legislation should deal with all parties on a fair and equitable basis. The inequities and the one-sided approach that this legislation has towards the franchisor, if enacted, will discourage the franchise business and the result will be a reduction of the entrepreneurial system which the franchise industry affords "the small man". A reduction of the franchise system will also have a deleterious affect upon the consumer public which receives better service and product through the franchise system.

The concept of an automatic renewal of a long-term franchise agreement at its expiration does not provide for a changing economy and a changing world. Hence, it is entirely unfair and we feel that commercial business law, good business practices and ethicacy should be the rule. Needless to say that the success of any business on a long-term basis is founded upon good common sense rather than legislation.

Within the entire franchise system, there are many types of franchises, many services and products afforded to the consumer public and many types of modus operandi. We feel that it is inconceivable that one broad bit of legislation could fairly and equitably handle all the indigenous situations that arise in so many varied types of enterprises.

Rather than continue with every aspect of S. 2335, we feel that an overview of the entire industry in this bill must force you, after due deliberation, to come to the conclusion that this proposed legislation is inadequate, inequitable and is not in the best interest of franchisors, franchisees and the public in general. Perhaps more important, this ype of legislation is contraindicated by the entrepreneurial system that has made this nation great.

Consequently, we respectfully request your due deliberation, consideration and our earnest hope that you will find a vote of "NO", on the "Mikva Bill" and request that you incorporate this letter into the hearing record.

Very truly yours,

HAROLD NORBITZ,
Vice President/Franchising, Real Estate.

AAMCO AUTOMATIC TRANSMISSIONS, INC.,
Bridgeport, Pa., April 26, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: Enclosed is a copy of the letter I submitted to Honorable Lionel Van Deerlin in my opposition to H.R. 8349. The Franchising Practices Reform Act. It is respectfully requested that my letter be incorporated into the hearing record.

Very truly yours,

GEORGE J. HAYWARD, *General Counsel.*

AAMCO AUTOMATIC TRANSMISSIONS, INC.,
Bridgeport, Pa., March 4, 1976.

Hon. LIONEL VAN DEERLIN,
2427 Rayburn House Office Building,
Washington, D.C.

DEAR MR. VAN DEERLIN: As General Counsel of AAMCO Transmissions, Inc., franchisor of transmission service centers, I respectfully submit the following comments on the proposed Franchising Practices Reform Act.

In introducing the Bill to the House of Representatives, the Bill's sponsor, Rep. Abner Mikva, told the House of the three purposes for the Bill:

1. To correct inequities in certain franchise practices,

2. to provide franchisors and franchisees with even-handed protection from unfair practices, and

3. to provide consumers with the benefits which accrue from competition and a free market economy.

The noble purposes espoused by Rep. Mikva were lost in translating them into the Bill. There is a reason for the loss which Rep. Mikva himself stated in his remarks to the House. That reason is the fact that the only real data concerning franchising practices which Rep. Mikva had before him was a survey of 300 retail gasoline filling stations in his Congressional District. The survey of Rep. Mikva is totally unrepresentative of the franchising industry. First, it considers only gasoline filling statoins which represent only one segment of the franchising industry. It is submitted that the indigenous problems of this type of franchising are uncharacteristic of the industry as a whole. Secondly, the sample represents only .065% of the total number of estimated franchised establishments in 1975 and only .193% of the estimated number of franchised gasoline service stations in 1975. (U.S. Dept. of Commerce, *Franchising in the Economy* 1973–75, pp. 1, 50). Certainly a much broader and representative survey should have been undertaken before concluding that the peculiar problems of a very small number of oil company franchisees are characteristic of the industry in general. Finally, we are not presented with the methodology of the survey and so it is impossbile to comment on its objectivity. Interestingly, the only abuse that Rep. Mikva mentions in his remarks is that the major oil companies are pressuring the dealers to increase the sale of gasoline and oil related products on penalty of loss of lease or reduction in service.

In view of the single abuse to be corrected, a serious question is raised as to the necessity of the Franchising Practices Reform Act. A less broad and encompassing legislative response would seem to be more appropriate and, in fact, constitutionally dictated. It appears that the proposed legislation is an impairment of the right of contract and a denial of due process to franchisors contrary to the Fifth Amendment of the Constitution. In recognition of the right to contract, franchisors have been able to terminate or refuse to renew franchise agreements, in their sole discretion, as long as the termination or refusal to renew was unrelated to other matters having antitrust implications. (*United States v. Colgate & Co.*, 250 U.S. 300 (1919)). The Bill is in derogation of this right of contract and has a decidedly coercive effect in that it forces parties to continue a contract which they presently have the right to terminate. Under the law of the Commonwealth of Pennsylvania, a statute which affects the duration of a contract is an unreasonable impairment of the right to contract. (*Beaver County Building & Loan Ass'n. v. Winowich*, 323 Pa. 483, 187 A. 921 (1936)). Analogously, a federal statute which unreasonably affects the duration of a contract, as the present Bill does, denies due process under the Fifth Amendment.

In examining individual provisions of the Bill one is led ineluctably and inexorably to the conclusion that more problems are raised by the Bill than the one abuse it was intended to remedy.

Section 2(1) fails to declare what inequities in certain franchise practices must be corrected. Rep. Mikva has listed only one. Moreover, the presumption that all franchisors deal unfairly with their franchisees is an unsupported generalization which has as its apparent object the engendering of an emotional reaction against franchisors.

That an even balance of power between franchisors and franchisees will engender competition and efficient functioning of a free market is a logical fallacy. In fact, if it becomes too burdensome to franchise, many franchisors would probably withdraw from franchising and vertically integrate. The declaration of the policy to promote competition and the proposed prohibitions against terminations and nonrenewals are also inconsistent. Most franchisees who are terminated are replaced with a new franchisee. There is no lessening of competition and hindering of the market. In fact, every franchisee knows that if he is neither competitive or efficient that he will be unsuccessful. Franchisors and the public must have efficient and competitive franchisees. The Bill has the effect of abetting both noncompetitiveness and inefficiency and perhaps rewards them.

The definition of "franchise" in the Bill is quite novel in that its focus is on peripheral aspects of the franchise relationship. The essence of the relationship, the trademark license, is obscured. By emphasizing what the license is used for by the licensee or the services he receives in addition to the license, the Bill is misleading. By obscuring that a contractual trademark license is involved, the Bill not only creates problems of basic contract law but creates Lanham Act problems as well, which will be discussed below.

The definition of the term "good cause" in Section 3(2) is no definition at all. Use of terminology such as "reasonable", "substantial" and "essential" is a serious deficiency. In using these terms, the definition creates, and does not resolve, three additional definitional problems.

Section 3(3)(C) fails to define "good will". In addition, this section is directly contradictory to the Lanham Act, Section 5, 15 U.S.C. § 1055, which states:

"Where a registered mark or mark sought to be registered is or may be used legitimately by related companies, *such use shall inure to the benefit of the registrant. . . .*" (Emphasis added)

Indeed, a trademark has no existence apart from the good will of the business it represents. A trademark is a symbol of good will. That the use by a licensee of a trademark inures to the benefit of the licensor is critical if trademarks are to be licensed at all. Without this benefit franchisors would vertically integrate. The licensing of a trademark is not a sale of the trademark. The licensee receives no property rights in the trademark of the licensor.

The use of the terms "fair" and "reasonable" in Section 3(4) creates ambiguities which the Bill does not resolve.

Section 4(b) gives a franchisee the right to endanger public health and safety for two days before the franchisor can act against him. One cannot believe that this was really intended. Moreover, this section raises a "control" problem under the Lanham Act.

Sections 5 and 6 of the Bill are its heart. In essence, they provide that a license must be perpetual, a contradiction in terms. The use of the terms "good cause" and "legitimate business reasons" are vague and ambiguous. These sections abrogate the right to contract. These sections raise a serious "control" problem under the Lanham Act. The ability to exercise control effectively in a relationship which should have ended is seriously impeded. To characterize the Bill as even-handed is curious when considering the termination and renewal provisions. While specific and detailed requirements for franchisor conduct are presented, nothing is said about a franchisee initiated termination or refusal to renew. It is important to a franchisor as well as the public that marketing areas are adequately serviced by franchisees. The dichotomy in standards of conduct presented in Sections 5 and 6 create a serious problem.

Section 7 (b) providing for payment for good will contradicts the Lanham Act as stated above.

Section 7(d), shifting the burden of proof to the franchisor, contradicts the usual rule in civil actions that the burden is on the plaintiff to prove every essential element of his claim by a preponderance of the evidence, that is, that something is more likely so than not so. The harm wrought by this shift in the burden of proof is exacerbated by the lack of guidance as to what constitutes "good cause" and "legitimate business reasons".

Rep. Mikva stated that the Bill is proposed to provide even-handed protection. Section 7, judicial remedies, is so one-sided that one is led to question the veracity of attributing evenhandedness to the Bill.

Section 8, the prohibition against waiver section, coupled with Section 7, judicial remedies, seems calculated to insure that franchisor-franchisee litigation will increase substantially.

The analysis of the Bill began by quoting Rep. Mikva's three reasons for proposing the Bill. As we examined the Bill by the light of the first two reasons, the great expectations which the stated noble purposes evoked were resolved into disappointment. Even less can be said about the third purpose. In fact, nothing can be said about it because nowhere does the act implement that purpose. The Bill would have a decidedly bad effect on competition and the free market economy.

In summary, for the reasons stated above, it is respectfully submitted that the Franchising Practices Reform Act should not be enacted.

Very truly yours,

GEORGE J. HAYWARD,
General Counsel.

RADIO SHACK,
RADIO SHACK FRANCHISE INTERNATIONAL DEALER DIVISION,
Fort Worth, Tex., April 26, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR MR. MAGNUSON: I have previously written you concerning Senate Bill 2335, "Fairness in Franchising Act". It is my understanding that this bill closely approximates the Mikva Bill HR 8349.

After reviewing my correspondence with Congressman Van Deerlin, I felt that I presented my objections to him a bit more clearly than I did in my letter to you. I am, therefore, enclosing a copy of my letter to Congressman Van Deerlin for your information and am further requesting that you incorporate its contents into the hearing record. For your convenience, I have underlined that portion of my letter which I feel best summarizes the effects of subject bill. Further enclosed is a copy of our current Authorized Sales Center Agreement.

Sincerely,

R. R. LYNCH, *Vice President.*

Enclosure.

RADIO SHACK,
RADIO SHACK FRANCHISE INTERNATIONAL/DEALER DIVISION,
Fort Worth, Tex., March 6, 1976.

Hon. LIONEL VAN DEERLIN,
2427 Rayburn House Office Building,
Washington, D.C.

DEAR MR. VAN DEERLING: This is to advise of our company's objections to subject bill. This bill, to me, represents a well intentioned effort to legislate perfidy out and integrity into existence. I am not a lawyer, but I can see that were this bill enacted it would negate not only the principles of good business but the very basis of contract law. It appears to be conceived by an under informed legislator who perhaps read the horror stories surrounding franchising in the Chicago Daily Newspaper, but missed the later edition showing the happy and honorable side of franchising.

To relieve a franchisee of the obligation of court costs and attorney's fees could do nothing but add to an already growing number of nuisance suits.

I will not go into the renewal and termination issues since they are so patently one-sided as to border on the ludicrous.

Enactment of this bill will, in many cases, slam the door in the face of thousands of franchise applicants. I, for one, would be loathe to recommend my company to enter into such an onerous relationship.

While we no longer offer full line franchises, we continue to serve 126 full line stores and 1240 "Authorized Sales Centers". I am attaching for your information a copy of our current Authorized Sales Center Agreement. Please take particular notice of Article V. *This article incorporates what might be referred to as a money back guarantee and gives some idea of the steps taken by honest franchisors to eliminate misunderstandings and possible damage to the individual.*

The answer, Mr. Van Deerlin, lies not in a one-sided contract but in full disclosure prior to the sale of a franchise or dealership. Our anti-trust statutes coupled with the FTC rule and various state statutes provide remedies for the abuses Congressman Mikva seeks to eliminate. Years of research and dialogue have gone into a proposed rule not yet enacted by the FTC. It is my sincere belief that this rule will serve to drive out of franchising the "fast buck" artists which are a small minority, if in fact, any still exist.

Very truly yours,

R. R. LYNCH, *Vice-President.*

P.S. Reference is made to your own state's franchising statutes which have, in my opinion, served to reduce the incidence of franchising abuses.

INSTY-PRINTS, INC.,
Minneapolis, Minn., April 26, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: I have enclosed a copy of my letter to the House Subcommittee on Consumer Protection and Finance expressing my thoughts on the franchise termination and renewal legislation introduced by Congressman Abner Mikva.

I would appreciate your incorporation of these thoughts into the committee hearing record.

Sincerely,

JOHN O. PRATER,
Marketing Manager.

Enclosure.

INSTY-PRINTS, INC.,
Minneapolis, Minn., March 10, 1976.

Hon. LIONEL VAN DEERLIN,
2427 Rayburn House Office Building,
Washington, D.C.

DEAR REPRESENTATIVE VAN DEERLIN: As a member of the "Franchising Community", I feel the necessity to write you regarding the franchise termination and renewal legislation introduced by Congressman Abner Mikva of Illinois, which your committee is now reviewing.

Franchising, as a form of distribution, has existed for many years in the United States, as you know, but has begun to be recognized as a powerful economic force only in the past ten to fifteen years, due to increased visibility via the print and broadcast media. This additional visibility took the form of high praise during the 1960's, due to the phenomenal success enjoyed by many of the franchisees and franchisors then present in the market place.

The franchise method of distribution was advertised as possibly the last hope for the small businessman to gain financial and personal satisfaction from operating his own independent business.

Unfortunately, with the increased public awareness of the method came the erroneous impression that franchising represented an easy road to riches, with little or no talent or effort, for franchisors and franchisees alike.

During the "boom" years of the 1960's, many under-capitalized and underqualified franchisors and franchisees entered the field and many fell by the wayside. This fallout has produced a swing of the publicity pendulum in the opposite direction, and has seen great activity on the part of various states to limit a franchisor's promises to that which he can deliver.

To the extent that this legislation forces a franchisor to fulfill his promises and document his ability to do so, our company and other responsible franchisors applaud the efforts to date.

However, when the Federal Government begins to move in the direction indicated by Congressman Mikva's bill, we must object. By curtailing or removing a franchisor's right to terminate the agreement between himself and a non-performing franchisee, or forcing a franchisor to renew a contract with such a franchisee severely lessens the options open to a franchisor in his efforts to maintain the standards of performance which are essential to the offering of high-quality products and services to the buying public.

With their courses of action so limited, many franchisors will elect to reduce or discontinue franchising activity, and will instead turn to company-owned operations as the prime method of expansion, thereby closing out franchising as vehicle for the small independent business man whom it has served so well in the past.

I urge you to reject this legislation for these reasons, and help keep franchising the strong marketing force it is today.

Sincerely,

JOHN O. PRATER,
Marketing Manager.

COMPREHENSIVE ACCOUNTING CO.,
Aurora, Ill., April 27, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: I am enclosing a copy of my letter to the Honorable Lionel Van Deerlin in regard to the Mikva bill introduced in the House as HR 8349 and request that you make this letter a part of the hearings record on S 2335.

This type of legislation, in my opinion, will force franchisors to cease their expansion through franchise outlets and dry up future opportunities for entrepreneurs who might otherwise have been successful businessmen.

Very truly yours,

JOHN J. KEEFER, *President.*

Enclosure.

COMPREHENSIVE ACCOUNTING CO.,
Aurora, Ill., March 5, 1976.

Hon. LIONEL VAN DEERLIN,
2427 Rayburn House Office Building,
Washington, D.C.

DEAR MR. VAN DEERLIN: It is my understanding that on Tuesday, March 9 the Consumer Protection and Finance Subcommittee of the House Interstate and Foreign Commerce Committee will begin a three-day hearing on HR 8349 which has been introduced by Congressman Abner Mikva.

I would like for you to know that I am not in favor of this bill; and if it is passed, it will have an adverse effect on our business, our 185 employees as well as the 300 families that depend upon our franchise for their living.

Because of a few cases of alleged abuses in regard to the termination and renewal of franchises, Mr. Mikva and his co-sponsors are overreacting to several incidents that are already adequately covered by existing law, whether it be as a result of state laws, general contract law or antitrust law.

We franchise a service-type business which is professional and personal, and I do not believe it's fair or equitable for additional legislation to be aimed at franchisors treating all of them in the same manner; the alleged abuses that have been cited by franchisee organizations are not prevalent in all franchisor relations with their franchisees. If a situation exists in one franchise industry, it would appear that specific legislation might correct the problem as opposed to a blanket bill covering all franchisors, assuming the need for additional legislation.

In order to maintain an adequate service to the clientele of our franchisees, certain standards must be spelled out in our contracts with franchisees; and if these standards are not met, we must have the freedom to terminate the franchisees whose lack of proper service subjects us to financial loss and also affects the business of other franchisees who do maintain quality service. Furthermore, the ultimate user of our services would also benefit, whereas the difficulties that would be thrown into our path in termination of this type of franchisee under the proposed legislation could ultimately lead to a discontinuance of our business, It costs more to furnish services to a substandard franchisee than to one who is functioning properly; yet royalty payments of substandard franchisees are significantly less even though our costs are more.

The entire philosophy of government is to encourage competition, yet provisions in the bill for withdrawal from the market as a possible method of ridding oneself of an undesirable franchisee certainly do nothing but lessen competition. Why should the entire franchisor/franchisee industry be subjected to such unfair legislation? Why should franchisees be given extraordinary rights while franchisors are stripped of the normal rights any businessman should have available to him.

There are thousands of persons operating as independent businessmen because their franchisors have taken the initiative to establish a business, train and finance the franchisee businessman. This is a healthy situation; and to upset the balance because of a few alleged abuses would, in my estimation, be a severe blow to the entire economy.

I am in favor of full disclosure by franchisors, and we operate under those principles. Several states in which we operate have a uniform franchise offering circular requirement; we feel the best solution to any problems would be for all states to have this type of law. Neither the public nor the thousands of businessmen who are franchisees will benefit from this proposed legislation. It will tend to dry up future opportunities in franchising business, and franchisors will be forced to cease expanding through franchise outlets and become operators of businesses that might otherwise be owned by entrepreneurs who are the successful franchisees.

I am sorry I cannot be at the hearings in person in order to further express my views of this ill-advised and unwarranted proposed legislation.

Very truly yours,

JOHN J. KEEFER, *President.*

SURFACE MAINTENANCE SYSTEMS,
Downers Grove, Ill., April 27, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MAGNUSON: The franchising system of distribution is a viable opportunity for many small businessmen to fulfill the great American dream of being in business for themselves. The reputation of the franchisor can be fully utilized by the small independent businessman to make him successful operating his own business in the American free enterprise system. S. 2335, "Fairness in Franchising Act" will seriously hamper, if not completely eliminate, the franchising system from the American way of life. I am sure that you, as a responsible representative of a segment of the American people, will carefully consider the obvious unfair, unjustified, and anti-competitive nature of this proposed legislation.

While it may be argued that some franchisors have abused the system by taking advantage of small investors, for the most part, these abuses can be categorized into a specific classification of industry. Bill S. 2335 clearly draws undue and unfair generalities that seeks to include all franchisors in the obvious assumption that they are all guilty of inequitable practices. There does not exist any real evidence that abuses such as the bill seems to be attacking are serious enough to warrant such abusive legislation. In this day and age when big government is seeking to snuff out the small businessman, it appears to be that the last thing a group of responsible legislators should be doing is to seek areas to create additional legislation that would govern activities that are already covered by state statutes, contract law and antitrust law. It seems we are bombarded on one side by government regulations that require that business not grow so big that they form a monopoly on the services and/or products they provide; while on the other hand, legislation such as this seems to be attacking at the very heart of the small businessman and will indeed withdraw the opportunity for him to exist.

There already exists a number of state statutes that cover the protection that needs to be afforded to franchisees from franchisors in the area of full disclosure. Our company categorically agrees with the approach of the Uniform Franchise Offering Circular now being refined by a number of state regulators. It is with healthy, honest competition that we feel most comfortable and believe that the state legislatures are approaching the problem from a legitimate and reasonable angle. The bill goes so far in its abuse of the privilege of doing business in the free enterprise system that it even penalizes the U.S. consumer since it will prohibit competition and thus will withhold services from consumers that would otherwise be available to them.

Our company has provided opportunity for over 1200 franchisees in the United States. We are proud of our record of fair practices in our relationship to our licensees and plan to continue to offer the independent small businessman an opportunity to be his own boss. Legislation such as proposed in S. 2335 will cause us to seriously reconsider the franchising method of distribution in favor of the company-owned franchise. As a tax payer, a U.S. citizen, and a representative of a franchisor, I urge you to reject the legislation in S. 2335.

Sincerely,

DELBERT D. STONER,
Vice President.

RECREATION VEHICLE INDUSTRY ASSOCIATION,
Washington, D.C., May 6, 1976.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on Consumer, 124 RSOB,
Washington, D.C.

DEAR MR. CHAIRMAN: RVIA is the National Trade Association for the manufacturers of recreational vehicles and their related suppliers.

It is our understanding that hearings have been held by your Subcommittee on § 2335. "Fairness in Franchising Act", during which statements were presented which directly impacted our industry.

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We are enclosing a statement which expresses the views of our industry regarding the bill. You will note that we oppose the bill in its present form.

We would appreciate the Subcommittee considering our views when it begins its deliberations on the bill. Copies of the statement, without enclosures, have been sent to all members of the Subcommittee.

Very truly yours,

DAVID J. HUMPHREYS,
General Counsel.

STATEMENT OF R–V–I–A ON S. 2335 "FAIRNESS IN FRANCHISING ACT" AND H.R. 8439 (H.R. 12352) "FRANCHISING PRACTICES REFORM ACT"

The Recreation Vehicle Industry Association (RVIA) is the national trade association representing approximately 500 recreation vehicle manufacturers and related supplier companies. Its headquarters are located in Chantilly, Va. with fully staffed offices in Elkhart, Ind. and Anaheim, Calif. A membership directory is enclosed for the committees' information.

RVIA provides a unified national RV organization for manufacturers of motor homes, travel trailers, truck campers, camping trailers and pickup covers throughout the United States and Canada. See the enclosed brochures "Facts and Trends" and "The Way to Go".

With regard to the pending franchise legislation (S. 2335, H.R. 8349), RVIA supports the already submitted statements of Gerald T. Aaron, Secretary, General Counsel of Pizza Hut, Inc.; Charles W. Burrow, Assistant Vice President and House Counsel of Holiday Inns, Inc.; Robert M. Rosenberg, President, Dunkin' Donuts Incorporated; Thomas W. Power, General Counsel, Food-service and Lodging Institute; and Jerry H. Opack, President, International Franchise Association.

For reasons more fully set forth below, RVIA opposes the passage of the pending legislation.

At the outset, RVIA wishes to take this opportunity to clear up what it feels to be misleading information submitted to the Congress by the Recreational Vehicle Dealers of America (RVDA).

In its statement, RVDA presented results of a survey which it concluded showed three things with regard to the RV industry:

(1) Franchise abuses are widespread;

(2) Franchisees not only desire corrective legislation; but

(3) Franchisees most urgently called for corrective legislation and are extremely willing themselves to become personally involved.

Whereas RVDA admits that there are thousands of dealers who are acting in a franchise relationship, it is not made clear that RVDA only represents approximately 10% of those dealers. They received a return of 45.9% on their survey, and of this number 70% stated that they *never* had an RV franchise unfairly cancelled (or not renewed when requested). Assuming RVDA's survey was only of its own members, then only 30% of 5% *claimed* to have had major franchise problems. This represents only 1½% of the entire industry. Furthermore, of that 1½% no study is made of the actual mutual reasons for the cancelling of the franchises. RVIA submits that such a survey is invalid for its lack of comprehensiveness, and that it can in no way be concluded that franchise abuses are widespread. Congressional legislation may tend to pacify a few, but it would create difficult problems for the majority. Such legislation is not necessary.

RVIA opposes the passage of the proposed bills on the grounds that such legislation is unnecessary and against the public interest. RVIA does support the concept of full and fair disclosure of all information which is material to the formation and continuing operation of any franchise agreement; however, the bills as presented appear aimed at regulating the contract relationship itself rather than fostering an atmosphere of complete disclosure.

Each individual industry within the franchising system is different; and each has its own needs and modes of operation. An all encompassing law in this area of franchising needs either to be so vague as to create grave constitutional problems or so definitive as to be irrationally burdensome. RVIA is of the opinion that the demands of the market place will effect a solution to any problems which Congress is by legislation seeking to correct.

The Recreational Vehicle industry is by and large composed of small business manufacturers. Within this atmosphere it is not hard to see that there is an extraordinary need for cooperation and mutual confidence between these manufacturers and their franchised dealers. Indeed, this dual relationship is one of the contributing factors to the industry's success. Without it the small business manufacturer could not long survive. Congress should think twice before injecting the element of antagonism and divisiveness which these bills would engender into an industry which can least support it and indeed is successfully surviving without it to the mutual satisfaction of the parties involved. The bills if passed would foreclose small business opportunities for both the potential franchisors and franchisees. The small franchisor is dependent upon the franchisee to adequately market his product in a competent and efficient manner. If such is not the case, he needs the fluidity to be able to find someone who can, not the rigidity which would lock him into a situation whereby his business would suffer, if not fold completely. The small franchisor, therefore, cannot afford these additional legislative burdens which stifle his ability to adequately market his product. RVIA submits that the mutual need of franchisor and franchisee for

each other, the cooperation which is an essential element to the industry's success, and the existing state laws are adequate safeguards against any abuses with which Congress is concerned.

Furthermore, RVIA is of the opinion that such legislation would stifle competition, the natural market influences, and the freedom of choice by which a manufacturer decides how he wishes to market his product. Since the majority of the industry is small business, franchise competition is substantial and the market system should be the balancing element of risk and return. The franchisee is looking for an adequate return on his investment and the manufacturer is looking for the most efficient and profitable way to market his product. The time element necessary to accomplish these purposes should be left to the mutual agreement of the parties involved. In legislating fixed franchise terms, Congress is not only interfering with the contractual freedom of the parties, it is also placing the manufacturer in the uncompromising position of possibly having to bear the burden, expense, and loss incurred by reason of a marginally inadequate or weak franchisee or going into court to litigate each non-renewal. Such a burden would be economically devastating to a small business manufacturer and inherently inequitable. Again, we emphasize the opinion that in this type of situation the market system with its demand for mutual cooperation and confidence coupled with its substantial competitive atmosphere should be the curative factor and not congressional legislation.

Additionally, RVIA feels that congressional legislation in this area will discourage further franchise expansion and force the manufacturers into considering the establishment of company owned dealerships. Such is not necessary, however, since we feel that at present there are adequate legal remedies available to a franchisee who feels his rights have been violated. When one surveys existing contract law, the requirements imposed by the Uniform Commercial Code, and the ever increasing enactment of state laws in this area, the above conclusion becomes even clearer. Indeed, the proposed congressional legislation might even go so far as to invalidate many state licensing laws.

For the above reasons, RVIA is of the opinion that the proposed legislation is unnecessary and against the public interest.

TELECHECK FRANCHISING, INC.,
Honolulu, Hawaii, May 11, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce, U.S. Senate, 5202 Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: It has come to my attention that the Consumer Protection and Finance Sub-committee of the House Interstate and Foreign Commerce Committee is considering Bill HR 8349, introduced by Congressman Abner Mikva. This suggested legislation is so extremely inequitable that if made law, it will create antagonisms and hardships which presently do not exist between franchisors and franchisees. Participants will be challenged to find ways to circumvent the unfair restrictions and thereby create problems far greater than those the regulations would control.

Our company has 16 franchisees who enjoy their respective businesses. We have never had a franchise fail or even sell his license. Ours is a community service which has received enthusiastic endorsement in every area in which we operate. HR 8349, as suggested, would create such potential legal problems that we would hesitate to offer our services in any new cities. At least we would reconsider establishing franchises.

Franchising has enabled several hundred thousand businessmen and businesses to prosper. The occurrences which require the type treatment recommended by HR 8349 are not prevalent in our areas of effort, and will certainly eliminate entrepreneurs from these opportunities.

We have already conformed to very stringent regulations when we established franchises in Minnesota, California and Washington. We are thoroughly regulated by the FTC. New federal controls are not needed by us or our franchisees. Our businesses are already besieged with government regulations which discourage their existence.

Please use your influence to oppose this bill which would attempt to force compliance with principles contrary to good business.

Very sincerely,

ROBERT J. BAER, *President.*

[From the New York Law Journal, April 13, 1976]

FRANCHISING

(By Harold Brown)

Mr. Brown, who writes this column as a regular feature of the Law Journal, is a partner in the Boston firm of Brown & Leighton.

THE 'MIKVA BILL'

At the annual convention of the International Franchise Association in February at Palm Springs, Calif., primary attention was devoted to the pending "Mikva bill"[1] designed to protect against any termination or failure to renew a franchise except for "good cause". The discussion was led by Sigmund Smith, staff director of the Consumer Protection and Finance subcommittee of the House Interstate and Foreign Commerce Committee which was scheduled to conduct public hearings in Washington, D.C., on March 9–11. According to Mr. Smith, the measure had to be taken seriously because of its sponsorship by over 100 Congressmen from every part of the country and of all political persuasions. He stated that in the prior year, out of 300 proposals, only eight had obtained a public hearing, for an average of about one a month. When the current "top ten" were culled this year, the Mikva bill received the highest number of votes for public airing.

He thus disclosed the great interest engendered by this measure, but downgraded its prospects in commenting that usually more than half of the House subscribers don't know what they've sponsored and almost none have read, let alone studied the particular matter. Conceivably, both the IFA and the Staff Director failed to grasp the full implications of such broad grass-roots support.

The March hearings lived up to their expectations, evoking broadside objections by the IFA, leading franchisors and several of its subgroups. Franchisees were almost equally vocal in their support, led by the recently formed National Franchise Association Coalition consisting of a large number of "line" associations of franchisees in individual industries with a composite of many thousands of individual franchise members. The most authoritative public opinion came from Paul Rand Dixon, then acting chairman of the Federal Trade Commission. No one appeared to notice the absence of the thousands of former franchisees who had lost their entire investments because of lack of national protection both from fraudulent schemes and from oppressive franchisor practices, including terminations. Instead, many of the objectors claimed that there was an absence of a proven record before the subcommittee.

Regardless of the substance of the proposal, it is now evident that the political world has become acutely conscious of the voter impact represented by the half million or more franchisees. They are demanding recognition of their fundamental rights in the operation of a "business of their own," precisely what every franchisor represents as the basic nature of the transaction.

In the hard-nosed world of getting elected, it has been proven that the home base support of thousands of franchisees can materially contribute to the success of such state office seekers as governors and attorneys general, as well as federal senators and representatives. As one politician recently put it, in a state with a population of 3 to 4 million, it is invaluable to have the enthusiastic support of 3,000 gasoline service station dealers as well as that of several hundred auto dealers and a few thousand franchisees in other business sectors. Perhaps this perspective is of more transcending interest than the specific proposals in the Mikva Bill and the comment they engendered.

FUNDAMENTAL THRUST

The fundamental thrust of the measure is to confirm the franchisee's ownership of the "business of his own" which was granted by the franchisor. That is what most franchisors expressly convey to their franchisees. It also reflects the "vested interests" which the franchisee instills in his local business through his expenditure of time, money and effort.[2] The "goodwill" of the franchisee

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[1] H.R. 8349 (94th Cong., 1st Sess.).
[2] Milsen & Co. v. Southland Corp., (7th Cir. 1971) 454 F.2d 363.

in his own locality has achieved common law [3] as well as general statutory recognition in ten states [4] through restrictions on termination of failure to renew a franchise unless the franchisor can sustain the burden of proving "good cause." [5]

Industry spokesmen have widely contended that they should retain the power to terminate bad franchisees in order to protect the value of their tradework for the benefit of other franchisees in the system. They also need that power to protect the consuming public from misuse through the "passing off" of inferior products or services, this being an express condition for the retention of their property right in the trade name under the Lanham Act.[7] Finally, fanchisors want to reserve the right to make a total withdrawal from the particular market.

To meet these objections, the Mikva bill would permit a termination or nonrenewal where the franchisor can sustain the burden of showing "good cause" or its intention to effect a "marketing area withdrawal." To assist the parties and the courts in applying these standards, the bill provides several specifications. In so doing, the measure may have created more problems than had been anticipated, though it would appear that these can be comfortably used by the parties and the courts in practical terms.

For example, for "good cause," the franchisor must show that the franchisee has failed to "substantially comply" with a requirement of the franchise agreement that is both "essential" and "reasonable" and that the franchisee's failure was "without reasonable excuse or justifictaion." Alternatively, the franchisor could show "good cause" where the franchisee had "used bad faith in carrying out the terms of the franchise." These even-handed standards clearly reflect the value judgment that a franchisee should not be deprived of his business and his livelihood unless there is serious cause for such deprivation and for the confiscation of the equity in his property.

REASONABLE COMPENSATION

The alternate would allow termination or non-renewal where the franchisor plans to withdraw from business in a particular market area. But such an act would be conditional on the franchisor's willingness to pay the franchisee "reasonable compensation for the value of the franchisee's business, including goodwill." As further assurance against the use of that alternative as a ruse, the franchisor would then be prohibited from reentering that area for a period of five years. Clearly, these conditions are reasonable and appropriate. They also confirm the franchisee's ownership of his own business, including the right *not* to be forced out of the marketplace because the franchisor simply became disenchanted.

The heart of the proposal thus reflects the fact that although the franchise may have had its origin in a "consensual relationship," the franchisee thereafter has a property interest which cannot be taken away except under exceptional circumstances. Whether or not that status is characterized as "license coupled with an interest" or some other familiar legal concept, sociological fact is that the small businessman would no longer be subject to termination or nonrenewal of his means of livelihood. It reflects the total lack of faith in some cleverly drafted "franchise agreement" that was offered to the franchisee on a "take-it-or-leave-it" basis. And it also confirms the widely spread view that such agreements are not only one-sided, but may not even be a contract at all.

That legal deficiency arises from the many provisions that are wholly subjective on the franchisor's side. These usually include such matters as the right to set and to change at will all the "quality standards," the manual of operations,

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[3] Shell Oil Co. v. Marinello, 63 N.J. 402, 307 A. 2d 598 (1973), cert. den. 415 U.S. 920

[4] Conn. (1975), De (1970), Hawaii (1975), Indiana (1976), Mich. (1974), Minn. (1975), Mo. (1975), N.J. (1971), Wash. (1972), and Wis. (1972). In addition, 34 States have adopted such legislation for automobile, petroleum, or other specific categories of dealers. (1974).

[5] Ten States have declined to adopt such general legislation, though efforts are continuing. Such a phrase has been judicially approved both generally and for constitutional purposes.[6]

[6] Globe Liquor Co. v. Four Roses Distillers Co., (Delaware) 281 A. 2d 19 (1971), cert. den. 404 U.S. 873 (1971).

[7] 15 U.S.C. 45; see H. Brown and J. Cohen, "Franchise Misuse," 48 Notre Dame Lawyer 1145 (1973).

the quotas, the products and services and even the prices which will be charged the franchises. As Professor Williston used to say, such "weasal words" destroy the very concept of a "contract."

The franchisor could also decline to renew the franchise if he were to prove that he had a "legitimate business reason," defined as "a fair and reasonable business decision." As further limitation, however, this choice would only be available if the original franchise had been for five years or longer and the renewal periods in the original grant had been for periods of two years or more. As a final deterrent, the non-renewing franchisor would have to pay the franchisee "reasonable compensation for the value of the franchisee's business, including goodwill."

90-DAY NOTICE

Finally, a ninety-day written notice would have to be given to the franchisee prior to any termination or refusal to renew the franchise. The only two exceptions would be the allowance of a forty-eight-hour notice either if required to protect against imminent danger to public health or safety or in case of insolvency, bankruptcy or receivership of the franchisee. The bill would provide an award of damages, including the value of the franchisee's business, exemplary damages and attorney's fees and costs. No contractual waiver would be allowed. Obviously, franchisors were opposed to these enforcement provisions, though they are clearly needed.

The statute would thus follow the pattern established in numerous state statutes both for franchisees in general and for dealers in particular industries, such as in automobiles and gasoline. Those enactments focused on the status of the franchisee as an independent businessman, rather than on the so-called "contract" that accompanied its creation.[8] The Mikva bill is replete with statements that implicitly acknowledge the existence of the franchisee's business as a property right, as distinguished from a contractual arrangement. Comparably with a family marriage, a franchise may be commenced with the consent of two parties, but the terms of its continuity and termination are governed by "conduct" rather than by the egregious terms unilaterally imposed by one of the parties. And this view has been confirmed in the judicial sanction granted to state legislation of like tenor. In this light, many of the principal objections to the Mikva bill cannot be sustained.

UNIFORMITY NOT SEEN

For example, it was claimed that the states are adequately addressing the problem, though in fact only ten states have acted generally and barely half of the states have taken care of specific industries. Obviously, the same public policy underlying the board sweep of such state enactments amply demonstrates the need for like treatment throughout the nation. It is only simple justice that all franchisees should be afforded the same confirmation of such fundamental rights. While franchisors have justifiably clamored for the need of uniformity in franchise-disclosure legislation by the states, franchisees are similarly entitled to the same protection nationwide. Otherwise stated, there is no valid reason why a Kentucky Fried Chicken or McDonald franchisee in ten states should be entitled to protection against unjustifiable terminations or failures to renew, while franchisees of the identical franchisor can be arbitrarily treated elsewhere. If their franchisors can live with such regulations in ten states, obviously they can do so everywhere.

The objectors first created false standards and then proceeded to destroy them. The primary attack was to classify a franchise as a "contract," rather than a status. They thus ignored the fact that such one-sided "agreements" are almost universally unfair, that their subjective terms destroy their being regarded as a valid "contract," and that even a valid contract cannot bar the protection of such basic human rights as those involved in making a living.

Faced with that very situation, the Supreme Court of New Jersey unanimously ruled that the "non-renewable" lease and supply contract provided by Shell Oil Co. to its dealers was subject to an implied convenant of renewability except for "good cause" and that the terms would have to be negotiated in "good faith."[9] In answer to Shell's argument that the gasoline station dealer simply

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[8] For extensive comment on this aspect of a State automobile dealer's statute, see H. Brown, "A Bill of Rights for Auto Dealers", 12 B.C. Ind. & Co. L. Rev. 758 (1971).

[9] See Marinello, n. 3 ,supra.

held a sublease of the station separate from the supply contract, the highest court in New Jersey labelled this as "pure sophistry." The same must be said of the technical objections to the Mikva bill.

No Retroactive Change

The foregoing analysis also avoids the spurious attack made on constitutional grounds. There is no "retroactive" change of an existing contract when the common law prescribes such an implied covenant of renewability. Nor can that objection be raised when there is no real contract in the objective sense of the common law. And there has never been any doubt that legislation can regulate future *conduct* and *practices*. For that reason, anticompetitive regulations have repeatedly been held by the U.S. Supreme Court to supersede any existing contract.

Having erroneously assumed that this is simply a matter of "contract" law, the objectors then claimed that Congress should not "write" a private contract. They also claimed that automatic renewability would deprive them of the franchise fees they could charge for "rewriting" the franchise at the end of its artificially prescribed term. Thus depriving them of valuable property without "due process of law" in contravention of the Fourteenth Amendment. The hearings disclosed that McDonald's has publicly announced that it will not "renew" any of its tweny-year franchises, but that it will "rewrite" them for a new franchise fees. This also confirms the fact that the contrived objections to renewability are in fact founded on a plan to charge the franchisee a second fee for the right to continue his local business which he himself has nutured for as long as twenty years. Of course, the objection is grossly invalid since the business and the renewal right belong to the franchisee and not to the franchisor.

In an effort to prove that compliance would be "anticompetitive," the IFA claimed that small and now franchisors simply could not afford the legal fees that would be required to comply with this federal legislation and the differing rules in fifty states. Such a "barrier to entry" is spacious on its face, since the Mikva bill will not change either present or future State legislation. It will, however, undoubtedly provide a national standard for such action, both existing and future, in precisely the same manner as is happening in pre-disclosure statutes. In the latter, most states have substantially copied the provisions of the first statute, as adopted in California. Further, with IFA cooperation, most states are accepting the "Franchise Uniform Offering Circular." And with the expected advent of the long awaited FTC Regulation on Disclosure to Prospective Franchisee,[10] they are already initiating steps to achieve as much uniformity as possible. The same state cooperation will clearly follow enactment of the Mikva bill.

ABUSE DOCUMENTED

As for the "clear evidence" of abuse, it is ridiculous to assume that the thousands of present and former franchisees could be expected to attend Washington hearings, even if they had adequate notice and the funds to spend. But there is now court documentation of the extensive abuse found in some leading franchises. In the foremost pancake system, the Franchisor's court-filed affidavit attested to 109 terminations out of 250 franchises in a three-year period, with no compensation to the ousted franchisees. In fact, each repossessed business was then resold at substantial prices as a "going business." In the leading fried chicken franchise, an area franchisor had the quaint practice of mailing registered letters of termination simply to discipline the recipients as well as the other franchisees who were informed of what could happen to them. And the obvious helplessness of the existing franchisee, both as to termination and renewal, is constantly used by the franchisor to impose onerous practices, especially with regard to unfair quotas and the purchase of undesirable merchandise which the franchisor needs to sell. The latter practices are almost universal in the automobile industry, particularly before each model change or when the auto factory has grossly misjudged the public's desire for small or large cars as in the past three consecutive years.

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[10] It is now over five years since the FTC first proposed such a regulation in 1970, conducted hearings in 1971, proposed a modification in 1974, and recently completed its "staff" work with a view toward promulgation in the Spring of 1976 (see news report in Wall St. Journal, March 31, 1976, p. 2). See H. Brown, "FTC Disclosure Regulation on Franchising", N.Y.L.J., Oct. 30, 1974.

While it might be argued that franchisors don't want their franchisees to fail and that it is expensive to train their successors, the fact is that franchisors place primary emphasis on gross sales by their franchisees and they are disdainful of their net profits. Where the franchisor sells products through its dealers, market penetration is the absolute goal and the impact on the dealer's net profit is secondary.

ROYALTY ON SALES

The same conflict occurs where the franchisor charges a royalty on gross sales. There the franchisee is pushed to the utmost to provide the maximum in gross sales, with little regard for net profit. Indeed, the leading hamburg and doughnut franchisors not only charge a percentage royalty on gross sales, but they also require an additional charge of 7 percent to 9 percent of the gross sales above certain specified amounts. The latter is charged in the form of "additional rent" in the sublease of the premises. And if such exorbitant pressures then result in the franchisee's failure, this provides the franchisor with an ideal opportunity to operate the business as a "company store" or to resell it at a handsome profit as a "going business." This is in fact the actual record of several major franchisors, though in some leading systems there is a practice of paying the outgoing franchisee a minimal sum in order to obtain a general release and to be able to characterize the transaction as a "repurchase" rather than a "failure." This format was standard procedure for the best known chicken franchisor which was thus able to claim that none of its franchisees had ever "failed."

It was rather amusing to observe the franchisors' boasting of the numerous remedies which already exist under federal and state law to redress some of the complaints of franchisees. This recitation included reference to the state law defenses of fraud, unconscionability, and even abuse of the fiduciary relationship which prevails in all franchising. Every state proceeding by a franchisee on these grounds has been vigorously attacked by all franchisors, though the courts are slowly becoming aware of the need to design new avenues of relief.[11] Similarly, such antitrust remedies as those against price-fixing, restraints on alienability, tying and attempted monopolization have not only met with individual franchisor resistance, but also with IFA participation as a friend of the court.

FUNDAMENTAL NEED

In any case, none of those remedies are directed to the fundamental need for protection against unwarranted terminations or refusals to renew the franchise. Such complaints have been universally regarded by the federal courts as nonviolative of the antitrust laws unless the termination or renewal was in aid of another antitrust violation or in retribution for the bringing of such litigation. And because of the rule that in the absence of exceptional circumstances, an antitrust claim *cannot* be used as a defense to a state lawsuit for rent, royalties, or goods sold and delivered, it has been virtually impossible to protect a franchisee's business through a temporary restraining order until the antitrust case was determined. In the very latest franchise case, the Third U.S. Circuit Court of Appeals took special note of the separate need to protect franchisees from unwarranted terminations, as well as against deception in the sale of the franchise. The availability of antitrust relief, with exemplary damages, attorneys' fees and injunctive relief, is the right of every businessman in the United States. It should not be regarded as a "special privilege" for franchisees in substitution for their most basic asset, namely, their very right to continue their *own* businesses.

In a similar vein, it was contended that franchising would be killed by the Mikva bill and many thousands of small businessmen would be deprived of the opportunity to "obtain a business of their own" as franchisees. First, that claim has repeatedly been made by franchisors in resisting all state regulation, yet franchising has continued and even flourished in all the states where legislation has been enacted. Further, it is "procompetitive" to assure the 500,000 existing franchises that they will be able to continue in business. They should not be sacrificed for some pretended repercussions. Future franchisees are also entitled to the same assurances. But the mere statement of this objection contains the strongest reason for the bill, namely, that both present and future franchisees are granted a "business of their own" which demands the full protection of the law.

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(11) E.g. Mobil Oil Co. v. Rubenfeld, 339 N.Y.S. 2d 623, 72 Misc. 2d. 392 (1972), aff'd App. Term. 357 N.Y.S.2d 589, 77 Misc. 2d 963 (1974), rev'd App. Div. 370 N.Y.S.2d 943 (1975), appeal pending.

ENTITLED TO FRUITS

So long as franchising has the goal of helping the franchisee to succeed more readily than other entrepreneurs, that ideal should not be conditioned on the forfeiture of his independent business. It may be warrant enough for him to work endless hours, often with his unpaid wife and teenage children at his side, to build a worthwhile asset. If he can do so in spite of large franchise fees, royalties on gross sales, profit from sales to the franchisees, profit on rentals of facilities and equipment, and often hidden kickbacks, then he is entitled to retain the fruits of such labor and devotion to his own business.

While regulations on disclosure to prospective franchisees are sorely needed in all states, as well as federally, this is no answer to the need to protect the franchisee's basic business. If it were, then additional legislation would not have been necessary in over half the states for general or specific industries. The criticism of the FTC for its inexcusable delay in issuing its disclosure regulation, provides no substitute. If anything, such incredible procrastination may simply indicate its subservience to industry argument until the pressure for reform reaches such a high degree that a modicum of relief must be granted to avoid more genuine protection. In the *Wall Street Journal* article noting the anticipated FTC action this spring, it was expressly reported that "industry sources" stated that such action would in fact assure the "demise" of the Mikva bill.

That premature "death" of an as yet unenacted proposal may have been a Freudian slip. For while the measure may need clarification to eliminate some vagueness and to make it fully workable, this proposal is too important to be laid to rest so unceremoniously. Quite, possibly, Congress may not prove as responsive as would be indicated in the sponsorship by over 100 federal legislators. But if action is not speedily forthcoming, this national notoriety and closing of the ranks may produce more vigorous legislative effort in the states. That is what happened six years ago when Senator Philip Hart's call for national relief went unheeded. And it is even more likely to occur now through the efforts of the many state agencies administering state disclosure procedures, as well as through the improved national communication provided by the National Association of Attorneys General. The latter have already shown an accelerated appreciation of the need to aid small businessmen in areas of vital concern. The continued right to make a living for one's family satisfies that criterion.

THE SECRETARY OF THE TREASURY,
Washington, D.C., April 24, 1976.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of April 9, 1976, with which you transmitted a copy of the transcript of the testimony of August Bequai, a former trial attorney with the Securities and Exchange Commission. In his testimony given before the Commerce Committee, Mr. Bequai indicated that, during this employment at the SEC, officials of the Bureau of Alcohol, Tobacco and Firearms were less than cooperative with the SEC in its investigations and may have failed to take appropriate action in regard to certain practices in the brewing industry.

The Office of the Assistant Secretary (Enforcement, Operations and Tariff Affairs) has previously been aware of Mr. Bequai's testimony and had directed that an investigation of his allegations be undertaken by the Office of Inspection of the Bureau of Alcohol, Tobacco and Firearms. In addition, the Office of the Assistant Secretary telephoned Mr. Bequai in an effort to obtain any information he had in his possession concerning any conduct of officials of the Bureau of Alcohol, Tobacco and Firearms, which he felt may have been improper or may have amounted to a failure to perform duties required by law. Mr. Bequai declined to furnish such information, citing as his reason the advice of his attorneys and attorneys for the Senate Committee on Commerce.

I appreciate your calling this matter to my attention and wish to assure you that we are vigorously pursuing our investigation to determine whether any official of ATF has acted improperly.

Sincerely yours,

WILLIAM E. SIMON,
Secretary.

[The following information was referred to on p. 49.]

San Francsico, Calif., April 25, 1976.

Mr. ED MERLIS,
Counsel, Consumer Subcommittee on the U.S. Senate Committee on Commerce, Richard Russell Senate Office Building, Washington, D.C.

DEAR ED: At the April 7, 1976 hearing on S. 2335 (Fairness in Franchising Act) by the Consumer Subcommittee of the Senate Committee on Commerce, Senator Tunney requested that we provide him with additional case histories of abuses of franchisees by franchisors. In response I enclose the following statements by franchisees or former franchisees:

1. Statement of Mr. D. L. Raymond,[1] Baskin-Robbins' franchisee;
2. Statement of Captain Leroy E. Harris (USN Ret.), a Denny's Restaurant franchisee;
3. Statement of Mr. H. E. Bentley, former Winchell's Donut Shop franchisee;
4. Statement of a Manager of a Winchell's Donut Shop who was a Winchell's Donut franchisee and requests to remain anonymous;
5. Statement of John and Olga Simon, former distributors of Schlitz products in Fresno, California;
6. Statement by Ms. Joanne Martin, former Mode O'Day franchisee;
7. Statement of Mr. Jerry Hays,[1] former Tidewater (acquired by Phillips Petroleum) service station dealer;
8. Statement of Stephen H. Alpine, Baskin-Robbins franchisee;
9. Statement of Samuel Burns, Baskin-Robbins franchisee;
10. Statement of a 7–11 store franchisee who requests to remain anonymous; and
11. Statement of Monroe H. Hess,[1] Jr., one-hour martinizing franchisee.

In view of Senator Tunney's request on the record, we would appreciate it very much if the eleven enclosed statements and this letter were printed in the official record of the hearings.

Thanking you for your consideration, I am

Yours very truly,

TIMOTHY H. FINE.

Enclosure.

STATEMENT OF CAPTAIN LEROY E. HARRIS, USN (RET.)

1. I am the franchise owner/operator of Denny's Restaurant No. 175, located on Highway 101 at Airport Blvd in Salinas, California. At the time I bought the franchise in mid-1970, I had, no formal or extensive experience in the restaurant business. As my title would indicate, however, I did have extensive managerial experience and was confident that, if I were reasonably selective in my choice of sites, my enterprise would be assured success with the expert assistance of the Franchisor. My formal education consisted of 3 years at Texas University and 4 years at the U.S. Naval Academy from which I was commissioned in 1939. My naval career was highlighted by duty as a fighter pilot in WW II and Korea and by ship commands of the USS Vesuvius (AE–15) and the Heavy Attack Aircraft Carrier, USS Midway (CVA–42) and by duty as Chief of Staff to Commander Carrier Division 9, in command off Vietnam during the Tonkin Gulf Incident. During this career I also obtained two advanced degrees, one of which was a Masters of Business Admin. Retired in 1966 for family reasons, but of necessity had to continue working. Took employment in the Aerospace industry at General Dynamics Quincy, Mass., then with a "Think Tank," the Institute for Defense Analyses, Arlington, Va. and finally to Lockheed Missiles and Space Sunnyvale, CA. None of these satisfied my yearning to try my hand in a civilian business and so when the opportunity presented itself, I bought a franchise.

2. From this overly long background outline one can see that although I had no business experience, I wasn't exactly a babe-in-the-woods waiting to be plucked. I knew all the cliches such as "Caveat Emptor," the Corporate maximum profit syndrome and that Corporations, like nations always act in their own self interest. Yet, I fell victim to the classy sales-front and self-greed

[1] These enclosures are in the committee files.

(my own) and was plucked—or so it seemed, for the first two years. I was permitted to visit the shop which I later bought, but was enjoined to talk to no one on the premises about the purchase. This was ostensibly to avoid the disturbance to employees, over fear of losing their jobs, that sales usually cause. I now think this restriction was a special one for me; I've talked to many and never found another Denny's franchisee upon whom this restriction was placed. In any event it prevented me from even inspecting the unit. I'm certain that had I been permitted no more than 5 minutes in the kitchen, I would have known it was in deplorable material condition. Or had I returned at night on the occasion of my only visit and seen all employees in sweaters and coats, as I did after purchase, I would have known the building had extreme comfort problems—rather disastrous for a restaurant. I reviewed and questioned every statement of my contract with the franchise salesman who as I later learned had never seen the unit and didn't know what it looked like. He assured me everything was as written and that everything was backed by Denny's impeccable reputation; he even let me know that some of my questions cast aspersions upon Denny's character. Just as he indicated, I was wasting my time, as well as his. We need not have proceeded beyond in the first sentence of the contract. This granted me the use of a "Standard, fully equipped Denny's restaurant building and facility which had been carefully designed, constructed and equipped at great expense." There is not one word of whole truth in the entire sentence. The only things owned by Denny's at unit No. 175 was a lease, some equipment picked up in the bankruptcy court of the previous operator and a few second hand appliances. Denny's had nothing to do with the design or construction of the building.

3. On my pre-purchase visit to the unit, I noted there appeared to be a cocktail lounge in the building with the restaurant. There was not a word in the Contract about a lounge so I questioned the franchisor about it. He didn't know one was in the building, but he later explained it away telling me it was under a totally separate arrangement and that there was absolutely nothing that would concern me about the lounge. After purchase I soon learned the lounge was located in the building leased to me and that its operators and its patrons occupied or used every logistic facility or service in the entire facility, all supported at my expense. Unbelievable, but I was expected to pay for all utilities, lights, gas and water, soften the water and heat it or cool it, make ice, remove all garbage and trash, supply and clean the rest rooms and provide all the coffee they could drink or use, maintain the parking lot and regularly clean everything. The lounge even used my cooks to make snacks.

4. The Contract Agreement stipulated the payment of $425 per week for the use of equipment in the restaurant. This is a price calculated to make one believe it was good, efficient equipment. In reality, much of it was inoperable and almost all the remainder was subject to almost daily breakdown. Of the 7 heaters on the roof required to heat this 9,000 ft.^{2} building, only one was working. Every time I arrived at the shop in the first three years, until it became funny it was so ludicrous, I was greeted with the report of another breakdown. Had I not been a graduate engineer who had learned his trade and practiced it from infancy on cars, planes, ships and homes, I would have been insolvent or unable to operate within 6 months.

5. Denny's formula for establishing the price of the franchise involved the preparation of a proforma to indicate the net income the franchisee could hope to generate in the shop if properly managed. Inputs to the P.F. are taken from operating data gained while the shop was operated as a Company shop. My P.F. indicated that if I could generate comparable sales and maintain $51,200 a year. The final calculation was to roughly double this and arrive at about the same percentile expenses in the cost of doing business, I would net a round price for the franchise of $100,000. Payment was to be $25K down with $75K @ 10% in 3 years. I know this meant making payments equalling $29K per year so I went over item in the P.F. with Denny's accounting. My first impression was one of suspicion. A cursory look at the P.F. indicated that if proper allowances were made for the fixed and "tie-in" fees assessed to the franchisee, Denny's had been netting a cool $150K from this one shop. Why would the Company wish to sell this money maker for less than it returned to them in one year? This was explained away by telling me the Company needed this instant sale of $100K on the books for the benefit of the annual report to stockholders. What I was not told was that through means of various

accounting strategems, all the expenses attributable to this shop's operations were not on the shop's Operating Statement, several very expensive matters were reported only on Company Administration reports. My P.F. contained a total labor cost. This matched that on the Units Operating Statement for all employees except Managers which averaged 3 to 4 the year round. Additionally there were no fringe benefits for anyone included. These two little matters alone add about 11% or $35K to the cost of operating the shop and would reduce the projected net income to about $16K per year.

6. Likewise the P.F. input for repairs and maintenance was a true reflection of funds expended as reported on the operating statement, but had no relationship to funds required to do the job. If a refrig broke down and there were no funds for repair, food was moved to another box or left in the open in hopes it could be used before it rotted—food was cheaper than repairs. As a matter of fact, again because of bookkeeping practices, the R & M funds on the P.F. were not even sufficient to cover the inescapable, day to day expenses such as garbage disposal, parking lot, bathrooms and pest control.

7. Denny's also failed to tell me the P.F. inputs did not reflect their three years operations, but came from only one, the last and best one. These figures were so much better than those of the prior two years that it appears the "mine was salted."

8. A professional economist and I have re-analyzed available data on this shop No. 175 and have concluded that instead of making $150K per year, Denny's was, in actuality, doing no better than breaking even, going down in material conditions and gaining many headaches. We may never know all the reasons Denny's wished to sell this profitable? restaurant, but one of them won't be a desire to enrich the franchisee.

9. We also concluded that at the time I bought this franchise, Denny's was almost insolvent, more than likely because of involvement in the Parvin-Dohrman affair in Las Vegas. All the top Executives lost their jobs and a new regime took over. Purse strings were practically cinched shut. I felt the effects of this through what Denny's calls its Takeover Schedule. When a franchisee takes over, an inspection is made and discrepancies are listed for correction within thirty days. The list here covered some two pages of fine print. The only thing on the list corrected by Denny's was a leaking roof. This took over two years and then was done only after I had invoked the assistance of the Health Inspector. He was kind enough to write Denny's threatening closure of the Shop if ever again he saw rainwater leaking onto the Orange Juice Dispenser.

10. When I bought the franchise I also bought several hundred shares of Denny's common. Early in my tenure I attended a shareholders annual meeting held in Denny's Hotel in Disneyland. Having the best interests of the Company, as I saw it, in mind, I obtained the floor and voiced my concern over the announced Company objective to sever itself from the franchising line of business. I pointed out that the annual report showed that the cost of doing business equalled or sometimes exceeded the net sales of all, both company and franchised, shops. Further, that the only discernible profit was generated from rental and management fees and from interest earned on the cash flow generated by these fees. Immediately a motion to close the proceedings was voiced, seconded and passed, and I've never received any answers—or arguments. When Denny's disinherits the franchisees in 1978–80, an infinitesimal sum can be saved in the cost of doing business, but all those profitable, usurious fees will disappear.

11. Denny's exacts these exorbitant "tie-in" fees through an organization of dummy corporations called Harold Butler Enterprises with the number of the shop. Thus each franchised shop reports to its own parent corporation. These fees are:

(*a*) Rental. Quarterly, HBE No. 175 pays rent to the owner of this property based upon 5% of everything sold on the property. Every week I pay a rental fee which consists of 7% of the first $2700 sales, 10% of the next $2300, 12% of the next $3000 and 14% of all sales over $8000. The average amount is about 11.5%. This year I will pay about $75,000 in rent and taxes for a profit of about $38,000 to Denny's.

(*b*) Since Denny's agreed to pay all utilities and taxes for the cocktail lounge in my building, a straight 12% of sales rental fee is exacted. This adds another $12,000 profit to Denny's coffers; they very graciously permit me to pay for utilities and taxes.

(*c*) There is a billboard and illuminated signs fee. For this I pay about $10,000 per year, again about double the cost to the Company.

(*d*) Denny's has a working agreement with several restaurant equipment suppliers. My Agreement stipulates that if Denny's decides that new equipment must be placed in a shop, it can be done without my permission, but at my expense. Theoretically, at least, in my last year in the shop, Denny's could place all new equipment and appliances in the shop, make me pay for them, then wait for termination and step in and take advantage of all the new equipment.

(*e*) Equipment rent is a flat fee of $425 per week or over $22K per year which is about what it cost Denny's to buy and use for 3 years. This is all profit for Denny's.

(*f*) The most pernicious of the tie-in fees foisted on the franchisee is one called Management Fee. This is a flat 5.3% of sales charged for several services:

(1) For the use of the Denny's trade name. This is illusory for what else did one pay the original franchise fee of $100K.

(2) For the Operator's training in, and use of, the Company's selling, promotion and merchandising methods and techniques. These are not, and never have been, provided and Denny's has no means for doing so.

(3) For the availability of supervisory and training personnel. The only individual available for this is the District Manager and his services are commandeered almost 100% by the Company Shops.

(4) For the Company's furnishing of accounting and administrative services. Denny's accounting provided the franchisee amounts to nothing more than "accounts payable" and a glorified billing statement to the franchisee. It's called a Profit and Loss statement, but it is no more than a demand for immediate payment of accounts and fixed charges plus tie-in fees. Denny's refuses to have anything to do with the most important accounting function, that of payroll and its attendant taxes. The Management Fee costs me about $35,000 per year. All it returns to me plus the entire payroll function can be obtained from the Bank of America for $1200.

I don't know what Denny's administrative services are supposed to be. The only things I see are papers passed on to me which have been sent to Company shops by executives. The things important to my Management, such as Denny's Profit Sharing Plan, are refused to all except Company employees.

Before leaving this subject of fixed tie-in fees, we should look at the tremendous cash flow built up by them, to be used by Denny's, the franchisor. My fixed payments amount to about $140,000 per year, paid weekly at the rate of $2690. Of this, $111,000 is estimated to be profit and the rest used to pay the quarterly to annual expenses. From annual reports, the total fees payment for all franchises is calculated to be in excess of $9 million. At least a quarter of this can be rolled-over in short term securities @ good interest. Thus the Denny's franchisees provide the Company not only about $7.2 million profit, but also provide the wherewithal to add at least another quarter million in interest.

12. Over a period of over two years after buying the franchise, I tottered on the brink of insolvency. Several times I had to dip into outside funds to meet the payroll. At the time I also attempted to negotiate another Agreement which would more realistically pertain to my particular shop situation, the only one of its kind under franchise. I received promises of relief from everyone in the chain of command up to and including the President of Denny's Restaurants. I received a few small tokens, but never anything that could be called an Agreement that could be lived with—probably because this would imply some admission of guilt. Finally, in despair, I filed legal action for injunctive relief, in July 1972. Denny's lost no time telling me my action would not bother them since their retained legal counsel would handle mine in a routine manner and warning me that I didn't have the resources or finances to pursue the matter. They further opined that even if I succeeded in bringing them to court and won, they would appeal and continue appealing until I'd never see a dime or compensation. They didn't have to tell me that if they delayed beyond my termination date in 1980, I would have no means to continue the action.

Denny's could be right. It is now almost 4 years after the action was filed and they haven't been brought to trial yet. The first trial date is in September

next and now it is not only possible, but absolutely predictabe that they will be able to appeal any adverse decision past my termination date. Just such a synopsis is being enacted at this moment in the case of Stevens versus Denny's in Sacramento, Stevens is a Black who bought a Denny's restaurant in a deteriorating area of Sacramento with a fraudulently misrepresented contract Agreement. He, too, was forced to commence action and his case was concluded more than two years ago, with a judgment in his favor of $250,000. However, Denny's was successful in getting his contract terminated and in appealing the verdict. Stevens is at this moment without a job and without funds.

13. A critical statement such as this is meant to be, is not complete without suggestions for improvement. From a hasty reading, it appears that S. 2335 and H.R. 8349 were written to cover my specific situation and that of other franchisees known to me. None of us could propose a better objective than that of S. 2335—" * * * to assure fairness and to protect against overreaching, unjust enrichment, and unjustifiable termination, and for other purposes." Although the franchisor has most of the weapons in cases involving contractural disputes, removal of the right to terminate without compensation except for cause, will eliminate some of the "double standard of independence" which exists, heavily weighted in favor of the franchisor, in every contract. This one factor alone would make the franchisor/franchisee arrangement more of a partnership which is what it should be. It would also give the franchisee a good lever to make the franchisor shoulder some of the mal-effects of inflation. At the present time all the burden of inflation is placed upon the franchisee. His only defense is a menu with higher prices and this seldom does anything more than neutralize the effects of rising food and labor costs and always loses to the dimunition in value of the dollar. At the same time the higher priced menu artificially pushes sales higher and this is where the franchisor gets his percentage. Certainly one must consider this inflation aspect an unjust enrichment for the franchisor.

14. One final statement and it's more of an observation. I noted that statements have been taken about the Winchell's Donut Shops operation. It may be desirable to coordinate my statement with these. Verne Winchell, the founder and owner of Winchell's Donuts, merged the operation with Denny's and is now the largest single shareholder, Chairman of the Board and the controlling entity of Denny's, Incorporated.

STATEMENT OF MR. H. E. BENTLEY, MANAGER, WINCHELL'S DONUT SHOP, CANOGA PARK, CALIF.

For the past seven years I have been responsible for the operation of a Winchell's Donut Shop in Canoga Park, California. I first acquired the franchise in 1969 from a franchisee who had run the business down. When I took the franchise over, the shop was grossing between $1,200 and $1,300 per week. By 1971 I had brought the gross up to approximately $2,200 per week, and at the present time the shop is grossing approximately $3,300 per week.

In July, 1971, at the commencement of their new fiscal year, the Winchell management called me into their offices and told me that they were going to change over to a new system. They outlined what it would be and said that everything would be going onto computers but that there would really be no change, that everything would stay the same and that the only change would be that I would be a manager instead of an owner-franchisee.

That one change seemed like a pretty big change to me, and I resisted it. Winchell pressured me to sign a manager agreement over several months, but I refused.

Finally I got a "Notice of Termination of Exclusive Franchisee and Licensing Agreement": "Effective October 28, 1971 at 1 o'clock p.m., Exclusive Franchise and Licensing Agreement dated February 20, 1969, the agreement between you and Winchell's Donuts, Inc., now a division of Denny's Restaurants, Inc., shall be terminated and all the rights thereunder shall immediately cease. On or before that date a representative of Winchell will meet with you to value and arrange for purchase by Winchell of your donut shop inventory and arrange to retake possession of the Winchell Donut Shop located at 21924 Saticoy, Canoga Park, California, the donut shop which is presently leased to you under the agreement."

When I got this notice I called them up and said, "What's the deal here, anyway?" They said, "If you don't sign the new agreement, we can't have two different systems, so we'll just have to close you out." When they put it that drastically I told them to bring the agreement out and let me look at it. They brought it out, and I signed it at that time.

The reason Winchell changed to company-owned stores was because of the antitrust laws. After the antitrust laws started cracking down on them, and they took over all the Winchell franchises, they sent out a letter containing "Purchasing Specifications for Operations" telling you you could buy from whom you wanted, but that you had to meet their specifications. For example, you had to buy paper cups with paper thickness .0154 and sidewall basic weight of 210 lb. per ream, bottom 160 lb. per ream. They had a Winchell's special coffee which had to be certain blends from certain ports in Portugal and South America and Hawaii which met Winchell's specifications. It was impossible to buy any coffee under those specifications except theirs. They did the same thing with coffee cups; you could buy them on the market for $10, but they charged $38.

Winchell sells you flour at an inflated price—practically double what you can buy flour for on the market. It is their flour and their special mix, and I can see paying for that. But I can't see paying a premium price for things you can buy on the market otherwise.

For example, just with sugar alone, I use six bags of powdered sugar a week; that's $180 a week I'm paying out just for sugar, which I could be buying $130 cheaper outside.

I did a lot of research on Winchell's shortening which they make you buy. I went to Proctor & Gamble who make a high-quality shortening which is better than the Winchell brand and which is cheaper. But Winchell wouldn't approve it.

Even though I am just a manager, I am responsible for paying all the expenses of the shop: accounting, maintenance, advertising, general insurance, group insurance, payroll taxes, workmen's compensation, utilities, linens, all supplies (mostly bought directly from Winchell) labor, and even the business license which is taken out in the name of Winchell but is charged to me.

Winchell has an item they call "administration fees" which is just rent. This is paid as a percentage of your volume—in my case it is 7.3% of the gross. That also is taken out of my income.

The way the management agreement is set up, I take a $200 per week salary which is based on the volume of my shop. After all the expenses are taken out, they pay a bonus on what is left. But since they are charging everything at inflated prices, plus the "administration fee" as a percentage of volume, what is left over for the bonus is not very much.

Right now Winchell's has an advertising deal where they tell the customer, "If you buy a dozen donuts you can get the pick of the case." Somebody can come in and buy $1.68 worth of donuts, then turn around and take a 30¢ or 35¢ "fancy," and you have to give it to them because it says "pick of the case." When we do that we're giving them a 15–20% discount. And I have to absorb this. If Winchell wants to advertise that way, that's fine, but they should absorb that cost, not pass it onto me.

As a manager, I'm nothing now; I'm just working for Winchell. They could close me out tomorrow. There's no goodwill. If I wanted to sell, I couldn't. I'd just have to walk away. With the volume I've built up, if I were a franchisee, I could sell this shop for $100,000. But right now I don't have any asset.

Senate Bill 2335 would make it impossible for companies like Winchell to take away the assets of independent owner-franchisees the way they did from me. I sincerely hope the Congress will pass this legislation.

STATEMENT OF MANAGER OF A WINCHELL'S DONUT SHOP

The following statement is made in support of S. 2335, a bill currently being considered by the Subcommittee on the Consumer, Commerce Committee, United States Senate. I feel it necessary to remain anonymous due to my position as an employee of the Winchell Company who currently have the power to fire their managers at 72 hours' notice.

My experience with the Winchell Company began in 1969 when I purchased a franchise from the Winchell Company. I increased the weekly sales volume substantially between 1969 and 1971.

In 1971 the district manager of Winchell telephoned me and said that he would like to meet with me at my Donut Shop the following day. When we met, the district manager had with him a new contract which converted my franchise to a company-owned store.

I asked him if there was any alternative available to being forced to become a company-owned store. He replied that there was not, that I must sign the agreement or lose my shop immediately. Under this threat I signed the management agreement.

The management agreement which went into effect in 1971 requires that the manager pay all of the following expenses: Business license (taken out in the name of Winchell); rent (paid to Winchell who has the master lease); all supplies (purchased directly from Winchell or from Winchell-approved sources); all labor expenses, including unemployment, FICA, disability; all insurance; all utilities; and any other fees required for the management of the shop.

The only exception to the above is a weekly salary which varies from one Donut Shop to the next but which normally is between $100 and $150 per week. After all expenses are paid, if there is a positive inventory for the week, the manager receives a "bonus."

If there is a negative inventory, the manager must make up the difference in the inventory for the following week or forfeit his bonus. If the inventory reaches a negative $1500, the manager is terminated immediately.

In 1975 over 60% of all my shop's gross sales were paid directly to Winchell. Since Winchell maintains complete control over the supplies I purchase, the company is able to control directly how much I must pay. Many supplies which I must purchase directly from Winchell could be purchased more cheaply from other sources with no difference in quality whatsoever. For example, powdered sugar costs $50 per 100 pounds from Winchell, but can be purchased from other suppliers for $25 per 100 pounds—in other words, Winchell marks this item up 100%! Winchell forbids me to buy sugar from any company other than Winchell.

The same holds true for many other products. I have been threatened, both in person and by letter from the company, with termination for buying a non-Winchell-approved product, even though it was of superior quality to the products on Winchell's approved list.

Winchell also controls the prices I charge my customers. This means that Winchell is controlling both what I must pay for supplies at the wholesale level and what I receive at the retail level.

In 1974 we had three price increases during a three-month period due to increases at the same time in the price of flour, shortening, and sugar. However, Winchell only permitted me to charge half as much in my retail prices as I was being charged wholesale in my payments to Winchell. This cut my profit in half during the following year.

Furthermore, Winchell has not allowed me to increase my retail prices since 1974, and inflation has increased many of my expenses since 1974—in fact, many of my expenses have doubled since 1974.

Another practice of Winchell which makes operations very difficult, not only for me, but for all Winchell managers (there are over 600 Winchell Donut Shops at the present time), is the way Winchell advertises at the expense of the manager. The company is presently running a "pick of the case" special. This special guarantees to the customer that, if he buys a dozen donuts, he may have any donut he chooses in the entire shop free. Many customers will buy the cheapest 12 donuts they can find, then choose the fanciest donut in the shop which they receive free. This special would be fine if the company reimbursed me for the free donut; but I have to absorb the entire cost, and it is presently cutting into my operating expenses to a great extent. I have no choice as to whether or not I participate in such a program.

If I were still an independent franchisee, many of the above-described practices would be illegal under the antitrust laws. I am convinced that Winchell converted all its franchised shops to company-owned shops to get around the antitrust laws.

In conclusion, I feel that I was unfairly terminated in 1971 and deprived of the investment I had made in my Donut Shop. Taking a case of this kind to court was too time-consuming and expensive for me to attempt on my own. Since 1971 I have been required to assume all of the responsibilities and liabilities which were mine as an independent businessman, yet I am not recognized as an independent businessman and have no recognized asset. All of my investment is owned by Winchell, and they can terminate me any time they wish. The only thing I own in my shop is the inventory, and even that is vulnerable since Winchell has almost total control over my expenses and my income. Even the rent I pay—which is charged on a sliding scale as a percentage of gross sales—is higher than the lease factor for the area in which I operate.

I consider myself to be a franchisee in everything except name.

Had S. 2335 been in effect in 1971, Winchell could not have deprived me of my business in this manner. I strongly recommend passage of this bill to prevent further injustices of this kind.

STATEMENT OF JOHN AND OLGA SIMON, FRESNO, CALIF., FORMER PROPRIETORS OF FRESNO BEER DISTRIBUTORS, INC.

During the decade of the 'fifties, Fresno Beer Distributors, Inc., FBDI, were the leading distributors of Burgermeister beers in Fresno County, California, serving over 900 accounts. In December 1961 the Burgermeister lines was acquired by the Joseph Schlitz Brewing Company, and FBDI was urged to promote Schlitz products Although Burgermeister was still available, without its fully compensate for the loss of Burgie sales.

I, John Simon, rendered assistance to the brewer in establishing new wholesale outlets in the State of Texas in the early 'sixties and enjoyed a position of great respect, both in the industry and in the area which I served.

During the decade of the 'sixties, the operating margin available to the wholesaler were not expanded in proportion to the inflationary increases in wages and other operating costs. In fact, operating margins in some of our Schlitz lines were actually reduced. With the population of the County declining and a less acceptable product line than previously, the profitability of FBDI was reduced to nothing. Notwithstanding this price squeeze, FBDI continued to perform far above the Statewide average for Schlitz wholesalers. The business was maintained by drawing increasingly on our personal credit and savings.

During the late 'sixties, we were continually urged by Schlitz to increase our inventories above realistic levels given the condition of the Fresno County market.

In June 1969, on one day's notice, we were terminated by the Joseph Schlitz Brewing Company, and our stock confiscated to pay outstanding bills with the brewer.

We had previously, at our expense, commissioned a management consulting firm, the George S. May Company, to provide an independent evaluation of our business. The May Company report cited the necessity for a larger margin between prices paid and prices received (both fixed by the brewer) to keep our wholesaling operation viable.

We subsequently learned that the brewer had been negotiating with our replacement for several months before terminating us.

The proposed legislation, S. 2335, is urgently needed to protect people like ourselves who devoted a lifetime to building up a business only to have it taken away arbitrarily without compensation or negotiation.

STATEMENT OF JOANNE MARTIN, SALINAS, CALIF.

From 1972 through January of 1976 I was a Mode O'Day franchise. During that time I tried to the best of my ability to live up to my obligations under my franchise agreement. I worked long hours and built the business up. Other members of my family assisted me on countless occasions. But no matter how much I was able to increase sales, I discovered that it was impossible to end up with compensation which in any way approximated the time and effort required to operate this franchise. I finally concluded that the terms and conditions of the Mode O'Day franchise, combined with the operating practices

of the Mode O'Day management, were inherently unfair. I closed my store in January 1976. I continue to feel that Mode O'Day forced me out of business without resorting to outright termination.

S. 2335, which is presently before the U.S. Senate, provides franchisors and franchisees with "certain remedies to assure fairness and to protect against overreaching, unjust enrichment, and unjustifiable termination." Legislation of this kind is desperately needed to protect franchisees who find themselves being subjected to the kinds of practices I experienced with Mode O'Day.

I originally bought the franchise from another franchisee for $5,000 and paid Mode O'Day a $2,500 security deposit. I borrowed the money from my mother to purchase the franchise and pay the other expenses associated with opening the store. The former owner of the franchise was grossing $40,000 a year. I felt that $5,000 was an excessive fee for the franchise, but Mode O'Day told me that the former franchisee had let the store run down and that it should gross at least $72,000 a year.

The Mode O'Day supervisor who encouraged me to enter into the franchise agreement represented the store to me as a lucrative business which would support my family with 5 children. After I queried Mode O'Day about the low net the business was yielding—even with increased sales—they claimed that the business should only be considered "supplemental income." This was not the basis upon which I entered into the the franchise agreement.

As soon as the store opened under my ownership, I discovered that the Mode O'Day projections regarding gross sales would be almost impossible to meet due to the fact that Mode O'Day was not shipping sufficient merchandise of high enough quality. Mode O'Day ships clothing on consignment. If the volume declines shipments are smaller, deliveries take longer, and the quality of the merchandise shipped declines. Since the previous owner had low gross sales, my shipments were being affected by the performance of my predecessor and were preventing me from increasing my volume of sales. Mode O'Day actually had more influence over my level of sales than I as the owner had by virtue of their deliveries.

Mode O'Day even recycled clothing, sending me clothing I had previously been unable to sell and which I had sent back to Mode O'Day.

Even with this major constraint, I did manage to increase the volume of sales—despite a major increase in competition due to the opening of a large new shopping center in Salinas. Prior to the opening of the new shopping center I had actually trebled the weekly sales of the previous franchisee.

The second major problem with the franchise involved the extremely complex paperwork and inventory procedures used by Mode O'Day. A complete inventory was taken every 3 months. When the store first opened a beginning inventory was taken. I was new in the franchise business, and I did not realize how crucial the inventory-taking process is to the survival of a franchisee. Three months later, when the inventory was taken again, Mode O'Day calculated $2,500 in inventory was missing. When there is a loss in inventory, the franchisee must pay 65% of the loss. When the $2,500 discrepancy was verified by the Mode O'Day supervisor some three months later, I had to pay Mode O'Day over $1,600 within 24 hours on threat of immediate termination. The only way I could come up with this money was to borrow it from my mother. To this day I cannot conceive that $2,500 in merchandise disappeared during this first three-month period. I am certain shoplifting did not account for the discrepancy. I had no way, in retrospect, to prove that the opening inventory was incorrect, but I was very nearly forced out of business within months of going into business as a franchisee on account of this rigid requirement. Of course, if I had been unable to come up with the $1,600, I would have forfeited my $2,500 security deposit, along with the balance of my investment in the franchise.

The third, and ultimately the most onerous condition to be found in the Mode O'Day franchise, involved the enormous payments required of the franchisee. I was required to pay 75% of all sales to Mode O'Day on a weekly basis. If a payment was even one day late I could be terminated.

The 25% left over for the franchisee had to cover: Rent (paid to Mode O'Day who sublet to me), insurance, utilities, advertising, employee salaries, merchant fees and licenses, losses from shoplifting, bad checks, errors in inventory adjustments, taxes on fixtures, new hangers, mannequins, cleaning supplies, bookkeeping, office supplies, etc.

It was impossible to make a profit with a payment schedule of this kind. The only way I was able to make ends meet was to mark up every item in the store $1. Mode O'Day discouraged this practice but, due to the antitrust laws, could not prevent it.

The Mode O'Day representative came to the store frequently, often with no advance notice, and would walk around the store making criticisms. He often accused me of not having "standard Mode O'Day windows," not having my back rooms in proper condition (areas where customers never went), hangers not hung properly, being one day late on my weekly payments, etc.

On many occasions this harassment took place in front of customers. I was actually reduced to tears at times and would have to go into the back room to regain composure. I recall one incident where I refused to return to the retail area from the back until the representative stopped harassing me publicly. On another occasion an older woman in the shop interceded on my behalf and said to the representative, "Young man, you leave that nice lady alone!"

There were numerous threats of termination—almost all verbal. Mode O'Day kept written statistics on anything they considered to be an infringement of the franchise agreement, and used these statistics like a stick in their constant admonishments about running the store on "Mode O'Day standards."

The final development which forced me out of business involved the expiration of Mode O'Day's lease. The landlord raised the rent, and Mode O'Day refused to enter into a new lease agreement. I looked all over Salinas for space to which I could relocate, but Mode O'Day made little or no effort to assist.

In the interim, I convinced Mode O'Day to negotiate a 60-day rent agreement for the store where I was then located. Since the new shopping center had opened in Salinas, containing 31 new shops (J. C. Penney, Mervyn's, Emporium, etc.), the competition had cut heavily into my volume. I wanted to relocate to the shopping center, but Mode O'Day would have saddled me with $1,000 per month rent, with no reduction in the 75% of gross sales fee. Inflation was already cutting deeper and deeper into my 25%.

I concluded that there was no way to continue under such onerous terms. Under these conditions, I really had no franchise, yet my obligations remained the same.

I feel that the above experiences represent a totally unjustified arbitrariness on the part of a franchisor. With constant threats of termination, harassment in the presence of customers, and a fee schedule which surely constitutes unjustified enrichment, Mode O'Day franchisees cannot survive. I know of 17 Mode O'Day stores which have closed down in California within the past year. Other closures are virtually assured unless franchisees obtain immediate relief.

I strongly endorse the passage of S. 2335 as a step in the direction of providing franchisees with some recourse against the kinds of practices which are commonplace in the Mode O'Day system. I would have received better treatment as a migrant worker. I hope something can be done, soon!

STATEMENT OF STEPHEN H. ALPINE, FRANCHISEE,
BASKIN-ROBBINS ICE CREAM STORE, DIAMOND HEIGHTS, SAN FRANCISCO

In July 1975 my wife and I entered into a franchise agreement with Baskin-Robbins, Inc. The initial cost of the franchise, inventory and equipment costs and other initial cash outlays required to commence operations totalled $65,000.

Baskin-Robbins advised me that I could have an attorney review my franchise agreement. My attorney reviewed the agreement and made a number of recommendations regarding modifications. When I presented these modifications to Baskin-Robbins, they informed me that I would have to accept the franchise agreement, and the associated master lease, as written. I therefore had to make the decision to proceed with my investment on a take-it-or-leave-it basis. After considerable protest from me and my attorney, we were able to achieve a few minor modifications in the franchise and lease agreements. However, Baskin-Robbins' position regarding its standard franchise agreement makes a mockery, in my opinion, of the California State law which gives the franchisee the "right" to obtain legal counsel prior to entering into a franchise agreement.

I have had little success in trying to communicate directly with Baskin-Robbins in order to rectify the countless deficiencies in the store, and have had to rely extensively upon my attorney, at considerable personal expense, to get any action from Baskin-Robbins.

Senate Bill 2335 represents a major step forward in making franchisors such as Baskin-Robbins more accountable to their franchisees. It is patently absurd that a franchisor should fail to provide the basic management and staff training, functioning equipment, and premises suitable for operation of a "turn-key operation", then turn around and accuse the franchisee of violating his franchise agreement when he is forced to make the adjustments himself in order to operate at all. This has been my experience to date. I trust that the Congress will understand the importance of this legislation and approve it without delay.

STATEMENT OF SAMUEL BURNS, BASKIN-ROBBINS FRANCHISEE, SACRAMENTO, CALIF.

The Senate's proposed legislation in S. 2335 has been brought to my attention. I understand that this legislation provides for protection of franchisees in the area of franchise renewal.

My experience as a Baskin-Robbins franchisee dates back to 1964 when I signed a five-year franchise with Baskin-Robbins, Inc. I had previously been a Safeway Stores manager for 20 years and therefore had extensive experience in the operation of a retail store. I was able to build up the volume of my store and decided to renew my lease at the expiration of the first five-year agreement.

My second five-year franchise expired in September 1975. At that time I advised Baskin-Robbins that I would like to renew the franchise for a third five-year term.

For reasons not clear to me, my third franchise agreement has not been forthcoming, and I have been operating on a month-to-month basis for over six months. During this time my entire investment in this operation is jeopardized. I have no asset as an owner without the guarantee of a franchise.

I am aware of situations where Baskin-Robbins has required franchisees to make an extensive investment in new equipment and remodeling as a condition for renewal of their franchise. Such expenses can amount to as much as $13,000–14,000.

I feel that my performance as a franchisee has benefited Baskin-Robbins and that I am a long-term asset to this franchisor. But the present system has no reciprocity built into it.

I feel that action at the Federal level like that in S. 2335 would provide some measure of protection to franchisees who have performed well and ask nothing more than the right to continue to maintain the record already established to the mutual benefit of both the franchisee and the franchisor.

STATEMENT OF A 7-11 FRANCHISEE

(Name withheld at request of franchisee)

For the past year and a half I have been a franchisee with ownership of a 7–11 store. I find that the operation, as run by the Southland Corporation, the owner of the 7–11 franchise system, leaves me with no control over the operation of my own store.

I would like to emphasize that the situation described in the following points holds true for all 7–11 franchisees, although obviously some franchisees are better off economically than others.

1. The Southland Corporation presents the 7–11 franchise to potential franchisees as a lucrative opportunity. My store in 1975 had gross sales of approx. $210,000, yet my net profit before taxes was only $10,000.

2. The initial cost of my franchise was $4,000 and the cost of the inventory was $3,000. Given my rate of earnings since opening the store, many many years will be required to recover what I have already paid into the franchise. At the present time new 7–11 franchisees must pay $5,000 for the franchise and $4,000 for the inventory.

3. The Southland Corporation maintains complete control over all aspects of the system at the individual store level. Representatives from Southland take inventory every 4 or 5 weeks. At least 95% of the time there is a shrinkage in the inventory, and sometimes this shrinkage is as high as $3,000. Franchisees cannot conceive how such large shrinkages occur and suspect that the way the inventory is conducted generally puts the owner at a disadvantage. Southland maintains control over all paperwork and Southland has complete control over

the taking of the inventory. The franchisee cannot follow around behind the Southland representative to verify the accuracy of the inventory, especially with customers in the store, employees to supervise, etc.

4. When there is a shrinkage in the inventory, the owner must pay for 70% of all shrinkage calculated; i.e., if there is $1,000 shrinkage, franchisee is paying $700 which represents the actual cost of the merchandise.

5. The franchisee is required to maintain a minimum inventory of $3,000 in the store. If the inventory falls below $3,000, the franchisee can be terminated, and I know of cases where this has happened.

6. Southland controls all financial disbursements, including payments to the franchisee's employees. Southland pays all invoices. This procedure leaves the franchisee with no leverage when problems arise with vendors.

7. Southland keeps in almost daily touch with the performance of each store through the store's merchandising logs where all incoming shipments are recorded and all sales are recorded. This is the basis on which inventories are monitored. All the information on the merchandising logs is computerized. If an error is made by Southland, it often takes months for the error to be corrected. This problem has been aggravated by a very high rate of turnover among Southland management personnel who generally remain no more than 2 or 3 months. With my background in business management (Master's degree), I know this to be an extremely high rate of turnover for a corporation the size of Southland. Some problems arising from errors in Southland's computerized system have never been taken care of due to the disappearance of a person responsible for the error.

8. Southland also requires, on threat of termination, that all 7–11 stores be operated 24 hours a day. The hours between 2 a.m. and 6 a.m. are always a 'dead time' and many franchisees would prefer not to remain open during those hours. But they are powerless to modify this condition in their franchise agreemen which is extremely costly.

In this franchise operation the Southland Corporation is bringing more and more rigid control over the franchisee day by day.

The Senate Bill 2335 would help protect franchisees like myself who right now do not have even enough control to be considered a manager, let alone an owner.

I urge the Senators to pass Senate Bill 2335.

STATEMENT OF ALBERT D. ROSELLINI, SEATTLE, WASH.

Albert D. Rosellini being first duly sworn on oath, deposes and says: That he is a resident of Seattle, King County, Washington. That by way of background, affiant states that he is a member of the Washington State Bar Association with law offices in Seattle, Washington. Affiant has also served in several public capacities having been a special assistant to the Attorney General, a Deputy Prosecuting Attorney—King County, eighteen years as a State Senator and eight years as Governor of the State of Washington.

In the last three years affiant has invested in and become a partner in the operation of Premium Distributors, Inc., a Washington corporation that has the distribution of Olympia and Hamm's beer in the Seattle, King County area. Affiant makes this statement in support of Senate Bill 2335 known as the "Fairness in Franchising" bill.

Affiant wants to make it clear at the outset that neither he nor his company is personally concerned about a written franchise or contract because they are working with a brewery of the highest integrity and sense of responsibility and the relationship has been of the best and affiant is confident that it will always remain as such. Nevertheless affiant has learned of many instances in different types of franchises where the franchisor has arbitrarily, without reason terminated franchises which has caused a tremendous hardship on the franchisee. I believe that the principal of "good cause" should prevail in any transaction. If there is good cause to terminate the franchise there should be no question but that the franchisor can establish the same and in those instances certainly he, as the owner of a product, should have the right to terminate.

Affiant feels that one who invests his own funds assumes the risks entailed in operating a franchise operation, exerts efforts and additional funds to make it go acquires a vested interest in the product that he is selling and should have some degree of protection.

As far as the brewery industry is concerned it is affiant's belief that a brewers success certainly is largely attributed to the investments, knowledge, skills and efforts of his franchisees. The wholesaler does create a value for the franchisor within his area. What is good for the wholesaler is good for the brewer and vice versa and you will find that a good solid franchisee is going to be working awfully hard for the product he is selling because it is in his interest, all of which inures to the interest of the supplier.

It has been stated that by protecting the wholesalers against unjust termination will encourage them to relax and not work so hard. In my judgment the contrary is true. I think that the wholesaler or franchisee would be more dedicated than ever if they realized that they have a vested right and interest and that they will continue to handle the product as long as they work in that direction.

Under no circumstances do I propose that a franchisee could not be terminated. I only suggest that in all fairness to all concerned, to the investment and vested interest acquired by the wholesaler he should not be arbitrarily terminated without some good cause or good reason.

STATEMENT OF NATIONAL ASSOCIATION OF CHAIN DRUG STORES

The National Association of Chain Drug Stores (NACDS) appreciates this opportunity to submit a statement for the record relative to legislation (S. 2335) now under consideration by the Senate Committee on Commerce which is entitled the Fairness in Franchising Act.

As a trade association, NACDS represents the management of more than 200 corporations which operate more than 9500 stores throughout the United States. Our members range in size from four store operations to companies with over 600 retail drug outlets. Many of these chain corporations are franchisors and others are franchisees in that they operate leased pharmacy departments. Additionally, NACDS represents approximately 350 associate members who are the major suppliers of consumer goods and services to the chain drug industry. A significant number of our associate members are also engaged in franchising as the means to distribute their products. This is quite evident with regard to franchise agreements that drug chains have with cosmetic manufacturers. Thus, NACDS represents all parties which would be ultimately affected by this proposal if it is approved by Congress.

After analyzing this measure, which has been introduced by Senator Frank Moss (D-Utah), NACDS firmly believes that there has been no solid need presented to date for this type of "correctional" legislation. In fact, it is our contention that safeguards in existing law provide more than adequate protection for franchise relationships. As presently drafted, the key terms contained in the bill are too broad and could be construed to govern many vital business relationships within our industry. Of particular concern to NACDS is the impact of the measure on small business. Approximately 45 percent of our membership are chains which are four to ten store operations. The strict requirements, pertaining to terminations, would drastically impede the ability of smaller business concerns from entering into the franchising system. We are certain the overall result would severely hurt both competition and growth within retail pharmacy.

From the regulatory area, the Federal Trade Commission has the authority to prevent abuses in franchising and handles all complaints regarding terminations, cancellations and failure to renew agreements. The Commission has also published a Trade Regulation Rule (TRR) to make certain improvements for disclosure requirements and is nearing the promulgation of a final order. In this connection, NACDS on behalf of the chain drug industry recommends that the Committee should not approve S. 2335 on the basis that it is poorly drafted, unnecessary and anticompetitive.

STATEMENT BY RUSSELL G. HOPKINS, CHIEF EXECUTIVE OFFICER, NATIONAL BEER WHOLESALERS' ASSOCIATION OF AMERICA, INC.

The National Beer Wholesalers' Association has been involved with the struggle for franchising reform since 1966 when the Senate Antitrust and Monopoly Subcommittee launched hearings examining the franchisor-franchisee relationship.

Subsequently, we testified before the same Subcommittee in 1967 when it was considering Sen. Philip Hart's "Fairness in Franchising" bill.

During 1974, NBWA participated in Senate Antitrust and Monopoly Subcommittee hearings on S. 978 and House Commerce and Finance Subcommittee hearings on H.R. 122 which dealt with the territorial franchising concept.

On March 9, 1976, we appeared before the House Consumer Protection and Finance Subcommittee hearings on the "Franchising Practices Reform Act", H.R. 8349.

Thus, we feel that the case for franchising reform as applicable to the brewing industry has been rather well documented. Therefore, we do not intend to cover the same ground in detail in this statement, which to a large extent, would only serve to provide the Subcommittee with information it already has at its disposal.

Instead, we would like to confine ourselves to a general review of the franchising reform issue commenting on several points raised in connection with the recent hearings in the House and submitting some observations regarding the provisions of the "Fairness in Franchising" bill itself.

We trust this will furnish sufficient background in which to interpret the testimony of the individual beer wholesalers who we understand will reveal their experiences and state their views at these hearings.

In the midst of all the claims and counterclaims with regard to franchising abuses inherent in the franchisor-franchisee relationship, it should be kept in mind that the basic goal of the "Fairness in Franchising" bill and the rationale underlying the legislation are actually quite simple and straightforward.

Advocates of franchising reform are merely seeking to establish the principle that a franchise shall not be terminated by a franchisor except for good cause and with due regard for the equity of the franchisee in the business he has jointly developed with the franchisor.

Enactment of a law establishing such a principle would discourage franchisors from terminating a franchise arbitrarily or for improper reason with the end result being the destruction or crippling of a small business and the attendant hardships such a course of events places upon owners, employees and their families.

It is not our intention that franchisors be prevented from discontinuing relationships with inefficient or unscrupulous partners. We simply want to prevent them from exterminating hard-working, efficient, diligent small businessmen who have contributed substantially to the success of the franchisor.

However, it is not solely a matter of protecting the small businessman himself against having his livelihood and investment wiped out overnight accompanied by the likely unjust enrichment at his expense to be enjoyed by his successor franchisee or the franchisor himself.

Apart from the termination itself, it is well recognized that a franchisee, operating under a one-sided agreement with his dominant partner, thereby relinquishes virtually total control of the management of his own enterprise to the franchisor. The small business owner puts his money on the line and assumes all risks but he is not permitted to run his own show in the manner he deems most appropriate.

This strangle-hold employed by too many franchisors enables them to impose unreasonable and illegal demands upon their partners with little or no fear of prosecution in the courts. Such an arrangement entails a host of anti-competitive and anti-social effects to the detriment of "the man and woman on the street", all of us.

The "Fairness in Franchising" bill seeks to relieve the strangle-hold and liberate thousands of franchisees so they may function as truly independent business firms and reap the fruits of their own efforts.

In the absence of such corrective legislation, we fear that the franchising field will be controlled (as it is to a large degree today) by a handful of national conglomerates. The choice is up to Congress. Do the American people want a highly centralized economy under the yoke of a few giants in concentrated industries or a decentralized economy with power widely dispersed among thousands of smaller companies?

We believe that enactment of the "Fairness in Franchising" bill would foster a decentralized system wherein local businesses play a major role and are able to provide consumers with a wide assortment of products and services designed to conform with community tastes and requirements.

The words contained in the statement of the Federal Trade Commission supporting the 1969 "Fairness in Franchising" bill, S. 1967, are worth pondering today: "The Commission is of the belief, that by freeing franchisees from unnecessary and unreasonable restrictive franchise provisions and eliminating the threat of arbitrary and unreasonable termination, the Act may likely promote both intrabrand and interbrand competition by freeing franchisees to select their own suppliers and products without fear of recrimination from franchisors. Small manufacturers may be able to find good, reliable dealers for their products, since franchisees will no longer have to deal exclusively, or nearly so, in the products supplied or designated by franchisors.

"The competitive benefits to be gained from the independence and the economic security which the Act provides for franchisees may well outweigh any restrictions which the Act places on franchisors."

The FTC could also have pointed out that franchisees freed from the incessant fear created by the "Sword of Damocles" hanging over their heads, would be more prone to resist franchisor demands to engage in predatory and discriminatory pricing tactics, as well as outright commercial bribery, which permits those with the most formidable financial resources and least scruples to literally remove their more vulnerable competitors from the economic scene.

Such is the fundamental argument on behalf of the setting of formal, enforceable, Federal Government Standards to govern franchising by neutralizing the termination weapon and equalizing somewhat the imbalance of power that now characterizes the franchisor-franchisee relationship.

The small businessmen of the nation are not completely alone in decrying the insidious abuses that stem from an imbalanced and inequitable franchise relationship.

Indeed, on March 4, 1976, the enlightened President of the country's third largest brewer, Mr. Frank C. DeGuire, who heads the Pabst Brewing Company, had the following to say about franchising in the brewing industry.

"We at Pabst totally agree with the historically proven chain of distribution. We believe the distributor is an independent businessman. We are, therefore, dismayed at times to see that not all brewers agree with the fact that the distributor is a free and independent businessman.

"When I hear about a substantial number of distributors of a particular brand being terminated without cause so that the brand can be transferred to another distributor in the same market, I'm not surprised that they go to their state legislators to seek protection, particularly when the brand may have been the sole means of livelihood.

"When I hear about unconscionable pressure being put on wholesalers to promote particular brands to the detriment of other brands he may distribute through threats and coercion, I'm not surprised that wholesalers push for franchise legislation.

"When I hear about dual distribution or quotas being imposed on distributors, coupled with threats that the distributorship can be cancelled in 30 days' notice if the quota isn't met, I'm not surprised that distributors seek relief.

"The policy of my company is not to oppose franchise legislation which is designed to protect the distributor's legitimate interest in his investment".

We shall turn our attention to certain aspects of the testimony presented by the Antitrust Division and the Federal Trade Commission on the subject of franchising reform at the recent House hearings and then proceed to set forth some observations and recommendations with respect to the provisions of S. 2335.

The U. S. Justice Department went on record during the House hearings on the "Franchising Practices Reform Act" with a statement to the effect that the agency does not support the bill even though it is in sympathy with its primary objective—"to prevent losses to franchisees which may result from arbitrary and unreasonable cancellations of franchise arrangements."

Among the objections raised by the Department:

1. "Terms contained in the legislation such as "good cause" are vague and invite litigation making it possibly very difficult for a franchisor to renew a franchise for valid reasons".

It may be that the term "good cause" is vague. But is vagueness of this nature not common to most laws and regulations. What about such terms as "competition", "discrimination", "conspiracy", "restraint of trade", "substantial", "reasonable"?

Such terms are utilized precisely because it is impossible to fairly draw a precise line to govern every conceivable situation that may arise in applying the provisions of a law. There is no substitute for impartial, trained judgment in such instances.

If vagueness were not inherent in our legal system based upon laws enacted under a process characterized by a balancing of numerous forces in our society with the aim of protecting the "common good" (another vague term), there would be minimal need for attorneys and judges.

Laws have been in effect in a number of states prohibiting brewers from terminating distributors unjustly or without good cause. There is no evidence that we are aware of that would suggest they have resulted in stepped up litigation.

To the contrary, we presume that such laws have discouraged brewers from terminating distributors without proper justification where before they could do so for no reason whatsoever. Furthermore, in instances wherein a brewer desires to terminate a wholesaler but cannot substantiate a good cause, the likely result is that the brewer arranges for an orderly, voluntary transfer of the franchise whereby the small businessman is adequately compensated for the value of his business. What is wrong with that?

Moreover, in cases where a brewer does terminate a distributor under strong protective state statute, it is certainly commendable that the small business is afforded the opportunity of pursuing a claim for relief based upon a contention that he has not been treated fairly.

2. "There are substantial costs to the economy associated with a measure which makes it difficult to terminate contractual arrangements."

We feel that there are substantial costs to the economy associated with a franchisor's ability to terminate a franchisee arbitrarily and without good and serious reasons. Did not the arbitrary termination by the Olympia Brewing Company in 1975 of 180 Hamm's distributors entail costs to the economy in terms of its disrupting of the businesses and lives of the small businessmen and their employees who paid the consequences of that action.

Again we must stress that it is not our intention to prohibit the termination of inefficient franchisees, which the Justice Department assumes to be the case. The economy won't be hurt by protecting efficient small business firms against anti-competitive controls or unjust termination. Quite the opposite, such a measure will encourage them to be even more efficient.

3. "The bill may operate against the best interests of franchisees by reducing a franchisor's willingness to appoint franchisees even encouraging them to integrate forward".

This is one of the oldest and most fallacious arguments on the books against franchising reform. It presumes that franchisors utilize the services of small business partners because of some altruistic motivation. They are doing the franchisee a favor by allowing them to invest their own funds, take the risks, and do the work necessary to succeed aware at the same time that they can be thrown out in the street with the dishwater for failure to comply with the franchisor's most petty demand.

Let us not kid ourselves. The franchisors use franchisees because such a combination of decentralization of management and investment is the most efficient and profitable alternative from the franchisor's standpoint. The enactment of a law requiring franchisors to adhere to standards of fairness which they already claim to embrace won't change the economics of the situation one iota except perhaps that the small business franchise partner may be able to retain more of the profits he generates which have heretofore been syphoned off by "headquarters."

4. "The bill may be ineffective in preventing coercive demands by a powerful franchisor on his "Captive Partner". A powerful manufacturer may simply create a new franchise to serve the customers of the old, causing the existing franchisee a significant loss of business, inducing him to abandon his franchise."

We agree wholeheartedly with the Justice Department that S. 2335 is too weak and may not live up to the expectations of its authors by virtue of the fact that it fails to prohibit unfair indirect forms of termination such as selective, retaliatory, dual distribution or encroachment and other forms of discrimination which violate the spirit of the antitrust laws.

Therefore, we recommend S. 2335 be amended by incorporating a provision similar to that contained in the "Wisconsin Fair Dealing Law" which seeks to curb indirect as well as direct termination without good cause.

Obviously, if it makes sense to prohibit one person to murder another with a rifle, it is equally sensible to outlaw the taking of another life by using a knife or a club. From the perspective of the victim, the end result is the same. Murder is Murder. Termination is termination, no matter what terminology is employed.

Earlier in our statement, we cited the Federal Trade Commission's Senate testimony in 1970 describing the pro-competitive benefits that might be expected to flow from enactment of a "Fairness in Franchising" proposal.

During testimony before the House on March 11, 1976, Acting FTC Chairman Paul Rand Dixon reiterated the Commission's support of such legislation on grounds of both equity and competition.

At the same time, Chairman Dixon made a few observations regarding the language of the House bill, H.R. 8349, which closely resembles S. 2335, and recommended a number of improvements that he felt should be incorporated into the legislation.

We would like to comment briefly on some of his suggestions for consideration by the Consumer Subcommittee as it deliberates on S. 2335.

1. We agree with the FTC that the definition of the term, "Franchise", should be carefully reviewed so the types of commercial arrangements covered are as clearly spelled out as possible.

Certainly, it would be inappropriate for the bill to apply to buyer-seller relationships wherein neither party is significantly dependent on the other to the extent that a discontinuance of dealings among the parties would prove seriously disruptive.

At the same time, it should be made clear that relationships of a buyer-seller nature of a continuous nature wherein one of the partners is significantly or substantially dependent on the other are covered by the legislation.

Where does one draw the line? How does one define "significant"? During the Senate Antitrust and Monopoly Subcommittee hearings in 1967 on S. 2321, Mr. Aaron Wiss, a leading CPA with a national reputation in the franchising field, examined this question in some detail.

In general, he concluded that when a beer wholesaler, for example, lost 10 to 25% of his business abruptly, it would have a substantial adverse impact on his financial well being and competitive posture, possibly turning a profitable enterprise into an unprofitable one.

This leads us to conclude that franchising arrangements wherein a franchisee is "significantly" dependent on the franchisor should be covered by the act and that the term "significant" should be acknowledged to apply to situations in which loss of 10 to 25% of a franchisee's gross sales are involved with the exact line of applicability contingent upon an examination of the facts of each case.

2. We agree with the FTC that a suitable franchise measure "should make clear that the term, 'good cause' refers to requirements which are objectively 'essential and reasonable' in light of the overall distribution system represented by the franchise agreement, and does not mean those requirements subjectively "essential and reasonable" in the eyes of the franchisor."

It is central to the resolving of franchise disputes that objective third parties determine whether provisions in a franchise agreement are reasonable or unreasonable or essential or non-essential and viewed in its totality, whether a termination is for good cause.

The normal predicament of the franchised small businessman now is that the franchisor established the standards and serves as judge, jury, and prosecutor in evaluating whether the franchisee deserves to be terminated. Clearly, what is called for is the setting of minimum standards by the people, the Government, with any disputes being resolved by the courts or arbitration if those involved cannot settle among themselves.

3. The FTC recommends that the term, "bad faith" be removed from the bill as part of the definition of good cause since "it might dilute the good cause requirement by providing an easy way for the franchisor to escape the bill's requirements." We once again concur with the FTC.

4. The FTC concludes that the formula inserted into the bill which would permit franchisors to terminate a franchise for "legitimate business reason" is unduly complex and cumbersome and that the impact of such a provision would be most uncertain.

We agree that consideration should be given to striking this rather complex formula which would simplify the language of the proposal to the point where it would more closely resemble existing state franchise laws of proven effectiveness.

Nevertheless, it might be worthwhile to consider incorporating "legitimate business reason" as part of the definition of "good cause." If such an alteration were adopted, we suggest that a term such as "compelling legitimate business reason" be used to assure that the phrase would not be narrowly construed to the detriment of franchisees.

We don't think that a successful franchisor should be permitted to terminate a franchisee merely to earn the franchise's profit since the franchisor obviously was not willing to assume the investment, risk, and even losses in leaner days. The definition of "legitimate business reason" should specifically preclude such a possibility.

As franchisors maintain, there may be circumstances under which a franchise termination might be justified without any breach of contract by the franchisee.

It would seem that such an occurrence could be covered by allowing a franchisor to terminate for "legitimate business reason" if he can conclusively demonstrate to a knowledgeable, impartial, third party that the act was necessary to assure the survival of the franchisor or would have the probable effect of substantially increasing long run competition in the particular industry by significantly enhancing consumer value.

5. The FTC recommends binding arbitration be provided for in the bill to facilitate disputes arising under the act. We favor arbitration with the end in mind that it may encourage a relatively prompt and inexpensive means of resolving such differences. At the same time, we are opposed to compulsory arbitration which would deprive the injured party of his right to sue. We believe the franchisee should have the right to arbitration of disputes arising under the law.

Examining the provisions of S. 2335, we recommend that the subcommittee study the franchise termination remedy proposed by the Small Business Administration in its "Brief to the Commission" dated Dec. 5, 1972, in the matter of Adolph Coors Company, Docket No. 8845, before the Federal Trade Commission and also the recommendations of Attorney Elliot S. Kaplan presented to the Senate Antitrust and Monopoly Subcommittee before hearings on S. 2321 in 1967.

We can only reiterate our request before the House Consumer Protection and Finance Subcommittee of several weeks ago concerning the provisions of H.R. 8349 with the stipulation that our remarks then apply in like manner to S. 2335.

It is imperative that S. 2335 pertain to circumstances wherein a franchisor is acquired by another company or a sub-franchisor, such as an importer, is terminated and the successor franchisor chooses not to deal with the franchisees appointed by its predecessor.

Two classic examples along these lines occurred in the brewing industry in 1975 when the Olympia Brewing Company purchased Hamm's and terminated almost 200 veteran Hamm's distributors and the Miller Brewing Company obtained the importation rights for Lowenbrau which led the firm to discontinue dealing with many veteran distributors of the brand who were appointed by sub-franchisor importers who preceeded Miller.

Finally, during our House testimony, we recommended that the legislation require franchisors to compensate terminated franchisees for the value of the business he has created regardless of whether the termination was found to be for "good cause" and that a provision should be included to give franchisees the right to sell their franchises to qualified third parties without consent of the franchisor being withheld unreasonably.

We are pleased that the Consumer Subcommittee has moved forward so expeditiously in pursuing the cause of "Fairness in Franchising" and we hope the information we have provided and that of the other brewing industry witnesses will be of assistance in developing and approving a measure that will be in the best interests of small business and American consumers.

STATEMENT OF THE ASSOCIATION OF HOME APPLIANCE MANUFACTURERS

This statement on S. 2335, a bill which would regulate the termination of franchises, is filed on behalf of the Association of Home Appliance Manufacturers

(AHAM). The association's members manufacture virtually all of such major home appliances as room air conditioners, refrigerators and freezers, dehumidifiers, ranges, and home laundry equipment. The members also manufacture such portable appliances as toasters, coffee makers, irons, electric skillets, broilers, and blenders. A list of AHAM's members is attached.

AHAM vigorously opposes S. 2335 as a costly unwarranted and unnecessary governmental intrusion into the business structure. The bill is vague and indefinite in its definitions and, in our view, incapable of enforcement. One of the bill's stated purposes is "to provide certain remedies to franchisors and franchisees to assure fair dealing, to protect franchisees from inequitable practices, and to guarantee to consumers the greater benefits that would flow from more equitable franchise agreements and relationships." The bill, as written, provides no remedies for franchisors. It is so one-sided in its attempt to protect the rights of a "franchisee" that its passage would have a severe and detrimental impact on a manufacturer's or other supplier's ability to effect orderly retail distribution of its goods or services. By attempting to make it extremely difficult or costly for a supplier to change retail outlets, S. 2335 would harm consumers, and reduce the utilization of independent "franchisees" as retailers. The reasons are set forth below.

I. Distribution patterns—the facilities used by suppliers to distribute their goods or services—vary from industry to industry. Within most industries, these patterns also vary from company to company. This is especially true of the appliance industry.

The patterns may be grouped into two broad types, for purposes of the present discussion. One is the true franchisor arrangement, in which the retailer, the outlet that sells to the ultimate consumer, handles the goods of only one supplier. (In addition to covering retail outlets, which sell to the ultimate consumer, the bill could cover the relationship between a manufacturer-supplier and its independent distributors or service centers. The bill could also encompass the relationship between distributors and retailers. For simplicity, however, this statement speaks primarily in terms of supplier and retailer.) Frequently such a retailer must provide his own premises or lease them from the supplier. He must make a sizeable investment in the premises, equipment, and stock. The business is known by the supplier's name, and the goodwill comes primarily from the buying public's reliance on the national or widespread regional recognition of the supplier's trademark. The supplier usually exercises a high degree of control over the franchisee's conduct of the business. This relation between the franchisor and franchisee is almost invariably set forth in detail in a written contract. Termination of the relationship can mean that the franchisee loses his monetary investment, has built no goodwill of his own, and must start in a new business.

The second type of distribution is that in which an entirely independent entrepreneur buys the products of a supplier and sells them to the public. This entrepreneur usually handles several competing brands of a given product. He typically makes no investment with the supplier other than the purchase price of the product, though he may agree to pay for some advertising. The retailer operates under its own name, and is not generally associated with the name and trademarks of the suppliers whose goods he sells. Any contract between the supplier and the outlet usually covers only terms of sale and may provide for cooperative advertising of the supplier's product. The supplier exercises no control over the outlet. If the arrangement is to be terminated, the retailer with rare exceptions is the one who decides to discontinue the sale of a supplier's product. Rarely is the product withdrawn by the supplier. The discontinuance of the sale of one supplier's product has little or no effect on the retailer's investment or on his continuing success as a business entity.

S. 2335 makes no distinction between these two types of distribution, although it may appear to do so in some sections. This failure is one of several important reasons for AHAM's objections to the bill.

In effect, when it defines the term franchise, in §3(3), S. 2335 would convert almost any conceivable commercial buy-sell transaction into a franchise relationship. Under a reasonable interpretation of the section any time a manufacturer, processor or distributor allows another party to offer, sell or distribute goods or commodities, a franchise would be created, and the relationship would then be subject to the terms of the act.

There is an apparent limitation in §3(3)(C) if the franchisee's business is not "substantially" associated with the franchisor's name or trademark, if a franchisor is not to lend "more than nominal assistance" to a franchisee, or if the franchisee's "annual gross volume" is $25,000 or more. (It is not clear whether this "annual gross volume" is in selling only the franchisor's goods or is to cover the franchisee's total sales.) Another apparent limitation is found in §3(3), last paragraph, for a franchisee who has been in business for two years, if the franchisee's business is not to consist "predominantly or primarily" in the sale or distribution of goods or services covered by the franchise.

The terms "nominal assistance," "substantially" associated with, "predominantly or primarily" are clearly vague and indefinite. They would invite, indeed demand, litigation, which would benefit neither the franchisee, the public, nor the supplier.

II. Another important reason for AHAM's objection to the bill is that once a franchise relationship is created, the bill would make it exceedingly difficult, if not impossible, for a franchisor to terminate the relationship. The bill §6(a), permits cancellation or termination only for "good cause" or for "a marketing area withdrawal" by the franchisor. Good cause is defined, §3(4), as a franchisee's "failure . . . to comply substantially, without reasonable excuse or justification, with an essential and reasonable requirement imposed by such franchisor," a franchisee's "bad faith conduct or unjustified failure to act" in carrying out the terms of a franchise. Again the terms "comply substantially," "reasonable excuse or justification," "essential and reasonable requirement," and "bad faith conduct" are vague and indefinite. Continuous litigation would be required to determine their meaning in individual situations. This would be costly, futile, and ultimately work against the best interest of ultimate consumers.

III. In addition §6(b), which deals with a failure to renew a franchise, is equally ambiguous. It, too, contains the term "good cause." It further states that a franchisor may fail to renew for "legitimate business reasons," but only when the franchise in question has an original duration of no less than five (5) years or the franchisor is withdrawing from the market. "Legitimate business reason," another vague term, is defined in §3(7) as "a commercial determination that is fair and reasonable in light of all the circumstances." There are probably few terms on which there may be greater diversity of views than there are as to what constitutes a "fair and reasonable" commercial determination; and, again, litigation would be required in each instance to determine whether a franchisor's decision to terminate was "fair and reasonable."

Of even greater significance, however, is the provision that the "legitimate business reason" would be available as a ground for failure to renew only when a franchise had been in existence for five years, or the franchisor were withdrawing from a market. In effect, a supplier would have to tie himself to five-year contracts to have available a "legitimate business reason" as a ground for failing to renew a franchise, or be forced to withdraw from a market entirely when refusing to renew a contract with a retailer whose performance is not satisfactory. A supplier's withdrawal from a market, whatever the reason, always reduces by one the number of competitive sources to which consumers may have access.

IV. Still further, under §7(a) and (c) of the act any franchisee who might feel aggrieved by a franchisor's action could file a suit in a United States District Court. In a reversal of usual practice, if such a suit were filed, under §7(d), the burden of proof would be on the defendant-franchisor to show that he acted within the terms of the act. Normally a plaintiff must initially prove his case, before a defendant is required to present his evidence. The bill thus would appear to assume guilt of the accused regardless of the circumstances under which the accusation may be made.

V. Taken as a whole, the bill would be self-defeating. By creating a situation in which a supplier might unwittingly find himself in a franchise relationship and given the extreme measures that would have to be taken to terminate such a relationship, suppliers, especially those who sell through independent entrepreneurs, would be extremely reluctant to deal with any but well established firms.

The bill would also preclude the development of new methods of distribution or new applications of existing methods. Under §§3(7) and 6, to terminate

existing distributors except for "good cause" or a "legitimate business reason" a supplier would have to withdraw from a marketing area entirely for a period of five years. Since absence from a market for five years would not be economically feasible for a supplier, any change would become impractical, regardless of the supplier's financial resources.

In effect, S. 2335 would inevitably freeze each supplier's distribution system as it now exists. Changes could not be made as economic conditions seem to make changes necessary. The freezing of a supplier's distribution system would remove the incentive of retailers within that system to provide satisfactory service either to the supplier or to the consuming public.

VI. Appliance manufacturers have no direct knowledge of the franchise problems to which S. 2335 may be addressed. They have no direct knowledge of the type of franchisor who is thought to be responsible for those problems. They are aware, however, of legislation enacted by a few states to regulate franchise relations, and to provide a balance of economic power between franchisee and franchisor in some areas. When the states have attempted to do this through legislation, they have in most instances defined the relationships with great precision. They have also carefully defined the grounds for termination of a franchise, by cancellation or failure to renew.

Actually, AHAM's members see the franchise relationship as a matter better controlled, where control is felt to be necessary, by state law than by federal law. Where there are critical problems, state laws appear to have been enacted. State laws can be adapted to and recognize varying state and local marketing conditions, which a federal statute cannot do.

STATEMENT OF WHIRLPOOL CORPORATION

Whirlpool Corporation would like to take this opportunity to comment on S 2335 as it relates to the appliance industry generally and also to our own specific franchise situation.

Whirlpool has approximately 13,000 franchise relationships which include retail dealers, wholesale distributors, parts distributors, commercial ice maker distributors, commercial laundry distributors and Tech-Care Service representatives. All of these relationships would appear to be covered by the bill as it is now written.

In no case does Whirlpool sell the use of its trademark or service emblem to a franchisee. To our best knowledge, neither do any of our major competitors. Because of the highly competitive nature of the appliance industry, we compete with numerous other companies in our industry to convince a large number of independent businessmen to sell or service our products.

Our thirty independent wholesale distributors are all multimillion dollar operations which, besides selling our Whirlpool products, typically distribute television and stereo equipment, microwave ovens, carpeting, other floor products, and often other brands of appliances.

On the retail side, our franchised dealers typically sell several competing appliance brands in addition to selling Whirlpool appliances.

Most of our competitors do business with independent distributors and retail dealers on pretty much the same basis as we do. And their distributors and dealers are structured very similar to ours—and, in the case of retailers, are often the same.

S 2335 seeks to require a franchisor to compensate a franchisee for a termination or expiration unless such a termination or expiration was made with "good cause." We believe such a remedy is unnecessary in case of the type of franchises we have in the appliance industry, because of the relationships described above. The reasons can be briefly summarized:

1. Since most appliance retail dealers market competing lines, the termination or expiration of a particular franchise, such as the Whirlpool franchise, does not typically pose a hardship to the dealer. In the instance where a dealer does market only one brand of appliances, the loss of that one line would typically trigger the quick appearance of one or more sellers of appliances who would be happy to sell to the dealer. It is quite typical for dealer franchise relationships to change periodically in our business.

2. As mentioned above, appliance distributors are typically multimillion dollar operations which often sell other products, including competing appliance lines.

They would normally not need or require the type of protection S 2335 strives to give.

3. In the case of franchised appliance service representatives, the standards imposed by franchisees are typically designed to assure that the products are satisfactorily serviced both in and out of warranty. The franchise agreements between manufacturers and such representatives typically require prompt service, regular training of service personnel, a high degree of customer satisfaction, and operation within carefully prescribed guidelines relating to the repair of appliances. If and when a service franchise is terminated or allowed to expire, it is typically in the best interest of the owners and users of our products. In most instances where a service franchise is discontinued, the company may nevertheless continue to service appliances, thus having a source of income, assuming it had the ability to perform in the market. We feel the establishment of and adherence to such standards of service performance in our service franchise programs is consistent with the spirit of consumer protection in which we all believe, and should be encouraged rather than discouraged.

Therefore, to mandate the compensation of a franchisee, as franchisee is so loosely defined in this bill, under the circumstances contemplated by this bill, would amount in our opinion to an unreasonable restriction being placed on many franchise agreements of the type outlined above, a result we believe was probably not contemplated by those introducing the bill.

Whirlpool recommends that Sec. 3, Paragraph (3) (B) of S. 2335 be amended so as to read:

(B) Pursuant to which one party (the franchisor) in return for the payment of a fee, grants, and a second party (the franchisee) receives, the right to, or permission, to sell, to offer to sell, to provide, or to distribute in commerce certain goods or services in return for the performance of certain obligations and on certain terms and conditions; (underlining added)

Such an amendment, we feel, would focus the proposed legislation more precisely on the type of true franchise agreements that we believe its authors had in mind when they drafted the bill, without sweeping all types of buyer-seller relationships into the same general pile. If the authors did have the type of franchise agreements we have in our industry in mind when they drafted the bill, we believe they should reconsider their position in light of the points we have made in this letter and amend the bill along the lines recommended above.

If we can provide any more input to your consideration of this matter, please contact me.

Statement of Barry A. Friedman,* Chamber of Commerce of the United States

The Chamber of Commerce of the United States has closely examined the various proposals now before Congress which deal with the franchising industry. These include S. 2335, the "Fairness in Franchising Act."

Our study leads us to the conclusion that S. 2335 will not benefit franchising, but will, in fact, have a detrimental effect. Therefore, we oppose this legislation as drafted.

WHAT THE LEGISLATION PRESCRIBES

This bill would radically alter the manner in which franchisors and franchisees deal with each other. No longer would contract law, state statutes, and the antitrust laws be the prevailing influences. Instead, a new federal standard would be imposed on all franchising relationships where the franchisee has an annual gross volume of $25,000 or more.

The legislation would severely curtail, perhaps even destroy, a franchisor's ability to end his dealings with a franchisee. A franchisor could cancel a franchise only if the franchisee fails to substantially comply (without providing reasonable excuse or justification) with essential and reasonable franchise requirements or exhibits bad faith in his conduct of franchise matters of when the franchisor leave a marketing area for five years.

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*Member, New York Bar; Antitrust and Trade Regulation Staff, Chamber of Commerce of the United States.

For his own part, to terminate an existing franchise, the franchisor will be required to show either the reasons for cancellation or demonstrate that his termination is a fair and reasonable one in light of all the circumstances.

The franchisor, in most terminations and cancellations, would be required to compensate the franchisee in an amount equal to the value of the going business and include a sum for goodwill. The federal courts would be empowered to handle any litigation arising out of this legislation.

THE FRANCHISING BUSINESS

Franchising is a rapidly expanding method for the distribution of goods and services. It is essentially a means of meshing local management and financial support with a national program of advertising and marketing. It gives a local businessman access to a nationally promoted product, and often, the assistance of the franchisor's management. The franchisor obtains a system for distributing his product and the use of local management and talent. This type of business can be advantageous to both the franchisor and franchisee.

The United States Department of Commerce has just published a report[1] which details the present status of the rapidly growing franchising industry. The report estimates that in 1975 franchising represented 28%, or $161 billion, of the total U.S. retail sales volume. Further, 3.5 million people are employed by franchise holders. Franchising's growth rate is expected to be about 18% over the coming two-year period.

The importance of this new industry to our economy suggests that Congress should proceed with great care and caution in passing legislation affecting the industry. In our view, S. 2335 does not reflect such care and caution.

We are disturbed by the following aspects of this legislation:

Findings which do not support its stated purpose.

Imprecision and vagueness in specific provisions of the bill.

Potential for restricting continued growth of the industry.

THE FINDINGS DO NOT PROVIDE SUPPORT FOR THE LEGISLATION

The legislative findings do not form an adequate basis upon which to proceed with this legislation. The authors of the bill deem existing law to be inadequate to deal with franchising problems, but do not justify this assumption. The Declaration of Policy section states: "Because the franchise relationship in its present form is a relatively new one, however, the law applicable thereto has not evolved sufficiently to protect adequately the parties thereto and to insure against overreaching, unjust enrichment, and unjustifiable termination."[2] We must disagree with these claims.

Far from being a "relatively new" relationship, franchising agreements are, in essence, contracts between the franchisors and franchisees. As such, they receive the panoply of protections that the common law offers to parties injured as a result of unfair contracts.

One must keep in mind the basic fact that these are contracts that have been freely entered into. In most instances they are fair and reasonable. This bill would do away with these contracts, not because of any legal infirmities, but rather because the parties merely desire to be free of restrictions originally agreed to. Judge Aldisert of the Third Circuit has recently commented on this situation:

We do not imagine that many persons are, in any meaningful sense, forced to enter into franchise agreements. It may be that some do so because they have been deceived as to the terms, or the potential profitability, of the franchise; it may be that others do so because they lack sophistication and do not understand or appreciate the details of the bargain. More realistically, we would expect to find that an arrangement apparently reasonable at its inception begins to seem burdensome to the franchisee as the business is successfully established. Only from the successful business can the franchisor effectively seek a continuing return on investment; yet as the venture prospers, the franchisee, in time, may come to regard the arrangement as onerous, restricting his profitability. Viewed this way, it is apparent that the issues are economic as much as legal.[3]

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[1] U.S. Department of Commerce, *Franchising in the Economy, 1974-1976* (1976).

[2] Section 2(a)(3) of S. 2335.

[3] *Ungar v. Dunkin' Donuts of America, Inc.*, 1976-1 Trade Cas. Par. 60,763 (3d Cir. 1976).

The antitrust laws have become a favorite legal weapon for some franchise holders. In a number of major cases they have alleged price-fixing, territorial restraints, tying arrangements, restrictive covenants and attempted monopolization on the part of the franchisors. The courts have, in a number of instances, been quite receptive to the franchisees' arguments. In the fast-food area, for instance, some tying arrangements have been held to be restrictive and have now been eliminated.[4]

It is surprising to find in the bill a section calling for establishment of a National Commission to study and report on franchise law. It does seem to place the cart before the horse to have a piece of legislation which calls for definitive action, also to contain a provision for a study that would lead to legislation. Surely, if the Committee believes that a study is necessary, legislation at this time is premature.

THE PROVISIONS OF S. 2335 ARE IMPRECISELY DRAWN

Definition of a Franchise

The definition of a franchise, found in Section 3(3) of S. 2335, is far too broad and may result in the inclusion of firms not ordinarily considered to be franchises.

The definition consists of four parts: contractual agreement between franchisor and franchisee; the right of the franchisee to utilize goods or services provided by the franchisor; assistance to franchisees either in the form of trademarked goods or actual managerial involvement in franchise operations; and the minimum gross volume of $25,000.

We are aware that there have been abuses in the franchising industry and these specific abuses should be corrected.[5] But a reading of Section 3(3) reveals, or may be construed by a court to reveal) that this legislation encompasses more than franchising. In most instances where two firms deal with each other in anything more than the ordinary buyer-seller relationship, they will come within the ambit of this bill.

The bill would affect business relationships that the sponsors had no intention of affecting, for instance, the relationship between appliance companies and their authorized dealers and repair shops. The legislation should be clearly drafted so that the firms affected are those that the Committee wants to affect.

A serious ramification of this definition is that some franchisors may well be forced to integrate totally their operations, thereby eliminating individual franchise holders. This would close off an area that has been recognized to offer small business opportunities in both urban and rural America.[6]

Definition of Good Cause

The definition of good cause, found in Section 3(4) is:

A. A failure by the franchisee involved to comply substantially, without reasonable excuse or justification, with an essential and reasonable requirement imposed by such franchise; or

B. Bad-faith conduct or unjustified and unreasonable failure to act, by the franchisee involved with respect to the carrying out of the terms of such franchise.

This definition is far too narrow. What it does is, in effect, limit the instances in which a franchisor may terminate a business relationship with a franchisee who breaches the franchise agreement.

The good-cause requirement proposed by this bill is not the requirement of material breach of an agreement which is a provision of contract law, but a far broader standard. The legislation contains such imprecise words of art as failure "to comply substantially without reasonable excuse or justification with an essential and reasonable requirement" and "bad faith conduct or unjustified and unreasonable failure to act."

A franchisor's legal adviser would be hard pressed to give guidance to his client as to what is an essential and reasonable requirement and what is substantial compliance. The only thing we can be assured of is more litigation until these terms are given meaning by the federal courts.

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[4] See *Siegel v. Chicken Delight, Inc.* 448 F. 2d 43 (9th Cir. 1971).

[5] See Ozanne and Hunt, 92d Cong., 1st Sess., *The Economic Effects of Franchising* (Comm. Print 1971).

[6] See Senate Select Committee on Small Business, Impact of Franchising on Small Business, S. Rep. No. 91–1344, 91st Cong., 2d Sess. (1970).Cf. *Ungar, supra.*

Business abhors operating in a climate of uncertainty and the possibility of litigation as surely as nature abhors a vacuum. It will seek to minimize these dangers in any way possible, including the financial integration already mentioned. Another response may be different forms of contractual agreements. Instead of providing for terminations or cancellations, the franchisor could protect himself by imposing restrictions on dealers' compensation in instances of breach. The franchisor would thereby protect himself against the financial losses he might face through inabilty to terminate a franchise that has been conducted improperly but has not reached the degree of improper conduct mandated by this bill.

Definiton of Legitimate Business Reason

Additonal vague terminology in this legislation relates to franchisor actions to not renew a franchise on the basis of a legitimate business reason. The definition found in the bill is. "a commercial determination that is fair and reasonable in light of all the circumstances." What guidance will this language offer a court faced with a franchisor's refusal to renew based on a claimed legitimate business reason?

A further problem we have is with the bill's failure to apply the legitimate business reason test to termination as well as to failures to renew. The good cause and marketing area withdrawal provisions apply to both instances. Certainly, legitimate business reasons to terminate contracts can exist and a franchisor should have the right to terminate for this reason.

JUDICIAL REMEDIES AND RELIEF

Despite the term "fairness" in its title, S. 2335 puts the franchisor at a significant disadvantage with respect to litgation. The burden of proof, of significant strategic value to litigants, is placed on the franchisor. This means that the franchisor will always have to prove, by preponderance of the evidence, that he has not violated the franchise provisions. This alters the general rules of presenting evidence to a court whereby the burden of proof is on the party bringing the litigation. Professor Fleming James, Jr. of the Yale Law School has written:

"Another rule for allocating the burden of proof would put it on the party having the readier access to knowledge about the fact in question. This, it will be noted, is not merely a formal rule. It refers rather to one of the considerations which should and do in fact influence the allocation of the burden of proof. But it is not the only consideration and it is by no means always controlling. It is an everyday occurrence in litigation that a party has the burden to prove what his opponent's conduct was. Examples are negligence, contributory negligence and breach of contract in many common situations. In these instances the consideration arising from greater access to evidence is overcome by a feeling that a charge of wrongdoing should in fairness be proven by the party making it." [7]

Should the franchisor lose the case, he is subject not only to compensatory damages but to court costs, attorneys' fees and expert witness fees. If the losing franchisor is required to pay these expenses, it is reasonable to impose the same obligation on a losing franchisee. This would serve to assure that the legislation not become the source of frivolous actions brought by disgruntled franchisees.

The bill goes on to grant the court authority to award compensation for the goodwill of the franchisee. Goodwill is an intangible, the value of which is terribly difficult to determine. Commissioner, then Acting Chairman, Paul Rand Dixon, in his prepared statement on the House counterpart of this legislation, H.R. 8349, wrote:

"Value has not been defined in the bill but may be intended to refer to an on-going business. As there are innumerable methods of determining the 'value' of an on-going business, we would like to point out that it might be unwise to legislatively mandate the use of any particular one of them. Perhaps a determination of what constitutes 'value' in a particular instance would be better resolved in the courts or through arbitration. However, there does not exist a franchise violation problem of particular importance which should be resolved

[7] James, Jr., Burdens of Proof, 47 Va. L. Rev. 51, 60 (1961).

by clarifying the bill's intent. Unless the parties to a franchise agreement contemplate that the franchisor is granting a perpetual source of supplies, the value of the business may have to be determined in light of the possibility that at some future date the franchise will be terminated. Where the franchise agreement itself makes explicit the termination date, or where termination is at will, the on-going value of the franchisee's business becomes increasingly speculative. The bill is unclear as to whether the possibility of a future permissible termination or failure to renew would have to be considered in determining value." [8]

Also, the provision appears to contradict the definition of the franchise. The definition implies that the franchisor is offering something to the franchisee in the form of trademark, management assistance, etc. We submit that this assistance becomes the "goodwill" of the franchise. The legislation prescribes that the franchisor compensate the franchisee for "goodwill." Thus, it does not take into recognition the franchisor's contribution. A franchisor could therefore be required to provide compensation for value that the franchisor created.

WAIVER OF FRANCHISEE RIGHTS

Another provision of the bill that is far too broad relates to waiver of rights; waiver as provided by this bill would effectively serve to prevent modification of any part of the franchise by contractual agreement. We object to this waiver section and believe that the legislation should permit at least some modification to take place upon agreement of the parties.

For instance, a liquidated damages clause, which prescribes the sum a party must pay if a contract is breached, is found in many contracts, and might be appropriate in this instance. Such a clause could be applied to terminations or cancellations and would provide a damage figure without recourse to litigation. This is the type of modification that would benefit both franchisor and franchisee by saving them litigation and other related expenses.

SUMMARY

The National Chamber is concerned with the implications of S. 2335. We doubt that there is any need for additional legislation in the franchising area. Leaving that point aside, this bill is not the appropriate remedy for the abuses presumably addressed.

We foresee many, and varied, legal problems arising from enactment of this bill. Its proposals are at some points far too broad, and at others, far too narrow. The result will be constant litigation to interpret these areas of the bill—a task that can properly be avoided by precise drafting in the Congress.

We also foresee wholesale changes in the franchising industry following enactment of the bill. A vital and expanding industry would have to alter its existing means of operations. Vertical integration and contractual safeguards would become the new standard practices with the losers being small businessmen who have often gained from franchising. Robert Demery, a Dunkin' Donuts franchisee for fifteen years, told the House Consumer Protection Subcommittee, "I would like to say that if this legislation is passed in its present form, it may very well do more harm than good to all current and future franchises." [9]

The National Chamber opposes S. 2335 and urges the Committee to not report the bill.

STATEMENT OF FACT, INC.

This statement is submitted on behalf of FACT, Inc., a non-profit membership corporation whose members are franchisees of the Hertz vehicle rental and leasing system. FACT was organized in 1971 to meet the need for a forum in which franchisees of the same system could discuss mutual problems and suggest solutions. Its function is one of providing a method of examining problems, alternative to that "officially" provided by the franchisor.

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[8] Testimony of Paul Rand Dixon on H.R. 8349 before the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee, March 11, 1976.

[9] Testimony of Robert Demery on H.R. 8349 before the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee, March 11, 1976.

GENERAL SUPPORT

FACT wishes to add its voice to that of the many other persons and organizations who support the general thrust of S. 2335. We believe it to be an excellent idea to seek by legislation a direct solution to the problem of termination in the franchise relationship. We believe such a solution should be national so that the members of the same franchise system operating in different states will be assured of uniform treatment.

There have now been enough cases, in the courts and before administrative tribunals, to make it clear that the termination problem is not unique to one or a few franchise systems but exists across the whole range of franchising. The solution embodied in the legislation is not unduly inconsistent with the decisions and settlements and should not evoke charges of radical change or surprise. The vast majority of legitimate franchisors are aware of the cases, and in all probability have adjusted their practices to that the rules embodied in S. 2335 will not involve a sudden wrench to existing ways of doing business.

Over the past years the cases involving franchising have eliminated, directly or indirectly, many of the crude arbitrary practices formerly employed by franchisors in the termination area. It would be asking too much of human nature however to believe that all arbitrariness in franchising has now disappeared. We have recent examples in other areas of human endeavor that unchecked power to make decisions affecting others will inevitably be exercised in an unjust way. Franchisors are no less susceptible to this fault and, if blocked with respect to the exercise of power in one direction—termination—will simply seek to achieve similar results in less apparent and more sophisticated ways.

Accordingly, the direction to the Federal Trade Commission, contained in Section 4 of S. 2335 is most heartening. The reviews and studies there required will insure a continuing and pragmatic examination of the dynamic and developing concepts embodied in franchising. It should enable these developments to proceed without freezing franchising into a fixed mold prematurely, and will permit a continuing focus on the relationship between franchisor, franchisee and the public, to focus upon, identify and correct other problem areas as these arise. FACT, and we're sure other groups and organizations, will be prepared to provide input to such reviews and studies.

Arbitrary termination, as a problem in franchising, has two aspects. One of them is the unjust termination itself in which a franchisee's life work may be arbitrarily taken away. S. 2335 will be of great help in correcting this aspect. The second feature of the ability to terminate arbitrarily is the use of that power, or the threat of its use, to force acceptance of decisions in other areas of the franchise relationship. Here again passage of S. 2335 will be of great assistance.

THE PROBLEM OF TERMINATION ON TRANSFER OF FRANCHISE

One corollary area of the first aspect of arbitrary termination mentioned above is use of the termination power in connection with a proposed sale or other transfer of the franchised business by a franchisee. At the outset we want to make it clear that we agree fully with the exercise of appropriate controls by a franchisor so that the new transferee meets requirements as to character, financial responsibility and in other respects, to insure that the operation proposed to be transferred will continue as an effective part of the franchised system. In many cases however those requirements are accompanied by the additional one that operation proposed to be transferred will continue as an effective part of the franchised system. In many cases however those requirements are accompanied by the additional one that the existing franchise be terminated and replaced by the then current franchise being offered to new operations, including new, additional and generally higher obligations for the payment of "front money" and system fees and charges. This means, in essence, that a franchisee can never transfer the existing business in its entirety to another. Inevitably it reduces the price which would be paid and, in essence, transfers a portion of the purchase price to the franchisor. This kind of legalized "pickpocketing" exists only because of the assertion of the right to terminate in the circumstances mentioned. It is a practice which should be flatly prohibited in the absence of evidence that the transfer will impose additional burdens or costs on the franchisor.

It may well be that the existing language of Section 3(4) meets the objective mentioned above. It would be clearer however if the definition of "good cause" set out in the section were amplified by additional language somewhat as follows:

(C) A sale or other transfer of a franchised business by a franchisee shall not of itself be a good cause or bad faith if: (i) made in accordance with the applicable provisions of the franchise as to notice and other information to be supplied the franchisor, and (ii) made to a transferee meeting uniform nondiscriminatory and reasonable requirements set out in the franchise, as to character, financial responsibility and experience.

OTHER ACTIVITIES FOR SIMILAR ENDS

Franchisors are now engaged in other activities which we believe can be used for the same objectives as the ability to arbitrarily terminate.

Among these practices by which franchisees are pressured or threatened to accept sales and sales promotion programs, ostensibly on a voluntary basis. These programs, in many cases, require the franchisee to provide service at a substantial discount from the base price. The entire arrangement is usually worked out by the franchisor without prior consultation with the franchisee who is simply presented with a finished program. The franchisee may be told that joining the particular program is voluntary, but that if he does not join, the potential customer will be told not to do business with the franchisee. Other forms of pressure may also be used to obtain "voluntary" acceptance, ranging from appeals to system patriotism, the promise of other benefits or the threat of penalties, or the requirement, after the sketchiest notice, that a franchisee is included unless he affirmatively acts to opt out within a limited period of time.

Programs of this nature may be successful for the franchisor but may be pyrrhic victories for the franchisee. A succession of such "successful" programs may be so costly as to force a termination just as surely as the direct use of an arbitrary termination procedure which is the subject of S. 2335. If the franchise arrangement is truly a kind of partnership, involving the beneficially combined aspects of large and small business, provision should be made, at least for those kinds of activities for which the franchisee is expected or required to bear the financial burden, for franchisee input into the very development of the program and its implementation. This is a concept widely employed in the development and implementation of advertising and other programs to which franchisees make a direct payment. It should be equally applicable in those situations where the contribution of the franchisee is no less direct by reason of being made in terms of reduced prices, fixed discounts and other incentives. And an honest method, not subject to the one-sided pressures and blandishments of the methods presently used, should be provided for determining the acceptability of any such program.

Franchisors have also used the threat of additional franchising in a previously franchised geographic area as a method for securing compliance with other franchisor decisions. We recognize that anti-trust considerations make action in this area difficult and we do not seek a solution which would weaken the anti-trust laws. But whether a franchise is labeled exclusive or nonexclusive, some solution should be available where the franchisee is meeting the just and reasonable obligations for developing a franchised territory. A franchisor should not be permitted, by threatening to enter the area itself, (the so-called dual distribution problem) or by the threat to franchise others, to goad an existing franchisee into engaging in activities not legally otherwise required. A standard somewhat like the "legitimate business reason" standard in the bill applicable to termination might very reasonably be employed in this connection as well, provided, as hereinafter pointed out, that some method is also established for determining legitimacy easily, quickly and inexpensively from an impartial third party.

Emphasis on correcting specific current problems or techniques is not, however, the ultimate solution. These problems arise, and as they are corrected, new problems can be expected to arise, because resolution of the problem is in the hands of an interested party, the franchisor. Working out of the problems on a basis which is acceptable to both the franchisor and franchisee will occur only when ultimate decisions are in the hands of a disinterested third party. The technique of arbitration provides such a method of insuring

against arbitrary action and should be broadly available, and indeed required, as a basic part of any franchising arrangement. It should be available, not only with respect to termination as S. 2335 presently permits, but with respect to programs or program changes that imposes on the franchisee costs or obligations beyond those in effect on the date the franchising relationship was entered into or with respect to any right or obligation claimed under franchise. We urge a legal requirement for an arbitration system in every franchising arrangement. The requirement could be met by voluntary action of the franchisor which would be required to meet certain minimum standards of fairness, efficiency and expertise with a back-up of a legally imposed system if voluntary action was not forthcoming or if the action taken failed to meet the standards. The disparity of bargaining power between franchisor and franchisee fully justifies this kind of control to assure fair dealing and prevent overreaching. Such a requirement, we believe, will provide security against the possibility of arbitrary action. With that security both franchisee and franchisor can feel free to make available resources required for development to the maximum extent deemed economically desirable with consequent benefits to the consumer and the economy.

COMMENTS ON SPECIFIC PROVISIONS

We have the following comments with respect to specific provisions of S. 2335:

Section 3(3). This section following Subsection (D), has two unfortunate defects. First, it would include in the definition of a "franchise", arrangements more characteristic of the function performed by a broker or the so-called subfranchisor, or area franchisor, in selling franchises. We believe that this inclusion tends to dilute the franchise definition and creates other problems more clearly covered under other branches of the law. The significant aspect of this problem is to insure that the basic franchisor is fully responsible for the acts and statements of its agent and to make the line between franchisee and franchisor, for the purpose of the statute, a clean one not diluted by an intervening agent.

To preserve the franchise concept as the kind of relationship characterized in Sec. 3(3)(A)(B)(C) and (D), and to make the basic franchisor responsible for acts or statements of its agents, it is suggested that the language of the sentence beginning at line 17 of p. 4 of the print of S. 2335 dated September 11, 1975 be revised and expanded as follows:

"The term includes any such relationship created through a broker, agent or other person authorized generally to grant franchises in the name of the franchisor, or authorized, on a basis limited geographically or in any other way, to grant franchises in the name of the franchisor, or with respect to the business, marks, symbols, names and standards of the franchisor. Acts, statements or representations of such broker, agent or representative shall, as between franchisee and franchisor, be the act, statement or representation of the franchisor, without regard to any limitation on the authority of such broker, agent or representative, and any such franchise so created shall run directly between and be the obligation of the franchisor and franchisee."

Second, the section, beginning at line 21 on p. 4 excludes what would otherwise be a franchise from the definition. We suggest that it be eliminated. Prior experience in a business may have some relationship to the kind of disclosure laws applicable in some states with respect to entrance into franchises. It has no bearing on the problem of unjust or arbitrary termination that relates peculiarly to one who has been in business for some time successfully. Nor should the fact that the franchisee is also engaged in other operations be a determinative factor. In many cases, particularly in smaller towns, franchisees also engage in other operations. Why should the fact that he or she does or does not, be determinative on the remedy for unjust or arbitrary termination of the franchise? If the purpose is to establish a kind of "de minimus" standard isn't this already covered by the annual gross volume standard set out in Section 3(3)(D)?

Section 3(5). The definition of "legitimate business reason" is applicable under this bill only to a failure to renew certain franchises, not amounting to a marketing area withdrawal or a good cause termination. See Section 6(b)(1)(B). Accordingly the definition of "legitimate business reason" might be

revised by adding to the language presently set out in Section 3(5) the following:

"Under Section 6(b)(1)(B) such circumstances shall include only the franchisors past practices with respect to renewal, representations to the franchisee with respect to renewal, and the franchisees development of the territory or area in which the franchisee has rights or responsibility."

Section 3(6) defines "market area" as the zone within which a franchisee has special or exclusive rights with respect to the goods or services covered by the franchise. The language employed in many franchises view this not in terms of "rights" but in terms of a special obligation of the franchisee. It would be perhaps somewhat more correct if language such as "or has assumed special obligations" were inserted after the word "rights" at line 21 on page 5.

Section 3(7) defines "marketing area" for the purpose of a withdrawal by the franchisor. Almost the same term is used as in Section 3(6) though the geographical area covered by the term in 3(7) is very different. To prevent confusion it is suggested that differing terms be used. Perhaps Section 3(7) can be headed "Withdrawal area" or Section 3(6) "Franchise area."

Section 3(7)(C). This section seems to require the franchisor to (1) buy the franchisee's business, or (2) give the franchisee a new and equivalent franchise for another area. Requirement (2) does not take into account the incidental expenses attendant on such a move. Neither requirement covers a situation in which the ex-franchisee stays in business but wants compensation flowing from the franchise. Accordingly we suggest that the provision be rewritten somewhat as follows:

(C) the franchisor, at the option of the franchisee:

(i) Pays the franchisee compensation for the value of the franchisee's business as a going concern including good will and as though such cancellation, termination or failure had not occurred, for the purpose of disposing or otherwise terminating said operation in compliance with (B) hereof; or

(ii) Pays the franchisee reasonable compensation for the loss of the franchise, including expenses incurred through loss or use of items obtained in connection with operations under the franchise; or

(iii) Provides the franchisee with a new franchise of equivalent value to the cancelled, terminated or not renewed franchise for a term not less than the original and any option term of the franchise cancelled, terminated or not renewed, and provides or pay for all costs incidental to the transfer by the franchisee to the new marketing area.

Section 5(a). This section which provides for notice to a franchisee, while otherwise acceptable, treats all cancellations, terminations or failure to renew in a similar manner. Other sections of the bill do not. We suggest that those terminations, cancellations or failure to renew which do not involve "good cause" be treated differently so that the franchisee involved will receive a somewhat more extended notice, perhaps 180 days.

Section 6(b)(1)(B). If a "legitimate business reason" is to be sufficient for a failure to renew certain franchises, then the only matter which may need to be considered by the franchisor, is whether the franchisor can make money by paying the sum required to be paid pursuant to Sec. 6(b)(2) and thereafter refranchising to another or establishing a franchisor owned operation in the area. The language of the payment provision is thus of considerable importance and we suggest it be changed to parallel subparagraphs (i) and (ii) of the proposed change in Section 3(7)(C) hereinbefore discussed at pp. 14–15 with subparagraph (i) revised to permit the franchisor to continue to operate.

STATEMENT OF RICHARD D. FRANKEL, CHAIRMAN, NATIONAL FRANCHISEE ASSOCIATION COALITION, VICE PRESIDENT OF THE MCDONALD'S OPERATORS ASSOCIATION

I am Richard D. Frankel, a resident of Asheville, North Carolina, and a franchisee of McDonald's Corporation, the hamburger fast food System. I am vice president of The McDonald's Operators Association, Inc., an Illinois not-for-profit corporation which is a trade association of franchisees of McDonald's Corporation, formed in March of 1975. Serving as that association's delegate to the National Franchisee Association Coalition, (hereinafter called "NFAC"), I was given the honor of acting as its first chairman. NFAC is a

coalition of trade associations, each association consisting of either a membership of franchisees of a particular franchisor as in the case of McDonald's, Dunkin' Donuts, Baskin-Robbins, Shakey's Pizza, Kentucky Fried Chicken, A&W Root Beer, or, also, associations consisting of franchisees of some or all the franchisors in a particular industry, such as automobile dealers, retail gasoline dealers, the recreational vehicle dealers, beer wholesale distributors, the wine and spirits dealers or news dealers. So we are both retailers and wholesalers, we are customers of our franchisors who buy his goods or we buy nothing from him, we pay royalties and fees or we do not, we are tenants of franchisors or we own our own physical plant, and we cut across many industries, including the critical energy, automobile and food industries, as well as others.

We are here because the problem of imminent termination and the even greater threat of abusive use of our franchisor's self-proclaimed "right not to renew" endangers our investments and business lives, and immediate legislative action must be undertaken to protect us. We are threatened with absolute forfeiture of our entire investment because traditional legal concepts do not apply easily to franchising and abuse which is rife in franchising can only be corrected with new federal law.

Franchising is the last stand of the American small businessman. But it is the franchisee who deals with a big franchisor in a maturing industry that is in danger. The temptation to squeeze him out is there, and there is no law to stop the franchisors from eliminating franchisees and unjustly enriching themselves by seizing the franchisees' investment and business by noncompensated forfeiture. The elimination of franchisees will be the end of small businessmen in this country, and the American hope of economic opportunity will become the exclusive property of the established few.

When most of us think of franchising today, we think of those well known trade names and trademarks which we often see in the communications media, especially television. Consequently, we think in terms of success because these are the franchise companies that became successful. But there were failures, and worse. During the 1950's and 1960's, the nation was shocked with scandals over "pyramid" schemes in the franchising field, where unscrupulous promoters sold "franchises" to individuals who were permitted to "subfranchise", etc. The first franchisee close to the top of the pyramid could pay a franchise fee of $10,000.00, but he had the right to let twenty franchise at $5,000.00 each, giving him a chance to recoup his franchise fee and reap a profit. The franchisee who paid $5,000.00 was given a right to sell additional subfranchises, which would give him a chance to recoup his franchise fee and reap a profit, and so on down to the bottom of the pyramid. There was usually a trademark or trade name involved, and a product or service involved. Some of those trademarks and trade names may have had value in another concept. The thing amounted to a vast "chain letter". Finally, through vigorous enforcement by federal agencies, of the mail fraud statute, most of these pyramids were stopped, but not before tens of thousands of Americans had lost money in their reliance upon them. Just about everybody tried to expand their businesses through franchises, from fast food to people with plans for franchising medical and nursing care. A lot of them ran into legal problems, others simply failed.

So, while we are constantly reminded today of McDonald's, Burger King, Kentucky Fried Chicken, and other successful franchise systems, when we hear names like "Franksville", "Henry's", and thousands of other names of franchise systems that were very similar in product and technological operations, we ask ourselves, "Who were they?". They have been terminated through failure, a risk that all of us undertake. Only last week, at the beginning of April, trading on the American Stock Exchange of Chicken Unlimited, a fast food franchise system with fried chicken and hamburgers as the primary products, with over one hundred outlets throughout the United States, had petitioned for re-organization under Chapter XI of the Federal Bankruptcy Laws. Failures are still occurring among the ranks of franchisors and franchisees are still taking risks. In the Chicken Unlimited case, it was the franchisor whose profits appeared so good and whose expansion rate seemed so healthy that it was publicly traded, first on the Midwest Stock Exchange, and by 1971, on the American Stock Exchange. Therefore, it should be known that we take a risk every time we assume the responsibility for a franchise. Even within McDonald's there have been failures. I defer to the

testimony of Donald R. Conley, the president of The McDonald's Operators Association, Inc., whose prepared statement is being filed before this Honorable Subcommittee for a more specific description of those instances of failures of McDonald's units. The reason I am submitting a statement to this Honorable Subcommittee, obviously, is because I have not failed. I am happy and proud to say that the franchise system of which I am a part, the McDonald's System, is the most successful and famous fast food franchise system in existence. We have been attributed with replacing the hot dog with the hamburger, as the favorite quick meal of Americans, and we are famous for our quality, service, and cleanliness. This is a tribute to McDonald's the franchisor, and it is also a tribute to my fellow franchisees. Both have contributed substantially, and while there have been failures, the McDonald's franchisees have, by and large, been successful, and while other franchisors have gone under, McDonald's Corporation has become possibly the most successful franchisor in the fast food industry, if not industry, generally.

I, and my fellow McDonald's operators, as McDonald's operators, have been successful businessmen, and having good relationships with our franchisor, did not, prior to this decade, feel any common cause with other franchisees. The abusive practices and failure to renew franchises and leases in the gasoline station industry, were completely foreign to us. In spite of the fact all of us purchased gasoline at least weekly, at gas stations near our homes and businesses, we were oblivious to the plight of franchised gas station dealers. In spite of the fact I buy newspapers daily, I was not even aware that the independent news distributor was a franchisee threatened with termination. In spite of the fact I buy automobiles, I was not alarmed by the abusive practices of termination of automobile dealer franchisees. In spite of the fact that I, along with other McDonald's operators, am a part of the system that is the second largest customer of Coca Cola in the world, I was not alarmed by the plight of the franchisees who distributed carbonated beverages or beer, or wine and spirits. I simply did not identify with them. In recent years, I have been made aware of three things:

1. McDonald's has changed its policy on renewal. However benign the policy may be at any one point in time, it is subject to change at the whim of corporate management. Moreover, McDonald's present policy does not guarantee me renewal, as previous policy did. It does not even guarantee me a re-write of a new license on more expensive terms. It only guarantees me that if McDonald's desires, for no reason, to fail to renew my franchises, that at present it is their policy to allow me to sell my franchises to buyers who will be given new twenty year licenses, on McDonald's present terms and conditions. Thus, it is McDonald's present policy to recognize my right to sell my businesses as going businesses, but not to have a right of renewal.

2. McDonald's is the only franchisor, to our knowledge, which has recognized the going business concept. It could very well change its policy to be more like those of its fellow franchisors, and not even give me the opportunity, upon expiration of my licenses, to sell my franchises as going businesses.

3. McDonald's does not recognize my right to continue to be a franchisee, even if I have honored every commitment I made or even gone beyond my commitment, even though I have high sales and customer satisfaction, and even though they have profited greatly from our relationship.

Apart from having successfully performed all my obligations to McDonald's for twenty years, what has been our relationship? It has been an exclusive dealing arrangement which provides I can't go into competing businesses at the same time I was a McDonald's franchisee. McDonald's franchise agreements have always contained in-term restrictive covenants as well as post-term restrictive covenants. That meant that as a McDonald's franchisee, they would not allow me to invest in any competitive business during the twenty-year term. Subject to the expiration of the term I cannot compete with McDonald's. Obviously, the post-term restriction means that upon failure to renew by McDonald's, they can try to stop me from being in any restaurant business. Therefore, failure to renew is not simply an end to my being a McDonald's licensee and a loss of my investment, because they control the franchised premises and will evict me, it also means that the one business I have devoted twenty years of my life to is a business I cannot go into. Moreover, the in-term restrictive covenants say neither I, my wife, my parents, my children, nor any near relative, could go into a competing business. We were locked into McDonald's exclusively. This meant, in addition, that if I wished

to expand my business with an additional outlet I could only do so by seeking additional franchises from McDonald's. To the extent they did not want to give me additional franchises, I could not expand. I have been one of the very fortunate franchisees who has become a large, multiple operator. McDonald's did, in fact, grant me additional franchises so that today I own, or will be opening, up to twenty-six units. My history in that regard is the exception rather than the rule. Many McDonald's operators have been held to one unit, even though they desired more and have never been permitted to expand.

Apart from this exclusive dealing arrangement, it should also be understood that when McDonald's states that upon a failure to renew, I can sell my units as going businesses, it must be remembered that McDonald's, in fact, can control the sale of those businesses. McDonald's normally has formulas for the sale of units which relate specifically to annual volume of gross sales. Since most McDonald's units do not have territorial protection, McDonald's can make a unit less valuable by opening units nearby, thus decreasing the sales of the existing franchisee and depressing the sales price of the unit. Because McDonald's has a right of first refusal to buy back units, it is legally simple for McDonald's, when desiring to reacquire a unit at a cheap price, simply to open new units (which could be either franchised units or company-owned units) nearby, thereby decreasing my sales by as much as twenty-five to thirty percent, and depressing the resale value of my unit. Using the same tactics, McDonald's can force myself or other franchisees to buy new units from McDonald's. Most franchisees, finding that the company is locating a new franchise so close to them that the franchisee's sales and profits will be severely damaged, will be willing to buy that new unit simply to protect his sales volume.

Thus, McDonald's policy has shifted from a policy of guaranteed renewal to a policy of non-renewal, (which, as a matter of present policy, involves minimal compensation for non-renewal, but which policy can be changed on a moment's notice), and the next shift in policy may be a policy of absolute forfeiture of franchisee investment. Another factor that must be taken into consideration in determining how safe we franchisees are from such a shift in policy is the fact that when we started with McDonald's there were no company-operated units and the company was dedicated to franchising. By the late 1950's the company had advised us that because they were buying back and reselling units and had some operational responsibility and to institute experimental programs, the company wanted to operate up to (but not more than) ten percent of the total number of units as company-owned units. Later, we were told the company intended to increase the number of company-owned units to not more than twenty per cent. In 1975, almost thirty-one percent of the McDonald's units were company-owned and operated. Of the remaining units not all of those were franchised, a small number were actually owned by McDonald's and simply leased to an individual who was not technically a franchisee. The critics of McDonald's have accused the company of attempting to take over the entire system and, indeed, company executives have made statements to the effect that the company can make more money owning a McDonald's unit itself than it can by franchising it. There is, therefore, a very real danger of McDonald's taking over the entire system to operate it as a chain. Because the expiration dates of franchise agreements are staggered, the takeover will be gradual, over a period of years. Obviously, the tremendous profit motive of having a company-owned chain of restaurants is a powerful financial inducement to such a takeover. Likewise, in the event of such a takeover, McDonald's could not permit a franchisee who was not being renewed to sell to a new franchisee coming in, because there would be no new franchisee, it would be programmed to be a company-owned operation. Just as obviously, McDonald's would not be buying back the franchise which it had failed to renew when it has the legal right under present law to simply take over the franchisee's investment.

In order to understand whether or not there is any justice in McDonald's being in position to effect such a forfeiture, it is necessary to understand how the McDonald's System developed.

In 1959, I and my cousin, Arthur Korf (and Whitlock Lees, now deceased), invested in McDonald's by becoming franchisees. At that time the company was tiny, with twenty-five or less employees and only about one hundred small units in existence, all of which were operated by independent franchisees. I

am a native of Wisconsin, but we had agreed to try to get McDonald's started in the Western halves of both North and South Carolina. Another franchisee was trying to do the same in the Eastern half of the Carolinas. I relocated to Asheville, North Carolina. McDonald's name and trademarks were virtually unknown and had no commercial value. Nor were hamburgers, fries and cokes a novelty in the Carolinas. I had to find locations, find suppliers and purveyors as well as promote the name and trademark. Without a product, the name and mark were meaningless. So, like all early McDonald's franchisees, I went into my territory with unheard of trademarks, no products, no location, relying to a great extent on my own investment, resources, and convictions.

McDonald's help was limited. Since the franchise itself was limited both in capital and access to financing, McDonald's relied to a great extent on the franchisee as the source of investment capital, leverage for financing, managerial ability, promotion and advertising. Fifteen years of additional investment and hard work have brought my partner and I to where we have fifteen (15) McDonald's units and have made McDonald's name a household word in the Western half of the Carolinas.

In 1968, McDonald's gave us the opportunity to repeat our success by opening up another territory where McDonald's was unknown, Phoenix, Arizona. My partner relocated to Phoenix and for three years we were the only franchisees in that market, bearing the entire financial burden of developing and promoting McDonald's there. Today, we have nine (9) units in Phoenix and other franchisees have another eight (8) units there, as well, because our groundwork between 1968 and 1971 opened up that market.

Note that McDonald's success in establishing any good will for its name and mark was predicated greatly upon the investment of the franchisees. This is the essence of franchising—the franchisors entry into the market largely on the franchisees' money. It is ideal for the franchisor who, like McDonald's, at the outset had limited funds.

While the franchisors talk in terms of their equity, in the case of McDonald's, it is an equity built on investments of franchisees. The basic fast food concept of McDonald's was started by the McDonald Brothers, who operated a small chain of restaurants in California. Ray Kroc, the principal shareholder and chairman of the board of McDonald's corporation, made a deal with the McDonald Brothers for the exclusive right to franchise their concept throughout the United States, for which he was to pay the McDonald Brothers one-half of one percent (.005%) of the gross receipts of the franchisees. Thus, from the outset, McDonald's, the franchise company Ray Kroc formed, was in the position of instituting operations on a franchise basis without any investment or risk. Back in 1955, the earliest McDonald's franchisees either leased their own real estate directly from a landlord or bought the real estate themselves. They put up their own building based on their ability to finance them. McDonald's System, Inc. did not have either adequate personnel or financial strength to obtain financing for the acquisition and development of real estate or to obtain favorable long-term leases. In fact, the company's profits were so marginal that, in 1956, Harry Sonneborn, minority stockholder in the then closely held company, determined that the company would not grow fast enough as a franchisor on a royalty basis, alone; that the company had to control the real estate on which franchisees did business; and that the company should, therefore, go into the real estate business. The first step in this direction was to require the franchisee to lease his premises to the franchisor. and the franchisor would sublease the real estate back to the franchisee, thus giving the franchisor absolute control over the real estate and more control over the business practices of the franchisee. Thus, the consequences of termination also carried with them eviction from the real estate premises and a loss of good will. New franchisees were told the only way they could get the franchise was for the franchisor to control the real estate. Initially the monetary benefits guaranteed to the franchisor were minimal, the typical net outlay by the franchisee on the sublease being only $150.00 per month higher than the rental under the ground lease. However, McDonald's quickly hit upon imposing percentage rent of six percent (6%) of gross sales (in addition to the royalty due under the franchise agreement) so that then the franchisor realized an additional piece of the franchisee's gross sales without having made any investment in the property.

In simple economic terms, through its scheme to require a franchisee to lease his premises to the franchisor and then leasing it back to the franchisee,

with no capital outlay on the part of the franchisor, the franchisor was able to increase his income three hundred percent, without raising franchise fees, without investing a nickel, and without giving any service to the franchisee. At this point, subsequent to 1956, McDonald's began to grow quickly and reap large profits for the first time, without having invested any capital. It is important to remember that, in the McDonald's System, McDonald's does not invest in the equipment for the franchise. The franchisee buys that from approved sources. McDonald's does not make the food products or paper supplies the franchisee sells, it just tells him where to get it. In short, McDonald's had no investment in the franchisee's operation.

Thus, in 1959, when we bought our franchise for the Western Carolinas, we were informed that we could not develop our own real estate or lease from a landlord other than McDonald's. That was McDonald's policy. The purpose was both for control of the franchised operation (by which termination of the franchise meant eviction from the franchised place of business) and for profit (a guaranteed minimum not tied to gross sales which were highly speculative but with percentage rent as a much greater profit, in case the franchisee was successful).

Most other fast food franchisors have followed the McDonald's example by going into the real estate business for both control and profit. In the food franchise industry, termination means eviction from the place of business, divestiture and forfeiture of property rights. The franchisee is forced to become the tenant of the franchisor in order to get the franchise. Typically, these franchisors lease the premises from the landlord at the market rate and jack the rent up in subleasing to the franchisee. The franchisor takes no risk, not even on the lease commitment (it has the franchisee's signed sublease so there is no risk)—it just has forced itself between the franchisee and the landlord to make a middleman's profit.

But McDonald's, even by 1959, had seen potential in the real estate business beyond the expectations of its competitors.

McDonald's ingenuity during the 1950's and 1960's was devoted primarily to developing a new array of ways in which McDonald's, with little or no investment of its own, could obtain new capital as well as profits from its franchisees. The next ingenious step in McDonald's program of earning huge multiples of income on the franchisee's investment was to utilize the franchisee's dollars to acquire land and construct buildings that McDonald's would own. No company has done that with the success that McDonald's has, and the practice has been in use since I became a franchisee, in 1959, to today. The franchisee signs a franchise agreement. Attached are Exhibits A, B, C, D, and E, typical McDonald's franchise agreements from 1959 to 1976. The franchise agreements state that McDonald's has already agreed that it will acquire and develop real estate for the franchisee. As a practical matter, since 1957, no franchisee has been given the option of acquiring and developing his own real estate. The franchisee does not know exactly what his rent will be because he is not sure, at the time he signs the franchise agreement, how much the building and land will cost, but the franchisor already has the commitment by the franchisee to sign a twenty-year lease for that location. The franchisor can then take a package of such signed franchise agreements and leases to a large lender, typically, an insurance company. A sale of the land and lease-back to McDonald's with an option to buy, is arranged (conventional lease-back financing). In addition, at McDonald's, the franchisees have paid McDonald's $10,000.00 each for franchise fees, and each of them has put up a $15,000.00 security deposit on each leasehold (technically, it is not a security deposit because McDonald' gives the franchisee a $15,000.00 non-interest bearing note, which means McDonald's has an additional $15,000.00 loan from the franchisee, interest free).

Thus, McDonald's was and is able, to finance the acquisition and improvement of real estate for itself on the franchisee's money. McDonald's obtains lease-back financing from an institutional lender on the strength of the franchisee's commitment to sign a "net net lease" for far more rent than the mortgage and interest and his commitment to pay all taxes, utilities, assessments and the like. With that lease, the franchisee's $10,000.00 franchise fee and the $15,000.00 non-interest bearing loan proceeds, McDonald's has enough leverage to obtain lease-back financing of the real estate with no investment to speak of. The franchisee, thus, has financed McDonald's acquisition of the

real estate, which McDonald's will eventually evict him from without compensation, exercising the franchisor's "right not to renew".

The risk of loss on operation is totally the franchisee's (and many have lost, although McDonald's has had less failures than most). Does McDonald's or any other franchisor *share* that risk? No! Typically, the base rent gives the franchisor a minimum guarantee of profit and through percentage rent, its big profits.

McDonald's base rent formula is illustrated in Exhibit S hereto. The worst McDonald's can do on that base rent is make more than forty percent (40%) profit on the franchisee's investment. After a short period of time, McDonald's owns the real estate free and clear and the franchisee's money has paid for it.

Furthermore, the forty percent markup on the fifteen-year proration is the minimum profit McDonald's can make, because the lease says that base rent is a guarantee against eight and one-half percent (8½%) of gross sales as percentage rent. Since the average sales volume of a McDonald's unit, in 1975, was over $700,000.00, a typical franchisee would be paying $59,500.00 in rent (8½% of gross sales), or $17,500.00 over the base rent. McDonald's ingenuity in making money on the franchisee's investment became even more refined. McDonald's is renting the franchised location on a monthly, rather than a yearly, basis. Therefore, the base rent is paid each month, even though the franchisee has had a very low volume month. As the following month is a high volume month, the franchisee goes way over the base rent and pays percentage rent. There is no averaging of rent from month to month, so that the franchisee, in a bad month, is still paying a high base rent and in a good month is paying even more and on a yearly basis, is actually paying more than eight and one-half percent of his gross sales. Rent in the United States normally averages at less than five percent of gross sales. Even in extremely desirable areas, where the landlords receive percentage rent, the average percentage rent would be five percent. In practically all landlord-tenant arrangements, the landlord has purchased the property and developed it with his own money and not with the tenant's money. The fact that McDonald's operators pay more rent than the average businessman has to pay is an inflationary practice which results in higher prices to the consumer, and is basically anti-competitive in the real estate market.

This remarkable and ingenious concept in creating a captive tenant out of a franchisee by requiring him to pay an extremely high rental, and to be able to develop his own real estate without investment, using the franchisee to lever leaseback financing, has not only allowed the company to reap tremendous profits, but has resulted in the following:

1. Even though McDonald's could not have afforded to acquire or develop the real estate without the franchisee's investment, it now owns or controls that real estate, free and clear, and termination or failure to renew a franchise means that the franchisee is going to be evicted from those premises.

2. While McDonald's Corporation's executives have stated that the reason they develop the real estate is that the franchisee could not obtain the financing to do so, simple economics dispel that contention. Even if the franchisee could not afford to acquire the real estate, he could certainly enter into a less costly lease package than McDonald's fifteen year proration and forty percent markup. Real estate developers across the nation would be anxious to compete with McDonald's formula price, but the franchisee simply is not allowed to shop for competitive prices and has an extremely high rental cost which must be passed on to the consumer.

3. The franchisees spent three or four percent of their gross sales (and in many instances they went beyond the obligation of their franchise agreement and spent almost seven percent of the gross sales) advertising and promoting McDonald's trademark and trade name. It has been the advertising investment of the franchisee that is largely responsible for the strength (economic, legal and political) which is used by the franchisor to dominate the franchisee.

The franchisor's assertion of a "right not to renew" a franchise is basically premised on an assumption that the franchisee has used a trademark and trade name that "belongs to" the franchisor. This argument assumes not only that the franchisor is the owner of a registered trademark and trade name, by virtue of having paid the inexpensive registration fees, but the argument assumes McDonald's has expended great sums of money to promote, exploit

it and develop the trade name and mark. McDonald's has acquired ownership of valuable real estate without an investment, using the franchisee's investment as leverage and, in addition, the franchisee has paid totally, for the following: (1) fire and casualty insurance on the real estate, naming McDonald's as the insured; (2) the entire equipment package and the trade fixtures located on the real estate; (3) public liability insurance, protecting McDonald's; (4) Workmen's Compensation insurance, protecting McDonald's; (5) Unemployment Compensation insurance; (6) the very expensive sign package placed on the real estate; (7) maintenance of the real estate, at his sole cost and expense, and improving McDonald's real estate at no cost to McDonald's.

To round out the McDonald's story, one must pay tribute to its most recent ingenious method of increasing its equity without spending a penny, by extracting additional capital from its franchisees. I have given this separate treatment because the franchisor's right not to renew, or conversely stated, the implicit threat of non-renewal, was the vehicle for accomplishing this extraction of additional franchisee investment. The McDonald's concept that franchisees invested in from 1955 until the late 1960's, was a fast food drive-in carry out store. They were not called restaurants; they were called stores. They consisted of a small red and white tile building, with distinctive golden arches, identifiable with McDonald's trademark, and a parking area and a carry out service, with no seating. In the late 1960's, McDonald's decided the System needed a "new image". The red and white building and the golden arches had to be completely done away with, and a much larger, aged brick facade building substituted. Moreover, the carry out store concept had to be eliminated and a restaurant concept initiated. The franchisees were not only going to have to expand and re-equip, but were going to have to install seating capacities, meaning a complete remodeling. Though cost of the original building was only $50,000.000, the new buildings were to cost about $200,000.00. The conversion program was to average about $150,000.00. Today, of the almost 4,000 McDonald's units, only a few of the old red and whites remain. How did McDonald's accomplish this tremendous improvement of its real estate. It did not not do it by reinvesting and remodeling its own real estate. McDonald's "convinced" the franchisees to remodel at their own expense—to improve McDonald's real estate, at the franchisee's expense—and they did it in large part by spreading the world that any franchisee who did not make the conversion was not going to be renewed. This threat of non-renewal extracted millions of dollars in remodeling expenses from franchisees. Thus, McDonald's property equities have increased four fold or more, on an additional investment extracted from the franchisees through a threat of non-renewal, when the so-called "franchise agreement" did not obligate the franchisees to spend any money remodeling McDonald's real estate.

The opponents of this legislation will assert that they somehow need this right not to renew which they have under present law. The question posed by the pending legislation is not whether or not they should have the right to enforce standards of quality or termination or failure to renew for cause, or for failure to maintain such standards, the question is the absolute right of the franchisor to take over without compensating a going business which the franchisee has built on his own investment. The question is, should this take-over occur without justification in the context of a relationship where the franchisee has been prevented from owning any business other than the franchised operation, where the franchisee will forfeit his investment, where the franchisee will not be able to make a new investment in a similar business, or may not have the funds to make any kind of new investment, where the franchisee has been a captive investor and a captive employee. Moreover, the case arises where the franchisee has built a good will attached to the franchisor's trade name and trademark, but under existing trademark law, has acquired no equity in them.

What the Senate is considering here is closing a gap in existing federal and state law; a gap which is largely created by the tremendous leverage given to the franchisors through the legal monopoly they acquire over the franchisee's good will by virtue of existing federal trademark law. It is a nationwide problem which cries for a federal answer.

STATEMENT OF DONALD R. CONLEY, PRESIDENT OF THE MCDONALD'S OPERATORS ASSOCIATION, INC.

My name is Donald R. Conley and I live in Kildeer, Illinois. I am a former vice-president of McDonald's System, Inc., an Illinois corporation and wholly-owned subsidiary of McDonald's Corporation. I am a franchisee of three McDonald's units in Wheeling, Niles, and Northbrook, Illinois, respectively. The McDonald's Operators Association, Inc. supports, in principle S. 2335, believing that it is necessary to give federal protection, not only to franchisees, but to the franchising industry. The opponents of S. 2335 are generally opposed to any protection for franchisees. They are franchisors who would gain substantially from a "takeover" of franchised outlets by the franchisors, and the resulting forfeiture to them of the franchisees' investments.

I. MCDONALD'S UNILATERAL SHIFTS IN RENEWAL "POLICY"

I joined McDonald's in May of 1957, when there were not even 100 units franchised. McDonald's Corporation, at that time, had less than ten employees, including officers. The corporate secretary, Mrs. June Martino, and I handled almost all of the franchising from 1957 through 1964. I had been advised by the Chairman of the Board and then president, Mr. Ray Kroc, that franchisees were to be informed that, the only reason their franchise had an expiration date was because the real estate was not committed for longer than a twenty-year lease and it was impossible to commit the location unless a new lease were obtained. Moreover, I was instructed to tell the prospective franchisees that the terms of their franchises would be renewed on exactly the same terms and conditions, with exactly the same territorial protection, if any, exactly the same royalty rate, franchise fee, rent, and the like, as was contained in the original franchise. I so informed the franchisees as we franchised the units. I do not believe we would have been in violation of any disclosure acts for having made those representations because they were not false, either on my part, Mrs. Martino's part, nor on the part of Mr. Kroc. The commitment to our original franchisees to renew on the same terms and conditions *was* our policy, and *was* our intent. There was only a small number of McDonald's units; the trademark and trade name were virtually unknown, and the company had literally no money to expand with. We needed the franchisees' investments as well as their managerial services, and those franchisees who received franchises, up until July of 1964, were given commitments verbally, not contained in their written contracts. To my knowledge, there was no change in that policy until the late 1960's. Later, franchisees I have interviewed, both inside and outside the McDonald's Operators Association, have expressed diverse views as to whether or not they understood that the franchise might not be renewed on the same terms and conditions. By then, the company controlled most of the real estate on which franchisees were operating, and had embarked on a substantial program of re-acquiring those franchisees who had large territories. I know of no statement of policy on renewal different from those I made as an officer, until the seventeenth year of our operations. In 1971, at a convention in Hawaii, Mr. Fred Turner, the president of the company, made a statement indicating that certain franchises might not be renewed even though their operations might have been satisfactory, so as to preclude termination prior to expiration. Up to that time it was understood and enthusiastically accepted by the other franchisees that operators who did not meet the standards the company set or honor their contracts could be terminated. It was also understood that operators who were satisfactory in their operations or who met the contractual obligations and the company's minimum standards, but who were not "outstanding" would not be considered for additional McDonald's units; would not be allowed to expand. Mr. Turner's remarks in 1971 left confusion as to an operator who might not be "renewed" unless he was "outstanding".

The situation was not clarified until after the formation of The McDonald's Operators Association, Inc. took place, in March of 1975. The subjects of renewal, expansion, and the grading system in general, were major sources of concern to the Association, and McDonald's was aware of it. In April of 1975, McDonald's celebrated its 20th anniversary, and it was at that time that John

Coons, a vice president of the corporation, made a statement, a copy of which was reprinted in McDonald's inhouse publication, "Insight". A reproduction of Mr. Coon's remarks taken from "Insight" is attached hereto and marked Exhibit "T". This policy statement coming at the 20th anniversary, on the eve of franchise expirations, was a complete reversal of policy. Renewal, even for successful franchisees who had honored their contractual obligations, was not to be expected. "Attitude" was now to be a basis for rejection. Failure to "volunteer" for "voluntary" programs was now a major factor. Even a franchisee with tremendous sales performance and customer good will, might be rejected for other undefined reasons. At the same time, McDonald's instituted a new evaluation form, where its field personnel were called upon to make extremely subjective and, in fact, speculative, evaluations of franchisees, evaluations by standards that were hardly measurable and could easily be used to create a false case against the franchisee. The utilization of these less than measurable evaluations, along with Mr. Coon's statement of policy, demonstrated that it was no longer simply a matter of being a satisfactory franchisee to be renewed, renewal could be denied for other completely subjective evaluations; in other words, at the whim of the franchisor's management. The second point to be noted is that McDonald's reserved the right to discriminate against existing franchisees as to renewal. Some franchisees would only be given a five-year renewal, some franchisees, a seven-year renewal, some a a ten-year renewal, and some a twenty-year renewal, at the sole discretion of McDonald's management. Of course, some franchisees were not to be renewed at all. McDonald's however, assured us as a matter of policy (at least as it existed in April of 1975), that they would be able to sell their business to a new franchisee acceptable to McDonald's.

The principles embodied in S. 2335 would give me more security than McDonald's stated good intentions. McDonald's policy statement in 1975 is not the policy that existed between 1957 and 1964, when I was the vice president called upon to make policy statements. The policy has simply changed. It took McDonald's until the twentieth year of its operation, virtually on the eve of the expiration of the first licenses, to make any definite policy statement inconsistent with the statements we had made at least until the late 1960's. Moreover, the new policy was not being implemented as to franchises signed during the time the new policy was in existence, but McDonald's was retroactively applying the new policy to those original franchisees who had been told something completely different.

As is apparent from Mr. Coon's address, Exhibit T, the new policy is a policy of re-writing the franchise on more expensive terms and conditions, doing away with territorial rights, or any geographic area of protection, thus exposing the franchisee to much more risk, not only in his overall cost of operation, but also as to McDonald's opening a store right across the street from him (and that is exactly what McDonald's has done in at least one instance we know of, in the past). Moreover, McDonald's only public statements of policy (which are normally few and far between) indicated that McDonald's "track record" is to abandon existing policy at their sole discretion, and institute new policy that is totally in conflict with the previous policy, and apply that new policy retroactively. It is safe to say that when these hearings have ended and if S. 2335 or similar legislation does not become law, McDonald's could easily change its policy again to provide that none of the franchises will be renewed and no one will be allowed to sell his franchise. McDonald's total shift in policy, between that stated by me to prospective franchisees, during 1957 to 1964, and its different policy ten years later, shows that we, as franchisees, cannot rely on the good intentions stated in McDonald's policy, and need the protection of federal law. The fact of the matter is, that in 1975, McDonald's executives were stating verbally that people over fifty years of age might not be renewed, and it was when The McDonald's Operators Association threatened to take action and bring these matters to the attention of the legislature, that the verbal statements subsided. McDonald's has not specified the policy, but we have evidence that McDonald's is discriminaing against franchisees over fifty years ago. A franchisee in Pennsylvania, in his late fifties, was being told he would not be able to expand because of his age, and that there was a serious question as to renewability of his franchises. Another McDonald's franchisee who had been ill, but was substantially recovering from his illness, was informed that he would have problems as to renewal, and at this time, pressure is being put upon him by the

franchisor to get out of the System. Both of these gentlemen are satisfactory operators. A third franchisee was told he would only be renewed for ten years, when twenty year franchises are being given to others. The question of renewal is new at McDonald's. It must be borne in mind, McDonald's original franchises are just expiring now. They have not had involuntary terminations because their franchisees generally have been doing too good a job to warrant being terminated and McDonald's has not been in a position where it could go into a court of chancery and achieve an involuntary termination. Also, McDonald's has only to let a franchisee know that he is earmarked for non-renewal, and he is easily encouraged to sell back to the company. Many such sales have been achieved by McDonald's.

The McDonald Brothers, the very originators of the McDonald's system, name and trademarks, after selling out to McDonald's Corporation, wished only to continue to operate the original McDonald's unit in San Bernadino. They woke up one day to find a mirror image of their restaurant across the street from them. It put them out of business. Our fear that failure to renew territorial rights (and McDonald's has declared it will not renew them) will result in a McDonald's across the street from us, putting us out of business, is not without historic precedent. The pending legislation does not reach the problem of encroachment. But the problem of encroachment does relate to the problem of termination. What McDonald's has been doing in recent years is to force franchisees to sell out prior to the expiration of their licenses, by surrounding their franchised location with new McDonald's units. By doing this, McDonald's cuts the sales volume of the franchisee's unit, thereby depressing the resale value of the franchise. Because McDonald's has a restrictive covenant in its franchise agreement that prevents the franchisee from owning any business other than his McDonald's operation, the franchisee is locked into the McDonald's unit as his only business, and cutting the sales volume or profitability of that one business interest by siphoning off sales to additional units, is a process by which the franchisor can wreck the franchisee's only business interest. There is substantial evidence that McDonald's locating of additional units near existing units has not been on the basis of any sensible or competent market survey, has been without consultation of the franchisee whose business is to be affected, and in some instances, there is evidence it has been done with the deliberate intention of driving the franchisee out of business.

When we say that there have not been terminations at McDonald's, we mean McDonald's has not had a legal basis for suing to terminate more than a handful of franchisees. By and large, these franchisees have been good operators. Moreover, McDonald's has, over its twenty-year history, been most effective in ridding itself of unwanted franchisees (that is to say, franchisees who were satisfactory operators, but who incurred the wrath of McDonald's executives in cases that would have to be regarded as unfair and unjust treatment of franchisees), through two vehicles that made outright termination unnecessary: (1) inhibiting franchisee expansion; and (2) encroachment.

As to inhibiting franchisee expansion, the restrictive covenants were the vehicle. The franchisee, having successfully built up his business at the franchised location, could not open a new franchise unless McDonald's was willing to give him one. Because of the restrictive covenants, he could not, in the event McDonald's did not want to give him a new location, open a business of his own somewhere else, or turn to another franchisor. There have been many instances where franchisees were denied the right to expand, so unfairly and so unjustly by McDonald's, that they simply sold out (usually to McDonald's, for stock rather than cash), so they could go into a business where they had the right to expand, in accordance with the economics of the market, and not be denied expansion through whimsy or prejudice from McDonald's management. Some of the original McDonald's franchisees who had been granted territorial rights (a practice long since abandoned by McDonald's), were not permitted to expand within their territories and, in fact, McDonald's sat on the territories and flatly refused to develop tremendous markets (including the entire North and Northwest sides of the City of Chicago, McDonald's home base, and the second largest city in the country), with the explicit intention of forcing the holders of those territorial rights to sell out. For those hearty individuals who were willing to forego expansion and elected to keep the one or two units they had, and where McDonald's

failed to drive them out by inhibiting expansion, McDonald's resorted to its second very effective technique, encroachment. The company developed units so close to the existing franchisee that the sales volume fell, the business was depressed, and the franchisee was forced to sell out. It is the use of these techniques and the vast success with which the techniques were used that has placed McDonald's in the position where it can say that there have been few outright terminations.

It is terribly significant that in offering renewal to its franchisees who had territorial rights, McDonald's has insisted renewal would involve elimination of the territorial rights, so that McDonald's would be in a position to locate units close to the franchisee's existing unit and drive him out of the System.

Since 1975, when McDonald's Corporation made it abundantly clear that being a good operator, having high sales volume, or being favorably regarded by his customers, will *not* entitle a franchisee to renewal, McDonald's franchisees realize they must go far beyond their contractual obligations to keep McDonald's happy. What does McDonald's mean when they say renewal depends on "stamina", "attitude", "cooperation", and the like? The franchisor means "volunteering" for every "voluntary" program. The franchisor means spending $150,000 to $200,000 to improve the franchisor's real estate (not replace obsolete equipment, but enlarge the building). If you are one of the few remaining early franchisees who owns his own real estate, renewal is contingent upon your selling that real estate to McDonald's, at McDonald's price. Age is certainly a factor in "stamina". "Attitude" and "cooperation" means you must force your partner out of your business, you may not live more than one and a half hour's drive from your unit (a requirement imposed only on those franchisees who are not "buddies" of the franchisor's management; "buddies" can live where they wish). You will not use any suppliers not customarily given business by the franchisor. You will "volunteer" for OPNAD (the franchisor-dominated national advertising program which spent almost thirty-five million dollars in 1975 and for which prior to 1975, there was no accounting made to franchisees). You will not sue the franchisor or any of its suppliers or employees. You will not listen to your lawyer's advice. The list is endless, frivolous, and ridiculous, and no state disclosure statute or FTC regulation will ever adequately protect franchisees from this type of abuse. The only fair disclosure necessary to alert a prospective franchisee would you "You will do whatever we tell you to, regardless of whether it is important or petty, intelligent or stupid, legal or illegal, profitable or unprofitable, safe or dangerous, business or personal. How does McDonald's impose its will, beyond contractual right, upon its franchisees? Is it just the right to fail to renew trademark licenses? Perhaps, in some cases that would be sufficient leverage, not in most. McDonald's insists on owning or leasing the franchised premises, so that the franchisee is always (except for the earliest deals) the tenant. The franchise agreement and lease are cross-collateralized and co-terminous. Failure to renew includes eviction and loss of the franchisee's business.

Use of the restrictive covenant is illustrated by the case of Louis Martino, who owned a McDonald's franchise at Ottumwa, Iowa. Lou Martino requested another store so he could help his son go into business with him, and McDonald's refused. Subsequently, and only after McDonald's persisted in its refusal, Mr. Martino gave his son the financial backing to obtain a franchise from a McDonald's competitor, Burger Chef. The Burger Chef franchise was located in another state, about 400 miles away. McDonald's was aware of the son being in the Burger Chef operation and that the father had helped the son get into it. For almost four years nothing happened. During the fourth year, Martino made a gross error at a regional meeting of McDonald's operators, by rising to the floor and publicly denouncing the fact McDonald's was receiving a rebate from Coca Cola on franchisees' sale of that product. Within four months after that incident, McDonald's attempted to terminate Martino on the basis that his son's Burger Chef franchise in Kansas violated the restrictive covenant contained in McDonald's franchise agreement (which covenant not only restricts the franchisee from taking a franchise from any other franchisor anywhere in the world, but also so restricts the franchisee's wife, mother, father, sons, daughters, or any other near relatives). Suit followed in the Federal District Court, which, while settled out of court, involved the

termination of Martino. (In fairness to McDonald's and Coca Cola, I must note that the rebate program was abandoned some years ago, and Coca Cola now sends those rebates to the franchisees).

When McDonald's claims to have been the most successful fast food franchisor in the United States, there is little question in anyone's mind that this is true. It is not to be inferred, however, that McDonald's was, or is, such a "sure thing" that the franchisee who commits $200,000 opening up a McDonald's franchise and who signs an absolute lease obligation for minimum rent often exceeding a million dollars, is not taking a substantial risk. There have been failures. McDonald's had a total failure in Birmingham, Alabama, where the units became insolvent. Another courageous franchisee agreed to buy the insolvent operation and try to turn it around.

The fact is, in most instances of failure, another franchisee came along who was willing to buy the operation and take the risk.

Some of the failures have not been turned around. In 1975, all the units in Puerto Rico were closed and to my knowledge, have never reopened. The reason was that the franchisee, Puerto Rican Franchising Corporation, became insolvent. At the time the operations closed, McDonald's and the franchisee were locked in a pitched battle. McDonald's had already terminated the exclusivity that the Puerto Rican Franchisee had, and was threatening to come into the territory, with the franchisee opposing that move, and claiming misconduct on the part of McDonald's. I would not, personally, or on behalf of The McDonald's Operators Association, speculate as to who was right or who was wrong in the situation, but McDonald's terminated the franchisee's right to expand, the franchisee's exclusivity, and the franchisee went under, and every store in Puerto Rico closed and has remained closed to this day.

Nonetheless, there have been more successes and fewer failures in the McDonald's System than anywhere else in franchising, and I share McDonald's pride in that. In part, that is due to the efforts and faith of franchisees. But in large part, those successes are largely due to McDonald's policies; policies which were successful for McDonald's, but which its imitators found too daring to emulate. The cornerstone of McDonald's successful policy has been the principle that the investor-franchisee does have an equity in the franchise as a going business that survives expiration of his franchise agreement. Inseparable from that principle, was the concept that a McDonald's operator who did a good job, had a right to renewal. Today, sadly, McDonald's riding the crest of the wave of success created by those policies, shows signs of abandoning them.

It is understandable that McDonald's fellow travelers within the International Franchise Association, would oppose this legislation. But it is difficult to see McDonald's opposed in principle to renewal rights for franchisees which were already a part of its successful twenty-year history

The proposed legislation does not eliminate termination, but simply requires that the franchisor have a reason for exercising this most harsh of remedies. McDonald's standards of quality, service and cleanliness, unquestionably the highest, have been enforced through salesmanship and cooperation and, only where that failed, through suits under contract law for damages, injunctive relief and a panoply of equitable remedies, short of termination. Termination may be equitable as a remedy in some instances. But refusal to renew a franchisee who has done his job well at the end of twenty years is grossly inequitable, and the question naturally arises, "Why did you wait twenty years without attempting to terminate him?". The purpose of S. 2335 is to give franchisees a minimal equity lacking at common law. The bill will not erode standards of quality. It will simply eliminate abuses based on "standards" unfairly and discriminatorily applied.

What is the relationship between franchisor and franchisee today? The franchisors claim it is one that should not be regulated because that would be substituting an "adverse legal relationship" for a "nonadverse business relationship". It is very much the same argument the Russians use to tell the free world not to attempt to influence internal Soviet affairs. In fact, the franchisors like their franchisees so much that their main trade association, the International Franchise Association (IFA) has always systematically excluded franchisees from membership. While McDonald's is a bulwark of the IFA leaning heavily on its skilled lobbying efforts at state and federal levels,

and its participation against franchisees in litigation with their franchisors, McDonald's has a vastly different attitude when it comes to franchisee trade associations. It attempts to destroy franchisee associations through threats of non-renewal and other discriminatory tactics; thus, treading on fundamental constitutional rights of American citizens, the right to assembly and freedom of speech.

When sixty franchisees owning almost ten percent (10%) of McDonald's franchised units, formed The McDonald's Operators Association, in 1975, the franchisor's reactions were swift and consisted of the following:

1. A refusal to meet with the Association or discuss any problems.
2. Individually interviewing almost half the known members and offering them benefits for abandoning the Association, (and succeeded in inducing one franchisee to quit the Association for a promise of six new stores).
3. Circulating letters such as that of June, 1975, from executive vice president, Ed Schmidt, warning franchisees that the Association was to be discredited and a "danger" to them. (See Exhibit U attached hereto).
4. Verbally communicated to franchisees threats of discrimination and non-renewal to keep them from joining the Association.
5. Attempted to buy out Association members who would not be intimidated (and during 1975 and 1976 have bought three franchisee-members).
6. Slandered myself, various directors of the Association and members generally.
7. Created an elected "advisory board" of franchisees and trying to persuade franchisees it was an "alternative" to our Association and that they no longer needed any association.

McDonald's main weapon was fear—fear of termination; fear of being denied expansion; fear of having a McDonald's unit opened across the street or down the block; and, mostly, fear of non-renewal. Many franchisees told us they wished to join, but were simply afraid.

McDonald's received a setback when, in a secret ballot election, the franchisees elected an advisory board consisting of thirty percent Association members, and a majority of members who concurred in the Association's published statement of six initial principles (primary of which was the right to renewal). McDonald's "fear" campaign intensified. Squads of executives roam the country today to ferret out Association members. Franchisees offered to support the Association only upon the assurance that their identity be kept secret. Thus, McDonald's policy was so adversary that our Association had to accept "confidential" members, concealing their number and identity. Even today, franchisees fear not being renewed for the "crime" of discussing their business problems with one another.

II. HOW DOES MCDONALD'S DETERMINE WHO WILL BE RENEWED?

And how is McDonald's utilizing *its* unrestricted "right not to renew"? The following cases and illustrations all involve franchisees whose operations are not only successful and who have complied fully with what is specified in their "contracts", but who have met every fair and measurable objective standard:

1. Franchisees have been told that because they did not join OPNAD. McDonald's national advertising co-op (it is a cooperative among franchised units, McDonalds' as a franchisor, contributes nothing) they would not be renewed. The franchise agreements did not require them to join the co-op, it simply required them to spend a percentage of gross sales for advertising, and they had met that obligation. Therefore, the OPNAD requirement was outside the agreement and not part of the deal, and supposedly, from its inception, had been voluntary. Now, after telling the franchisees it was "voluntary", McDonald's will not renew those who failed to volunteer.
2. *Local advertising co-ops.* Franchisees have been told they would not be renewed for this reason. Franchisees are still being told they will not be renewed unless they joined the co-op. Again, there is no contractural requirement that they do so, it was supposedly voluntary.
3. For those few franchisees who objected to spending one hundred thousand dollars to two hundred thousand dollars to "remodel" their unit, or who were audacious enough to suggest that since it was McDonald's real estate that was being improved, McDonald's should share in the cost of remodeling, they are not being renewed.

4. While McDonald's apparently changed its mind about openly declaring fifty as being a mandatory age for non-renewal, and instead relied on terms like "stamina" and other terms equally difficult to define, a Denver, Colorado franchisee, Carter Farrar, has been informed that he will not be renewed as long as his father-in-law is a partner in the franchise, because the father-in-law is too old. Since it is Farrar, and not his father-in-law, who manages the franchise, there is no justification for this attempt to squeeze out the father-in-law.

5. Widows and children who have inherited the franchise from a deceased franchisee may not be renewed. In fact, the company has asserted a right to terminate widows and heirs during the term of the franchise agreement.

6. The franchisees for New Mexico did not have sufficient capital to start their investment, and took in two partners. The partners are non-working and the partnership has been going along pretty well. The operations are obviously satisfactory, since renewal has been offered, but it is being conditioned on the franchisee buying out, or otherwise getting rid of his partners.

7. George Kreuger and Carl Reed have a unit in Denver, in which they are 50/50 partners. They would like to remodel the unit, but have only a short time to go on their franchise. George Kreuger also has four units in Tucson, Arizona and is a satisfactory operator. The Denver unit is managed entirely by Reed, who has other units in that town. Reed was told that he would not be renewed unless he get rid of Kreuger and that he should not run the risk of remodeling or making other improvements since he will probably not be renewed. To make matters worse, McDonald's pointed out to Reed that the business had very little value because the franchise was expiring and not about to be renewed, and that he should not have to pay Kreuger as if the unit was going to be an on-going business. Thus, McDonald's, by exercising its right not to renew, is not only attempting to split up the partners, but to somewhat control the remuneration that will be offered to the partner they are squeezing out. The unit is a satisfactory operation as are all the units of either Reed or Kreuger, and there is no legal justification given for the assertion of the night not to renew.

8. A number of operators have been told that they will not be renewed if they live more than an hour and a half's driving time from their units. At the same time, operators who, for one reason or another, are more favored by McDonald's present management, are permitted to live hundreds of miles from their units. Indeed, McDonald's has no similar requirements of proximity to the unit that it imposes upon its managerial employees who are responsible for operating company-owned units.

9. Manny and Eleanor Opper, franchisees of two units in Syracuse, New York, have been denied additional units in that community, and probably will not be renewed simply because McDonald's constructed a unit not far from Syracuse which was arguably a badly located unit, not likely to be successful, and the Oppers refused to buy it from McDonald's. The Oppers disinclination to tie up another major investment in what in their business judgment, was a potentially bad and poorly located McDonald's unit, will be sufficient reason for McDonald's to exercise its asserted "right not to renew".

10. Suing the Company, regardless of the merits of the case, is definitely to be assured that one will not be renewed.

11. Following the advice of an attorney to incur the company's displeasure, is a definite way not to get renewed.

12. If you can own your own real estate, McDonald's will insist you sell it to them at a price they name, as a condition of renewal. If you do not want to divest yourself of the real estate, you will not be renewed.

13. Anyone who invests in a business other than McDonald's, regardless of the efficiency of his operation, will not be renewed.

14. Finally, it would appear from the Picchietti case, the Kreuger case, the Opper case, and from the company's statements at the 20th Anniversary Celebration, that any franchisee who has intentionally or unintentionally ever offended in the slightest way, any McDonald managerial employee, from the lowest to the highest levels, will not be renewed.

15. Finally, any franchisee who has exercised his constitutionally guaranteed freedom to associate with other franchisees, to solve their problems

and improve the McDonald's System, such as those who have become members of The McDonald's Operators Association, Inc., may be victims of an exercise of the company's "right not to renew". McDonald's, by letter and by visual communication, has informed operators throughout the United States that it disapproves of such associations, and the threat of termination or non-renewal has become so effective that in the words of one executive vice president, "if it wasn't for the fact of fear on the part of the operators, ninety-five percent of them would be members of The McDonald's Operators Association." This is further evidenced by the fact many operators ask for confidential or secret membership in franchisee associations, fearing that the very exercise of their right to associate with other Americans could subject them to non-renewal.

III. THE FRANCHISE AGREEMENT OR LICENSE AGREEMENT—IS IT A CONTRACT AT ALL?

The franchisors have publicly stated that there should be no federal franchise legislation because that would disrupt existing contractual relationships. The argument is absured. It could hardly be suggested that the status of corporations, partnerships, or joint ventures should have been left solely to common law principles of contract and fraud. The same argument could, if not so obviously outlandish, be made to prevent legislation covering the solicitation of investment for business ventures, so that the security laws could be done away with. Certainly, a franchise is somewhat a solicited investment; somewhat a joint venture. What the franchisors are claiming is that they should be free to abuse franchisees, because they have come up with a new lawful concept for misappropriating to themselves their franchisees' investments, by soliciting those investments through an undefined term loosely called "franchising". Further, they do not want federal legislation even though the vehicle for their franchise systems is a federally created body of exclusive rights under trademark laws.

Furthermore, the "disruption of existing contract rights" argument assumes a stable contractual relationship which defines all the rights and obligations of the parties to it. Franchise agreements, however, do not fit into that definition. The relationship of the franchisee and franchisor is in a constant state of disruption, but only at the whim of the franchisor. Further, the obligations of the parties are seldom spelled out, to the franchisees' great disadvantage. One of the major reasons for an imbalance of power between franchisors and their franchisees today is that most judges will take any piece of paper that is headed up with the word "Agreement" and assume that it *is* a contract, and impose on it that sanctity which state laws have customarily attached to preserving contracts. However, an examination of the franchise agreements attached hereto as Exhibits A, B, C, D, and E, (McDonald's 1959 to 1976 forms), P, (Dunkin' Donuts), Q, (Baskin-Robbins) and R, (Chicken Unlimited), the reader wil see that these are not "contracts" in any traditional sense. The franchisor has undertaken virtually no obligations whatsoever. Apart from the franchisees' obligation to pay certain monies, the franchisees' obligations are not spelled out at all. The franchisee has undertaken a broad and undefined obligation of "compliance" and "conformity" with the "System". Moreover, an examination of those contracts demonstrates a number of acknowledgments, by both the franchisor and the franchisee, that they were part of an entire system of other Franchisees who are not parties to the contract. Many of the broad undertakings of the franchisee were undertaken in the name of protecting all the other franchisees in the system. It is as if all the other franchisees in the system were third party beneficiaries to the so-called "contract". Referring to the McDonald's agreements, Exhibits A, B, C, and D hereto, Paragraph 3, entitled, "Services to be Rendered by Licensor", consists of less than 10 full lines of language, that basically says that McDonald's will give this franchisee whatever it is giving to the other franchisees in the System, without any commitment on the part of McDonald's as to any minimum standard. While the franchisors claim they need the right of termination and non-renewal to protect their trademarks, nowhere in the McDonald's contracts does the franchisor set forth any standards for the protection of that trademark. When it comes right down to it, the only consideration the franchisee gets in this so-called "agreement" is a license of a trademark or trade name for which the franchisee has paid a franchise fee, in the

case of McDonald's, of $10,000. What consideration does the franchisee receive for service fees he pays? There is no minimum spelled out in the contract, and whether or not the franchisee is getting any services can only be determined by reference to what the franchisor is giving to all the other franchisees who are not party to that particular franchise agreement.

By contrast, the obligations of the franchisee to the franchisor take up over 350 lines of the agreements. But, nowhere in the 350 lines are all the obligations of the licensee under this agreement spelled out. The key to this so-called "agreement" being contained in Paragraph 7 (of Exhibits C and D):

"7. Compliance with Entire System. Licensee understands and acknowledges that each and every detail of said System is most important and advantageous, not only to Licensor hereunder and McDonald's Corporation, but also to its licensees, including Licensee hereunder as one thereof, that benefits to both parties will be derived from the uniformity of menu, food product specifications, quality, appearance, facilities and service among all Licensees, and that full compliance and conformance therewith and all other business policies, practices, and procedures by all Licensees is essential to best preserve, maintain and enhance the reputation, trade demand and good will built up by the System, the establishments adopting and using the same, the products sold and dispensed therefrom, and the aforementioned names and marks used in conjunction therewith."

Thus, by simply changing uages in its "other business policies" the franchisor is able, unilaterally and at will, to alter the contract on almost a daily basis, with the franchisee being committed to honor those unilateral changes. It is difficult to see how the franchisors can argue that these franchise agreements are simply contracts between two parties and not subject to alteration by legislation when, in fact, the franchisor, by changing any business policies can and does alter the contract on a daily basis, and the franchisee, by virtue of Paragraph 7 must "comply" to the changed deal. For example, McDonald's contract supposedly was for a small red and white tile building, for a carry out store, costing approximately $50,000 to build, and the equipment package was a small equipment package. The franchisor, without renegotiating or amending the contracts, was able to alter that contract, unilaterally, by changing its system to a large restaurant building, with seating capacity, and a much larger equipment package and a totally different building that called for a much bigger piece of real estate and required a tremendous reinvestment by each franchisee in order to accomplish the conversion. So how much of a "contract" does the franchisee have?

The so-called contract is, in effect, a blank check given by the franchisee to McDonald's by which the franchisee agrees to do what he is told, regardless of the scope, nature, or legality of those instructions. Attached hereto as Exhibits P, Q, and R, Dunkin' Donuts, Baskin-Robbins, and Chicken Unlimited, contracts. The common theme running through all these agreements in the fast food industry, is that the franchisee undertakes to do whatever the franchisor tells him to do, which can be the opposite one day to what it was the preceding day. When the franchisors criticize the prospect of legislation in this area, claiming that legislation will upset existing contractual "rights", they are simply not being intellectually honest. There is nothing in any one of these franchise agreements that suggests a complete understanding between the parties that has been negotiated and reduced to language, where both parties have undertaken certain definite obligations. In short, the franchise agreements are not traditional contracts, at all. They are one-sided commitments by the franchisee, to do whatever the franchisor tells him to do.

The penalty for failing to do so, regardless of the correctness or the lawfulness of the instruction, is termination or non-renewal. One other point should be noted, and that is that these so-called franchise agreements are not, in fact, negotiated at all; they are form contracts, utilized by the franchisor, and signed by the franchisee, without removing a comma, or changing a word, and often without legal advice.

It should also be noted, that when we talk about termination or non-renewal, we are not talking about the franchisor divesting himself of the entire franchise system. When the franchisee signs the "agreement", it is noted in that agreement that the franchisee is becoming a part of a system, joining the ranks, as it were, of the other franchisees already in the system. The franchisor bases nearly all his restrictions upon protecting the interests of all the other franchisees in the system.

Yet, when it comes to termination or non-renewal, the franchisors assert that they have the right to divest the individual franchisee of his investment, regardless of what they are doing with other franchisees elsewhere in the system, and they suddenly talk about the franchise agreement as simply being a contract between two parties, one-on-one; the individual franchisee and the franchisor.

Besides, in McDonald's, and most fast food franchises, there is also a landlord-tenant relationship. Often the franchisor is also a supplier of foods and services which the franchisee buys. Sometimes the franchisor is a lender and the franchisee the creditor. While federal and state courts have held that there is no fiduciary relationship between the franchisor and the franchisee, obviously, the franchisee relies on the franchisor's assumed expertise.

Early in the history of our thirteen colonies, it was possible under traditional contract law for a person to sell himself or herself into slavery. It was called indentured service. The party would sign the indenture and, if properly witnessed and notarized and if the "master" paid the "slave" the money he had agreed to in the "indenture" then by the common law of contract that "contract" was enforced and the indentured servant was enslaved for the period provided. Today such indentures are void in our country, because our forefathers did not leave such relationships to common law principles of contract and fraud. But the franchisors have managed to resurrect indentured service in this country by calling the victims of abuse "franchisees". Contracts which call for the taking of property from franchisees without due process of law are contrary to the public policy of this country and traditionally, legislation is enacted to prevent abuses through such contracts and that is what we seek in these proceedings.

The franchise relationship is not simply a matter of a contract. The reason that it is a problem for state and federal courts at the present time is that the franchisor has accumulated to itself the rights of several different kinds of relationships under traditional common law, while at the same time commiting himself to few, if any, obligations that would normally be imposed on such an entity. The franchise relationship, at McDonald's, at least, is, therefore, also an investment relationship. The franchisee not only pays his franchise fee and loans $15,000.00 to the company (interest free), but he also pays for all the equipment and signs that go into the operation. Nonetheless, at the end of the franchise all he gets back is the loan, without interest. There is a landlord-tenant relationship and the franchisee has no choice about that. He is not permitted to acquire and develop his own real estate. On termination, he is evicted. Now, most leases could not prevent the tenant from leasing business premises elsewhere and going into other businesses. Because the McDonald's lease is cross collateralized with the franchise agreement, and the McDonald's franchise agreement prevents the franchisee (or his family) from going into other businesses, the franchisee is a captive tenant. Likewise, for the same exclusive dealing reasons, the franchise agreement is a personal service contract. A franchisee has less chance than a professional baseball player or movie star of contracting for employment elsewhere. To the extent the contract has an open end, saying that the franchisee will do whatever the franchisor tells him, there are aspects of the relationship of master and servant. Yet, the franchisee is not covered by the definition of an employee and state and federal labor laws are of no avail to him. There is certainly the license of a trade name or trademark involved, for which the franchisee pays royalties, but the franchisee is so tightly controlled in his use of the trade name and trademark that existing federal trademark law is a sword for the franchisor and not a shield for the franchisee, and abuses, particularly in antitrust violations, have occurred. Certainly the franchise relationship appears to be a joint venture, although the franchise agreement disclaims that, because, in addition to the joint investment of the parties it is the franchisee who pays to advertise and promote the trade name and trademark and the good will attached thereto. Finally, there is an option arrangement by which the franchisor has the right of first refusal to buy the franchisee's business and, in essence, because of the franchisor's ability to decrease the value of that business, the franchisor can depress the sale price so that a buyout would be cheap, even prior to expiration. Thus, the policy raised by the pending legislation is that the franchise relationship is so sophisticated that it is not presently regulated by any traditional state or federal law, and has basically become a vehicle for getting around traditional law,

to the disadvantage of the franchisee. Moreover, it provides a basis for basically anti-competitive trends in our economy by which the mature and entrenched franchisors will dominate markets to the extent it will be nearly impossible for new franchising companies to get started. I view the legislation as basically being pro-franchising in that it is only with this type of legislation that franchising will become a viable means for distribution of new products. By and large, the opponents of this legislation are those entrenched franchisors, who would prefer to see a few large company chains replace the franchisees who already exist. There is an historical pattern among successful franchisors of takeover by large business corporations. While McDonald's itself was not so taken over, this is largely due to the fact McDonald's went public, with a degree of success almost unprecedented in recent years. As to other successful franchising companies, the trend has been quite different. Kentucky Fried Childen was sold to Hublein, a huge food and liquor concern. Burger King is owned by Pillsbury Mills. 7-Eleven Stores is owned by Southland Corporation. Baskin-Robbins is owned by the American subsidiary of a huge British cartel (J. Lyons, U. S. holding), Jack-in-the-Box is owned by Ralston Purina, Chicken Delight is owned by Consolidated Foods, Burger Chef is owned by General Foods.

It is noteworthy that Ralston Purina is reported, in 1971, to have given termination notices to all its franchisees simply because it did not intend to remain in franchising. When the Olympia Breweries bought Hamms, it terminated a large number of Hamms' distributors, summarily.

Thus, we have a situation in franchising today, at least in the fast food industry, where the legal definitions of franchises vary from place to place, or are non-existent, where the so-called "franchisee has made an investment (indeed, has put up practically all the investment for the enterprise), but, in addition to assuming all the risk he is to be responsible for the management of the enterprise, so it is not simply an investment. Finally, the documents executed by the parties have the words "contract" or "agreement" on them, or in them, but, in fact, the franchisor is obligated to do only what he wants to do from time to time, and the franchisee is obligated to do whatever the franchisor tells him to do, at all times, which results in the fact the franchisor can completely rewrite the contract by changing his demands upon the franchisee, on a daily basis. In this turbulent relationship, to try to speak of preserving contract rights is absolutely specious, since franchisors disrupt the "relationship" almost daily by unilaterally changing "policy" to add to franchisees' obligations the affirmative duty to maintain objective standards of performance and, where the franchisee fails to meet those standards to the detriment of the trademark and trade name and general image of the other franchisees, that franchisee, should be terminated. By "terminated" we mean a cessation through use of due process of law of the franchise relationship before it reaches its renewal date or expiration date, as the case may be.

We do not subscribe to forfeitures. There are many ways to get a sub-standard franchisee out of the system without appropriating his investment without compensation.

The proposed legislation does not deprive the franchisors of remedies for ridding themselves of sub-standard franchisees, but rather, seeks only to limit the use of the most harsh remedy—termination, which causes a forfeiture of the franchisee's investment, to those situations where forfeiture is justified.

Where a franchisee has breached the agreement, the franchisor has many remedies, the franchisor may sue for damages to its trademark and trade name; may sue for an injunction to prevent perpetration of the breach; may sue for specific performance of the contract, forcing the franchisee to comply to its standards; or may sue for rescission of the contract, voiding the contract from its beginning. Rescission is a form of termination, which does not involve forfeiture. The franchisee is out, and must return to the franchisor the profits he has enjoyed, and the franchisor must return to the franchisee such amounts as the franchisee paid. Rescission accomplishes the same result as termination, insofar as ridding the system of the sub-standard franchisee is concerned. Termination, however, is the most harsh remedy that the franchisor can pursue, and the one course which lends itself most easily to abuse, since it involves not only ridding the system of the sub-standard franchisee, but involves the franchisor keeping what the franchisee has built up, the franchisee's investment. The proposed legislation does not eliminate termination, but properly requires that this very harsh remedy be exercised only upon a showing of fairness and

just cause. The majority of franchise agreements have been written, however, in such a way that the franchisor can terminate the franchisee for almost any reason, without having to establish the fairness or just cause in any court.

The franchisor can make termination an accomplished fact, leaving the franchisee out in the street, looking for a lawyer. Needless to say, the McDonald's agreements attached hereto as Exhibits A, B, C, and D, and many other franchise agreements, specifically provide that the franchisee, during his franchise operation, will devote his full time to the franchise, and engage in no other businesses. He even commits that even his wife, his parents, children, and other near relatives will not engage in any competing business. Therefore, if termination is an accomplished fact, the franchisee cannot even generate enough money to hire a lawyer and contest it.

The proposed legislation gives the franchisee a day in court and requires the franchisor to show that the reason for termination is justified. If we are not speaking of a failure of a franchisee to pay monies owing to the franchisor, then the reason for the termination must be some failure to comply with that "system" or some "policy" of the franchisor's. In that sense, the sub-standard franchisee is in no position whatsoever to prove whether or not he complied with the system. Since the system, and all the documentary evidence of what the system involves, is in the hands of the franchisor, it is only logical that the franchisor bear the burden of proof in this regard, since he will be establishing that the franchisee was substandard, in comparison with all the other franchisees. The individual franchisee could not possibly be expected to prove the opposite, and in litigation where franchisees have sued franchisors, the courts have shown a steady refusal to permit into evidence anything regarding dealings between the franchisor and its franchisees other than the one directly involved in that particular case. Because it is virtually impossible for a franchisee, today, to get evidence before a court of dealings between the franchisor and any other franchisees than himself, putting the burden of proof upon the franchisor is the only fair or expedient way in which justice will be achieved.

There has been very little litigation in McDonald's franchise system but that which has occurred demonstrated McDonald's ability to maintain quality without resorting to termination. Suit was brought by McDonald's in the Circuit Court of Cook County, in Chicago, McDonald's home base, against a Kentucky franchisee who was allegedly allowing the hamburger sandwiches to become cold, by keeping them too long before selling them. McDonald's was able to get an immediate temporary restraining order against this allegedly sub-standard franchisee, a restraining order that assured that the sandwiches would not get cold.

Obviously, not every failure to follow procedure justifies termination as the appropriate remedy. This is especially true where the franchisee is considered to be sub-standard because he failed to follow procedures not spelled out in his contract and where he has actually honored all the obligations spelled out in his agreement. Nevertheless, over the last two years, the managerial philosophy of McDonald's and other fast food franchisors, has been to define every breach of procedure as an important material breach of contract, and not to talk in terms of termination as the remedy but, rather, speak of the franchisor's "right not to renew" as the means by which a franchisor can get rid of anyone, without the necessity of demonstrating a justification of any kind.

What McDonald's and the other franchisors are doing is hanging on to the franchisee until another more attractive alternative shows up (either a company-owned operation or a new franchisee), and then the franchisor simply exercises his "right not to renew". While it is one thing for the franchisor to argue that he must have a right to terminate a bad franchisee, it is quite another for him to argue that he must have the "right not to renew" any franchisee. The fact that the franchisor allowed the franchisee to stay there for twenty years, without trying to terminate him (much less use any of the other judicial remedies to enforce compliance) establishes two facts: (a) that the fellow really was a good franchisee; or (b) that the franchisor had no measurable standards which it maintained to distinguish good from bad franchisees.

The so-called "right not to renew" does nothing towards maintaining standards, and the argument that the franchisor will only fail to renew sub-standard franchisees, is specious.

Historically significant is the franchisor's constant characterization of any franchisee who feels he has a legitimate dispute with the franchisor as a "bad

operator". The Picchietti case is a classic example. Richard and Romaine Picchietti, his wife, were among the first McDonald's franchisees. Their franchise agreement was executed in June of 1956 and not only covered a small unit in Skokie, Illinois, but guaranteed to them that any units built anywhere in Skokie, or the adjoining suburb of Morton Grove would be offered to them before being offered to anyone else. No move was ever made to terminate them; no suit was brought against them. What McDonald's did do was simply allow the territory to lie fallow, not building any other units in Skokie or Morton Grove that the Picchiettis could lay claim to; a territory that would take another half dozen units comfortably. Dick Picchietti became a kind of "outcast" within McDonald's. There were few corporate executives who did not characterize Picchietti as "a bad operator", and most franchisees were encouraged to stay away from him. After years of being cut off from normal dealings, Picchietti, in 1970, finally succeeded in initiating a dialogue with McDonald's management, with the hope that McDonald's management would help him upgrade the operation. He wrote letters to the management of the company reporting on his problems and sales, almost monthly. While a large number of letters went unanswered, the company did send some field personnel into his stores and gave him some assistance. Picchietti's sales began to increase, on a monthly basis. From July of 1970, Picchietti's sales rose each month anywhere from twenty to forty-three percent, making him a leader in sales increases not only in the Metropolitan Chicago area, but in the country. Nevertheless, the corporate officers continually criticized him as sub-standard and his operations as sub-standard. The company claimed to have letters of complaint from members of the public, but Picchietti produced letters from his customers, praising his operation. Since his sales were showing amazing increases, it would seem Picchietti was more right than his critics. Still he was called a "bad operator". The company executives accused Picchietti of not contributing to the National Advertising Cooperative (OPNAD), but Picchietti actually had always been a contributor and the company had its facts wrong. In May of 1971, Picchietti inquired as to what would take place in June of 1976, the end of his first twenty years. He was informed that that matter was something that would not be considered until two years prior to the end of his first twenty years. Throughout 1971 Picchietti wrote monthly letters, showing his tremendous sales increases and asking the company what its position would be at the end of his first twenty years, so he could decide whether to remodel. On December 20, 1971, the president of the company refused to make a commitment on whether or not Picchietti's agreement would continue to be in effect, or would be rewritten. Sometime during 1973, Picchietti's district developed a practice of congratulating the top stores in the area with form letters that went out automatically to those franchisees who showed substantial sales increases. That result in a peculiar course of events during 1973 and 1974. Almost monthly, Picchietti, being in the top five or top ten stores in the area, received a letter of congratulations from McDonald's (see Group Exhibit H). During the same period officers at the vice presidential level and above, including the chairman of the board, wrote letters to Picchietti, berating him for being sub-standard (see Exhibits E and F). Obviously, the left hand did not know what the right hand was doing. More obviously, Picchietti was one of the top ten, and at times, one of the top five franchisees in the Midwest, insofar as increased sales volume was concerned. Throughout this period Picchietti wrote letters to the company requesting some definition of the company's renewal policy, so he could make a decision on whether or not to remodel. It must be borne in mind, that other than the commitments made to Picchietti when he first took the franchise, that it would be his forever, McDonald's had not made a public statement on its renewal policy in almost twenty years. Such a statement was made to Picchietti before it was any other franchisees, on April 19, 1974, in a letter from Burton Cohen, assistant general counsel for McDonald's, a copy of which is marked Exhibit E and attached to this statement. No one was going to be renewed. Some franchisees would be offered new agreements, but the old agreements would not be renewed. Also, the new agreements were not going to be offered to everyone. Lest there be any misunderstanding that the assistant general counsel was accurately stating the company's position, Picchietti received a letter on April 8, 1974, from the most authoritative and highest source, Ray A. Kroc, chairman of the board and major stockholder of McDonald's, a copy of which is attached hereto and marked Exhibit F, where-

in Mr. Kroc: (1) completely discounted Picchietti's recent remodeling and renovation of his restaurant as being a factor to be considered; (2) failed to specify how Picchietti's operation had been in any way deficient; (3) indicated the criticism of Picchietti was for action or inaction on Picchietti's part that in no way constituted a breach of Picchietti's license agreement and, in fact, inferrentially acknowledged that Picchietti has lived up to his legal obligations; (4) completely discounted the fact that the only subjective indication of Picchietti's operations, his top performance in increased sales, was being entirely disregarded by McDonald's; and (5) in spite of McDonald's pronouncement that an evaluation could not be made until almost the expiration date of the license with inference that Picchietti had that time to upgrade his operation, or meet whatever unspecified demands McDonald's wished to make upon him, Mr. Kroc indicated that anything Picchietti did was "too little, too late". It, therefore, becomes clear that in spite of the statements made to Picchietti, as to his actually being considered for a new franchise agreement (a rewrite as opposed to a renewal) based upon his efforts during the last years of his original agreement, to upgrade himself to McDonald's expectations, McDonald's chairman of the board obviously was predetermined not to allow Picchietti to continue as a franchisee.

In the Spring of 1975, McDonald's, being aware of tremendous pressure for introduction and passage of the pending legislation, shifted its position on Picchietti, and offered him a new agreement of five years in length. New franchisees today get twenty (20) years. It is only because of the pendency of this legislation that any new agreement was offered. However, it should be noted that the offer of a new franchise to Picchietti was discriminatorily and unfairly conditioned. In addition to offering Picchietti a new agreement at a royalty rate of three percent (3%) of his gross sales, (which is the standard royalty for new franchisees at this time and an increase over the 1.9% royalty that Picchietti's original agreement provided for), McDonald's also insisted that: (1) the agreement only covered Picchietti's street address, thus doing away entirely with Picchietti's territorial rights for additional units and subjecting Picchietti to the danger that McDonald's could open up a unit across the street from him and drive him out of business; (2) McDonald's insisted that Picchietti sell to McDonald's, at McDonald's valuation, the real estate Picchietti owned or controlled, or, in the alternative, pay McDonald's a surcharge, an additional royalty of 8½% of his gross receipts, a demand without precedent. Whereas the newest royalty is 3%, Picchietti's royalty would be 11½% of his gross sales. Dick Picchietti's first twenty years with McDonald's will end June 30, 1976.

IV. THE FRANCHISOR'S RIGHT NOT TO RENEW

Obviously, then, since the franchisor has a right to terminate franchisees under existing law, and S. 2335 preserves that right to the franchisor, where there is cause, it becomes apparent that the proposed legislation's curtailing of what the franchisor asserts as his "right not to renew" cannot in any way affect quality standards or enforcement of specifications.

In the case of McDonald's, of course, we are not talking about a policy of "renewal", we are talking about a policy of rewriting, since McDonald's has declared it will renew absolutely no one. This refusal by McDonald's to renew has never been justified. McDonald's cannot claim it is not profiting off the terms of the existing licenses. Indeed, we have already demonstrated that McDonald's has profited greatly with little or no investment. McDonald's cannot suggest that the rewriting is justified because the franchisee is making a disproportionate profit, because, indeed, the franchisee bears all the risk of investment and cost or operation, the franchisees' profit margin by percentage of gross sales has dwindled considerably in this period of rising costs and inflation (See Exhibits N and O).[2] On the other hand, because McDonald's income comes from guaranteed rental and a percentage of gross sales taken off the top, risk free, McDonald's has maintained an annual 32% profit growth over recent years.

It should be noted from the attached Exhibit M, that McDonald's operates more than thirty percent of the[3] McDonald's units itself, through wholly-owned

[2] Source of exhibits M and O—a critical analysis: McDonald's Corporation by Carl F. DeBiase © the Fourteen Research Corporation 1974.

[3] A Critical Analysis: McDonald's Corporation, Carl F. DeBiase, © the Fourteen Research Corporation, 1974.

subsidiary corporations. Many franchisees find their toughest competition is a nearby McDonald's unit owned by the company. No court has ever ruled this dominant position of McDonald's operating more than thirty percent of its units to be monopolistic, but it should be obvious that there is a tremendous motivation here for McDonald's to use the so-called "right not to renew" to take over the entire system and divest all the franchisees of their investments without paying a penny, and operate as a chain. The franchisors assert a naked right not to renew and McDonald's, with a market position of in excess of thirty percent company-owned units, is in a position for a takeover and the potential financial gain to McDonald's by exercising what is an absolute right not to renew, has a potential gain of at least five hundred million dollars in such a takeover. Who is to assure us that it will not happen? The program of McDonald's and other franchisors to assert the right not to renew, is a program the goal of which is to eliminate franchising, and run as a company chain.

Moreover, while franchisors today are selling franchises to the public on the premise that the franchisee will become an independent businessman by investing with the franchisor, recent history tells us that the franchisors use "the right not to renew" to destroy that independence and turn the franchisee into nothing more than a successful serf.

For example two groups of Dunkin' Donuts franchisees filed two antitrust cases against Dunkin' Donuts and other defendants in the United States District Court for the Eastern District of Pennsylvania, at Philadelphia. The judge in the Federal District Court certified the action as a class action so the named plaintiffs could proceed as representatives of a class consisting of all Dunkin' Donuts' franchisees and the franchisor appealed that certification. While the Court of Appeals was determining the propriety of that certification, Dunkin' Donuts made a settlement offer to the franchisees. The president of Dunkin' Donuts then appeared at a meeting called in Chicago for some members of the class. At that meeting, he calmly stated that the named plaintiffs in the antitrust action, and some members of the class would not be renewed and, in fact, the company was going to take action while the suit was pending to terminate some of them. Mr. Rosenberg discussed, at great length, the proposed legislation which this Honorable Sub-committee is studying, and pointed out that even if the legislation was passed into law, the franchisor would still have a right not to renew, "for legitimate business reasons" and indicated that the latter phrase was so broad that the franchisor could apply it whimsically. The message was obvious, accept the settlement offer or risk non-renewal.

Thus, we have a situation where the franchisors' right not to renew is a right which can, as of today, be exercised against any franchisee, or group of franchisees who have the courage to assert a violation of any federal or state law against the franchisor. Existing antitrust laws are so inadequate to protect the franchisee from the franchisor's right not to renew that Dunkin' Donuts was able to use the threat of non-renewal to attempt to coerce a settlement of a pending antitrust case, and the United States District Court was powerless to stop them. That is a typical example of what we franchisees can expect as justification for non-renewal. Moreover, Dunkin' Donuts' president's assertion that the pending legislation will not be able to prevent non-renewal because it contains language legitimatizing non-renewal "for legitimate business reasons" demonstrates a flaw in the bill's language as proposed. "Legitimate business reasons" must be more carefully defined in the bill, to exclude discriminatory and unfair treatment just because an additional lawful motive might be present. In a case where the franchisor's reason for non-renewal was based on several reasons, only one of which was a legitimate business reason, then the failure to renew should be presumed to be unlawful, unless the franchisor can demonstrate that the legitimate business reasons were the only reasons for the failure to renew and the decision was not discriminatory.

Most importantly, the legislation should not be preemptive of state law. The proposed legislation is de minimus legislation. It is legislation to prevent the forfeiture of an investment and prevent the franchisor from reaping a windfall where he has made little or no investment. There are a number of abuses in the franchise industry which we have been subjected to which are not covered by the proposed legislation, but, which either have, or may be, covered by state legislation. The area of attempting to eliminate fraud and failure to make disclosures by franchisors, may continue to become a reality at the state level and the federal legislation does not touch on it.

The problem of encroachment is a major problem we face, which is not covered by any law. Not only at McDonald's, but in the entire industry, if a franchisor wants to freeze out an existing unit or force sales of additional units, all he has to do is place a unit close to an existing franchisee, in order to cut the sales of the franchisee, and the franchisee is forced to purchase the unit, although he may not have the financial ability with which to do so. This problem of encroachment may also be called market saturation. On the other hand, where a franchisee has gone into virgin territory and established good will with his investment for the goods, trademark, trade name, McDonald's and other franchisors have located company-owned units so close to that existing franchisee as to dilute the market, cut the franchisee's sales, and with little risk, ride the coattails of the franchisee's investment. In fact, by surrounding an exising franchisee with company-owned units, or units licensed to new franchisees, the franchisor can so grievously injure the franchisee economically as to drive him out of business. The proposed legislation does not touch on that problem which is all too common in franchising.

The proposed legislation also does not at all deal with favoritism and outright discrimination practiced by the franchisor among franchisees, giving vast benefits to the franchisor's corporate insiders, giving rise to payoffs and corruption and penalizing the honest franchisee who will not stoop to bribery and humiliation. The entire area of discrimination is not touched by the proposed legislation. The proposed legislation deals with the only one primary and fundamental problem: the right of an American businessman not to be subjected to forfeiture of his investment, without due process of law and the right of the small businessman to be free from takeover of his investment by a franchising company.

There are many more problems in franchising that are crucial and pressing, and the federal government should not preempt the area from action by the states. But franchisees must have the protection of the proposed bill, without delay. If it is not passed immediately, there will be few franchisees left around to be protected. The passage of the present law is an emergency measure, that is necessary now to protect small businessmen. Furthermore, a provision should be inserted in the proposed legislation providing it will apply to all franchise agreements in existence on the effective date of the Act, which have not been terminated, or which have not expired, prior to the effective date of the Act. To pass this law without protecting those franchisees who are presently operating would give the franchisors an opportunity to take over large segments of the industry and use threats of termination and non-renewal for even more abusive practices than they have in the past.

Finally, I would urge the deletion from Section 3(3)(D), the following language:

"The term does not include any relationship that would otherwise be included, if the second party thereto has been engaged in the same type of business for a period of two or more years prior to entering upon such relationship with such a first party so long as such parties do not contemplate or anticipate that such second party will be involved, predominantly or primarily, in the sale or distribution of goods or services covered by such relationship;"

I would also urge the deletion from Section 6(b)(1)B, the language: ". . . if the term of the agreement which is not being renewed was five years or more, . . ."

These provisions are arbitrary, being based solely on time periods which may or may not be significant in a given instance. Some franchises are indefinite, going on forever unless terminated by either party (some beverages and automobile dealerships), some are month to month (some fast food franchises), some are five years, some twenty, some are verbal, rather than written. The franchisees who need the protection of the proposed legislation are those who have made a substantial investment and have an investment to protect, who have devoted themselves to building good will for the trademark, and neither the length of time they have been in business nor the length of the franchise agreement is truly meaningful. Nor is two years' experience prior to entering the franchise meaningful. Many McDonald's franchisees are former employees of other McDonald's franchisees. The McDonald's Operators' Association Coalition urges the Honorable members of the Senate to change this language so that the franchisees covered by the Act will, at least be those who, whether by franchise fees, lease obligations, security deposits, purchase of equipment,

goods, services, or real estate, or other forms of direct investment or assumption of indebtedness, have committed themselves for more than $10,000.00 as a part of being granted the initial franchise.

Why is non-renewal so awesome that it can turn American citizens into fearful people? Because existing law in most American jurisdictions permits unfair cancellation and forfeiture. The leverage arises from one major source, federal laws giving trademark owners a monopoly. The proposed legislation will not eliminate all the abuses of trademark rights that exist in franchising, but it will eliminate the worst of those abuses—unfail non-renewal or termination; and will render ineffective the abusive practice of using threats of unjustified termination or non-renewal to violate fundamental rights of American citizens.

STATEMENT OF JAMES D. CERAJEWSKI, PRESIDENT, CONSOLIDATED FRANCHISE ASSOCIATION, AN INDEPENDENT NATIONAL ASSOCIATION OF DUNKIN' DONUTS FRANCHISE OPERATORS

Mr. Chairman, Members of the Subcommittee. This opportunity to present to you my statement favoring passage of S. 2335, the "Fairness in Franchising Act," which I will refer to as "the Bill," is deeply appreciated. Franchisees have long been in need of federal legislation to help prevent various abuses prevalent in our industry. The mere fact your committee is conducting hearings, in and of itself, shows a growing recognition of our problems.

I have been a Dunkin' Donuts franchisee since 1967. My shop is located in Hammond, Indiana. I am the president of Consolidated Franchise Association ("CFA"), an independent national association of about 200 Dunkin' Donuts franchise operators, and CFA's delegate to the National Franchise Association Coalition ("the NFAC"), a coalition of what is now about 19 separate independent franchisee associations. CFA initiated and sponsored the first meeting of the NFAC, which was held in Las Vegas, Nevada in November, 1975, in conjunction with meetings of the CFA Board of Directors and membership. It is with great pride that we can point to the very rapid growth of the NFAC during the past several months of its brief existence, and to the tremendous cooperative efforts that have been exerted by various members of the franchisee associations that has made it possible for many thousands of franchised business persons in the U.S. to finally be represented by one cohesive organization.

This statement is the first of two statements to be submitted in behalf of CFA supporting the Bill. In it, I will try to provide some information pertinent primarily to the Dunkin' Donuts systems. CFA's general counsel, Mark Klein, will submit a separate statement that will consider both legal matters, and his experiences with Dunkin' Donuts and other franchise systems.

1. BRIEF HISTORY ON DUNKIN' DONUTS FRANCHISING SYSTEM

In 1950, William Rosenberg, the present Chairman of the Board of Dunkin' Donuts, started the Dunkin' Donuts chain with the opening of his first donut and coffee shop in Quincy, Massachusetts. With the success of this initial shop, he opened four more soon thereafter. He became "convinced that his product and marketing concept could be successfully applied on a nationwide basis and that franchising was the best method for rapid expansion and dynamic growth." The first Dunkin' Donuts franchise license agreement was signed in 1955, as a result. "At the close of fiscal 1975, there were 820 Dunkin' Donuts shops operating in the United States, Puerto Rico and Canada. Of this total, 753 shops are operated by franchise owners and 67 by Dunkin' Donuts; 48 permanently and 19 on a temporary basis.***." (Dunkin' Donuts Annual Report 1975, Ex. 1, pp. 2, 8.)

Sometime after I entered the Dunkin' Donuts system, I discovered it was beset with a myriad of problems in relationships with its franchisees. Complaints of the franchisees were numerous. Rent was excessive. Equipment and signs that had to be purchased from the company were overpriced. Some local markets were oversaturated with Dunkin' Donuts shops. Promotional programs seemed designed more to increase gross sales and percentages paid to Dunkin' Donuts. Promotional merchandise had to be purchased from Dunkin' Donuts. It seemed that the promotional programs and merchandise were intended more for the benefit of the company than the net profit of the franchisees. There was gross inattentiveness to franchisee complaints, most particularly construction

problems. The company provided little service of value, if any at all, in exchange for the 4.9% continuing royalty fee. The company was dilatory and evasive with respect to having suppliers, other than a favored few, approved. Despite supposed expertise in site selection, many Dunkin' Donuts shops were poorly located. There were numerous other complaints.

It should come as no surprise that Dunkin' Donuts franchisees had it extremely tough during that period. We were paying 14% and more of our gross revenues to Dunkin' Donuts on our 4.9% continuing royalty, our 2% advertising fee, and, generally speaking, over 7% for rent. In return we were supposed to get, in addition to the Dunkin' Donuts name and image, a lot of service and expertise that we didn't get. As a result, Dunkin' Donuts franchisees had a lot of problems making much of a living off of their profits, and many simply couldn't pay their bills, even though it was common for a husband and wife, and perhaps even other members of a family, to devote hours to their shops.

What with all of the foregoing problems, the franchise failure rate was high in terms of turnover in individual stores. By "failure rate," I include franchisees who sold their stores back to the company or to others at a substantial loss because of inability to operate at a profit, or at a profit sufficient to raise a family, as well as many who either went bankrupt or simply abandoned their stores out of utter frustration. Mr. Rick Bolinger, the former franchisee of a Dunkin' Donuts shop in Michigan City, Indiana, was one who sold his store back to the company for $2,000. He claims a total loss of about $80,000. (Ex. 5.)

Many franchisees were becoming quite upset with the failures of our franchisor to live up to its obligations and with the excessive amounts we had to pay far in excess of the value received from the franchisor. Meanwhile, its profits were growing by leaps and bounds, from $903,000 in fiscal 1966 to $3,474,000 in fiscal 1970. (Dunkin' Donuts Annual Report 1975, Ex. 1, pp. 10–11.)

The unhappiness of the franchisees resulted in the formation of CFA, starting with a meeting of Mid-Atlantic zone franchisees in late 1970. I have appended two CFA brochures, one entitled "CFA in Action . . . A Story of Results" (Ex. 2), the other "Questions and Answers About Consolidated Franchise Association" (Ex. 3). These two brochures summarize the beginnings of CFA, and some of its accomplishments and objectives. For this statement, suffice it to say that, from its small beginnings, CFA has grown to about 200 members today, and is rapidly expanding, despite opposition from the company, and despite its escalation of the activities of its franchisee advisory council in an attempt to dilute the effect of CFA.

CFA was initially successful in influencing the company to put a $2,000 annual ceiling on Consumer Price Index increases on *new* Dunkin' Donuts store leases. It did not achieve any immediate economic benefits for old franchisees, who were becoming exceedingly unhappy. This unhappiness resulted in the filing of a class action suit against Dunkin' in the Federal District Court in Philadelphia in 1972 (*Ungar et al.* v. *Dunkin' Donuts of America, Inc. et al.*, Civil Action No. 72–88.) I subsequently became a moving plaintiff in this litigation by filing suit myself.

Dunkin' Donuts started paying attention to franchisee grievances thereafter. A policy decision was made in 1973, and effected in 1974, to start concentrating on individual store profits rather than continuing the former policy of concentrating on expansion. About that same time Dunkin' Donuts decided it had experienced too many marginal stores, and that it should be more selective in picking sites for new stores. (Dunkin' Donuts Annual Report 1974, Ex. 4, pp. 2–5, 12–14; Dunkin' Donuts Annual Report 1975, Ex. 1. pp. 4–6, 8, 14, 16.)

The company has, in fact, during the past two years, taken some steps that, together with some other factors, have helped increase store profits. These steps included, for example, a joint purchasing program that has helped reduce costs. Credit will be given where due. Unfortunately, the company's change in emphasis from expansion to increased store profits was long overdue. Many franchisees undoubtedly lost thousands of dollars in the process. Meanwhile, at least since 1965 (the first year for which figures are immediately available to me), the company has prospered. (Dunkin' Donuts Annual Report 1974, Ex. 4, inside back cover).

2. TRENDS FOR THE FUTURE

In commenting upon an increase in corporate net earnings and revenues from fiscal 1974 to fiscal 1975, management stated in the Dunkin' Donuts Annual Report 1975 (Ex. 1, at page 4):

"These achievements have resulted principally from certain strategic corporate decisions made two years ago. At that time we decided to increase our emphasis on improvement of the sale and profits of franchised and Company-owned shops already in operation. We also decided to open fewer new shops and, more recently, to own and operate a larger percentage of them. By placing less emphasis on expansion and more on shop operations, we were able to devote time and resources more effectively and knowledgeably to the development of programs essential to the improvement of shop sales and profits. This change in strategy to date has proven to be effective. Average sales and profits of shops in operation a full year have increased, and the number of marginal shops and permanently closed shops has been reduced substantially."

Finally, after engaging in the franchising business some 19 years, our franchisor switched its emphasis from expansion to increasing shop profits and reducing the number of marginal shops. This is a very meaningful admission of prior inattentiveness to the problems many Dunkin' Donuts franchisees had in keeping their heads above water. During this long period of expansion, how many Dunkin' Donuts franchisees lost thousands of dollars, perhaps their life savings, in a Dunkin' Donuts shop primarily because our franchisor selected poor sites, oversaturated a local market with competing Dunkin' Donuts shops, gave little or no service to its franchisees, ran worthless promotions, etc.? Sure, the franchisor also may have lost some money itself on stores it had to permanently close. But in only one of the last ten years has it had a net loss, and now, after some 20 years of expansion, it has a thriving chain from which to derive increasing net profits. And all the while the individual franchisees were suffering from net losses and low net profits, Dunkin' Donuts was raking in over 14% of their gross revenues off the top!

And now comes the real clincher. The company wants to start increasing the number of company-owned stores because it can make more money that way. At page 13 of the Dunkin' Donuts Annual Report 1974 (Ex. 4), the following question and answer appear:

"6. Why hasn't Dunkin' Donuts expanded with more Company-owned shops?

"Dunkin' Donuts is currently giving more emphasis to its company-owned operations than ever before in its history. In fiscal 1975, approximately 40% of all new shops planned to be opened will be Company-owned, up from 24% in 1974. In the past, franchising was used almost exclusively to expand. However, the favorable projected return on investment has increased emphasis on Company-owned shops.***"

And what were the results? The 1974 Annual Report (Ex. 1), states at page 5:

"In fiscal 1975, our Company-owned shop division opened 15 of the 40 new Dunkin' Donuts shops developed during the year and acquired 14 existing shops from franchise owners, *increasing the number of shops it permanently operated at year end to 48* from 19 the prior year. Accelerated development of Company-owned shops has contributed to increased Company profits and return on investment, despite the reduced number of new shops being developed.***" (Emphasis supplied.)

And at page 8 of the same annual report, the following question and answer (in pertinent part) appear:

"1. Why is the Company opening more Company-operated shops?

"The Company typically earns greater profits and a higher rate of return on its investment in the development and operation of Company-owned shops than in franchised shops.***"

The company then goes on to describe how the company-owned shop division "developed a significant number of programs designed to improve the sales and profits of all shops in the system." That's fine. But how many shops does the company have to own to accomplish this result, and why can't the same be accomplished in volunteer franchised shops?

The picture becomes abundantly clear. What our franchisor was unable to do on its own initially, build a network of some 820 Dunkin' Donuts shops in 41 states, Canada and Puerto Rico, as reported at page 5 of its 1975 Annual Report (Ex. 1), and establish purchasing programs and advertising groups in which its numerous franchisees are absolutely essential ingredients, it is now starting to accomplish. It is building on the ashes of many fallen franchisees, untold numbers of whom failed primarily because of our franchisor's admitted concentration on expansion rather than shop profits, and on the blood, sweat and lost profits of many others who had to suffer through these earlier policies.

This new concentration on increasing company stores, most pointedly the reacquisition "of 14 existing shops from franchise owners" in 1975, emphasizes more than ever the need of Dunkin' Donuts franchisees for legislative protection from improper terminations and failures to renew

3. THE SITE SELECTION AND LICENSING OF A DUNKIN' DONUT SHOP

In about 1971, Robert M. Rosenberg, the president of Dunkin' Donuts, stated that Dunkin' Donuts "'doesn't put a shop just anywhere. We find the best location we can for the franchise holder, a location where he can make money from his investment.'" (Dunkin' Donuts News, date illegible but reasonably believed to have been published about 1971 because of contents. Ex. 6.) This statement was made before the company, as previously stated, admitted it had too many marginal shops and had to be more selective in picking sites. Even so, the usual format is, and has been, for the company to select a site, with the franchisee depending entirely on the company's expertise in this regard. One of the criteria used in site selection is proximity to other Dunkin' Donuts shops. (Dunkin' Donuts Michigan Disclosure Statement, Ex. 7, p. 17; Dunkin' Donuts Annual Report 1975, Ex. 1. p. 6.)

The franchising documents consists of a Franchise Agreement (Ex. 7A), a Lease of Dunkin' Donuts Shop (Ex. 7B), an Equipment Agreement (Ex. 7C). Various different types of forms have been used over the years. Those appended as exhibits are believed to be representative of forms used in recent years.

All of the franchisor's licensing documents are on printed forms drafted by the franchisor. There is no negotiation. The franchisee must accept the terms as offered by the franchisor if he wants a Dunkin' Donuts franchise.

There are many claims that the purchase of equipment and leasing of real estate are illegally tied to the purchase of the Dunkin' Donuts franchise. This is one of the issues before the court in the Dunkin' Donuts Philadelphia class action now proceeding. Regardless of the outcome of that litigation, it is a fact that, as of the end of October, 1975, the company controlled the real estate, as owner or prime lessor, of 686 of the 753 Dunkin' Donuts shops then operated by franchisees. (Dunkin' Donuts Annual Report 1975, Ex. 1, p. 8.)

The original Dunkin' Donuts franchisee fee, as of late 1975, ranged from $22,000 to $27,000, depending primarily upon that part of the country in which the shop is located. The equipment and the sign package, if purchased from the franchisor, then cost about $27,000 and $5,500, respectively. The franchisor estimates that initial working capital requirements would be about $8,900. (The foregoing estimates were for a location in Michigan, and may vary for different locations.) (Dunkin' Donuts Michigan Disclosure Statement. Ex. 7. pp. 1, 8–10.) The purchase of the equipment and sign package may be financed through the company.

The continuing financial obligations of the franchisee to the franchisor under the standard forms of licensing documents are substantial. These include a continuing franchisee fee of 4.9% of gross sales, a required contribution to the Franchise Owners Advertising and Sales Promotion Fund of 2% of gross sales, rent for the shop, and any installments due on the purchase of equipment. (See standard forms of franchising documents appended as Ex. 7 A, 7B and 7C.)

It is my understanding that the greatest portion of the Dunkin' Donuts shops whose real estate is controlled by the franchisor is leased by the franchisor and sub-leased to franchisees. The franchisor rents the land only from the land owner, and constructs the Dunkin' Donuts shop at its own expense. The franchisee, who subleases from the franchisor, pays a base rent equal to the rent paid to the land owner on the prime lease increased by $3,000 per

year, plus an additional amount calculated to yield about 14% per year on the cost of the building to Dunkin' Donuts. At the end of the first ten years of his lease, the base rent is subject to increase in the same percentage as the increase in the Consumer Price Index for Urban Wage Earner's and Clerical Workers. All Items—Series A (1967=100), published by the Bureau of Labor Statistics (herein "the CPI increase").

There was no ceiling in the possible CPI increase in standard forms of Dunkin' Donuts shop leases until about 1971, at which time a $2,000 ceiling was inserted, but only for the benefit of subsequently signed franchisees. In addition, the franchisee is required to pay the franchisor a 7% over-ride on all gross sales in excess of $150,000 or $165,000 per year, depending on when the lease was signed, and to pay all real estate taxes and insurance with respect to the leased premises. The required insurance includes "rental insurance" payable in the event of damage to the premises arising from casualty.

Dunkin' Donuts franchisees are under the franchisor's thumb, as far as gainful employment is concerned. Full time must be devoted to the franchised Dunkin' Donuts shop, and the franchisee cannot "own, maintain, engage in, participate or have any interest in the operation of any enterprise which is the same or substantially similar to" the franchised Dunkin' Donuts shop, other than other Dunkin' Donuts shops. Whether or not the franchisee is permitted to increase his income by purchasing other Dunkin' Donuts shops, should he have the financial resources, is completely up to Dunkin' Donuts. (Dunkin' Donuts Franchise Agreement, Ex. 7A, Par. 8.)

4. EXCESSIVE RENTS CHARGED BY DUNKIN' DONUTS FOR SHOPS

The base rent for my shop, which was opened in 1968, is $13,500 per year. In addition, I have to pay a rent over-ride of 7% of all sales in excess of $150,000. With the over-ride, my base rent is approximately doubled to a total rent of about $27,000 per year. On top of this I pay annual insurance premiums of about $900, and real estate taxes of $2,400, and must pay all maintenance and upkeep for "my" building, interior and exterior, and parking lot. I even had to pay $5,000 of the original cost of the building! Dunkin' Donuts pays my landowner $450 per month land rent, and probably pays the amortization on a note with respect to building costs. These two items are covered entirely by my base rent, even without addition of any $3,000 increment. Everything else is clear profit.

A recent appraisal of my shop by a competent local realtor who handles a lot of commercial property indicates that the fair rental value of my shop, on the open market, would be $15,000 per year! (Ex. 8) In addition, it is my understanding that, in the ordinary commercial lease other than the "net, net" variety, the lessee pays only increases in taxes and insurance after the base year, not the total amounts, and that the tenant is responsible only for interior maintenance.

The effect of net rental income from Dunkin' Donuts shops leased to franchisees on Dunkin' Donuts net profits from all sources is quite revealing. The following information is gleaned from the franchisor's 1975 Annual Report (Ex. 1):

	Fiscal year ended	
	Oct. 26, 1974	Oct. 25, 1975
Rental income	$12,168,000	$13,329,000
Total expenses of rental properties	10,267,000	10,540,000
Net profit from rental properties	1,901,000	2,789,000
Net income before income taxes (all sources)	2,701,000	3,771,000
Gross revenues from all sources	26,719,000	34,465,000
Rental income, as a percentage of gross revenues from all sources	46	39
Net profit from rental properties, as a percentage of net income from all sources	70	74

Rental income represents by far the greatest portion of Dunkin' Donuts gross revenues than any other single source, and net profits from rental properties represents by far well over half of Dunkin' Donuts net income from all sources. Dunkin' Donuts, in effect, is primarily a massive national landlord.

The franchising system is merely a source of tenants for its real estate properties!

I am not in any way opposed to a franchisor being a landlord for its franchisees, as long as there is no illegality involved, such as a tying arrangement in violation of the anti-trust laws, and as long as that landlord interest does not tend to diminish its obligations to its franchisees. And I am not opposed to the franchisor making a fair profit for its function as a landlord, whether it be as the owner of the real estate profit for its function as a landlessee. But there is something grossly wrong, on the face of things, with a franchising system that must absolutely depend upon its rental income as its greatest source of net income from all sources!

This is a subject very directly related to the issue of requiring a franchisor to prove good cause before terminating a franchisee, or refusing to renew his franchise. Dunkin' Donuts is, as I understand it, only one of many franchisors engaged substantially in the business of renting locations to their franchisees. And the general rule is to make the store lease and the franchise agreement interdependent. The termination of one automatically terminates the other. This is the situation with Dunkin' Donuts.

Let's assume that a Dunkin' Donuts franchisee falls behind in his payments to the franchisor. This sometimes happens primarily because *Dunkin' Donuts*, with all of its expertise and years of experience, picked a bad site. The franchisee not only relied extensively on the franchisor's expertise and experience in selecting good sites, he aid for it initially when he paid the franchise fee, and continuously thereafter with each rental payment. But when the excessive rental helps break his back, he is either terminated, or forced to sell at a bargain price back to the company under threat of termination, a la Mr. Bolinger. And then the franchisor often times proceeds to sell and resell the same store to a succession of other franchisees, making new profits on each transaction. I am not unmindful of the company's current policy of having a "finance committee" consider temporarily deferring (not forgiving) part of a franchisee's rent. I understand this committee acts very slowly, and the company has let it be known that most favorable consideration will be given to applications from conformists with the right attitude.

The franchisee must be armed with some type of legal defense to such terminations that will make the franchisor more accountable for its mistakes and short comings. The Bill, as I see, should be a big help in this regard. This is a subject that will be treated more extensively in the presentation of Mark Klein, as CFA's General Counsel.

5. AN OVERVIEW OF THE SITUATION

The Bill is directed toward the prevention of unjust franchise terminations and failures to renew. In the Dunkin' Donuts situation, the actual and threatened franchise terminations and failures to renew are the end result. It is essential that attention be directed toward the basic reasons discussed herein that underlie the disintegration of relationships between Dunkin' Donuts and its franchisees.

We have many common interests with our franchisor. Primarily, these relate to protecting and enhancing the Dunkin' Donuts name, a name which I feel is unexcelled in the donut and coffee fast food trade. We indeed have a marriage of business interests with our franchisor, who is also, in the greatest majority of cases, also our landlord, our consultant, and our final authority in the approval of numerous purveyors to us of food, paper goods and supplies, etc. And so it is, I understand, in many other franchise systems, most particularly in the fast food business.

But we also have many conflicting interests. Our franchisor's immediate concern is to earn profits for itself, and pay dividends to its shareholders. In achieving these goals, Dunkin' Donuts has been accused of moving in directions that tend to increase gross revenues of the whole Dunkin' Donuts system and net profits of the franchisor, but often times at the expense of the net profits of its franchisees. As is apparent in a brief examination of the Dunkin' Donuts licensing documents, Dunkin' Donuts' principal revenues are derived from percentages of our aggregate gross revenues. Increasing these aggregate gross revenues is often inconsistent with concurrent increases in our individual net profits.

I most certainly believe in franchising as a means of retaining the small businessman as an important factor in the American economy. But there appear to be some built-in dangers that must be recognized and removed.

First we must consider the ordinary contract of adhesion that, generally speaking, all franchisees must sign in order to get a franchise. When we complain about this contract, the terms of which are drawn by the franchisor and are completely one-sided, the usual response is that we're over 21 and competent, and that we freely signed the agreement.

There is a big fallacy to this response. We really don't have that much choice if we want to own and operate our own small business. It is my assumption that the Congress does consider it important to encourage healthy competition through growth of small business.

When I decided to buy a franchise in 1967, I had several choices open to me. I could buy a franchise and subject myself to all of the contractural burdens of the franchise agreement, or I could go into business entirely on my own. In the latter instance, I could try to compete with the franchised shops by building a fancy shop with all the trimmings, or I could open a barebones shop, and hope to still be able to attract customers away from the franchised operations that were financed by a national corporation and had a good national image. This is the choice all small businessmen face today. Few can compete with the franchisers with their own resources.

The fact is that, because of the tremendous growth of franchising, individual small businessmen are faced with ever-growing standards in terms of decor, public image and advertising. It is getting tougher and tougher for the independent unfranchised small business to succeed, much less get started, in the face of all the competition from the franchised operations.

The situation is compounded by the competition the franchisors create for good commercial real estate, of which here is a limited supply. Given a choice, a landowner obviously would much prefer a national tenant with huge resources on a long-term lease, rather than a small local businessman with only a fraction of those resources.

Without the competition from large national franchisors, the small businessmen could more often get by without fancy buildings with all the trimmings, and would have a greater supply of commercial properties available at lower rents.

Whether or not it is good for the American economy to have fancy retail operations with national images is irrelevant The point is, such operations are becoming more and more essential in today's market, and the large franchisors are using their economic power to, in effect, coerce small businessmen to sign whatever form of agreement is offered. That is the extent of our choice.

In conclusion, I'd like to thank the members of this subcommittee and its staff for all the time taken to hold hearings and consider all of the statements and other documentation. The ordinary person often does not appreciate all that Congress does, and how Congressmen spend their time. Having had an opportunity to be in Washington, and see first hand some of your responsibilities, I can appreciate your accomplishments all the more.

I urge you that passage of the Bill is an essential first step toward providing franchisees with protection from franchising abuses, both actual and threatened, and respectfully request your favorable report.

CONSOLIDATED FRANCHISE ASSOCIATION ("CFA") EXHIBIT LIST

Exhibit No.	Description of document
1	Dunkin' Donuts Annual Report 1975.
2	"CFA In Action . . . A Story of Results!"
3	"Questions and Answers about Consolidated Franchise Association."
4	Dunkin' Donuts Annual Report 1974.
5	Statement Regarding Personal Loss and Mistreatment by a Franchisor—Richard F. Bolinger, Jr.
6	Dunkin' Donuts News (Believed to be dated sometime in 1971—date is not legible or not imprinted on copies pages).
7	Dunkin' Donuts Michigan Franchise Investment Law Offering Circular.
7A	Dunkin' Donuts standard form of franchise agreement.
7B	Lease of Dunkin' Donuts Shop (standard form).
7C	Dunkin' Donuts standard form of Equipment Agreement.

CONSOLIDATED FRANCHISE ASSOCIATION ("CFA") EXHIBIT LIST—Continued

Exhibit No.	Description of document
8	Appraisal of Vernon E. Lee to Mr. James Cerajewski, dated March 20, 1976.
9	An Address to a Meeting of Security Analysts by Al Lapin, Jr., President of International Industries, Inc., New York, April 20, 1966.
10	Extracts from Depositions of Al Lapin, Jr., In Re International House of Pancakes Franchise Litigation, MDL Dkt No. 77, U.S. District Court for the Western District of Missouri, Western Division, taken:
10A	April 16, 1793.
10B	April 17, 1973.
10C	May 10, 1973.
11	List of International House of Pancakes restaurants, with chronological history of operators.
12	Letter from Joseph C. Venziano to Consolidated Franchise Association, January 22, 1976.
13	Statement of Calvin and Teresa Davis (March 17, 1976) and letter from Calvin and Teresa Davis to "Mr. Rosenberg" dated February 27, 1976.
14	Form of letter from Robert M. Rosenberg, President, Dunkin' Donuts Incorporated transmitting to Dunkin' Donuts franchisees an offer to revise their franchise agreements and shop leases and a general release form.

NOTE.—Exhibits 1, 4–14 are in the Committee files.

CFA IN ACTION . . . A STORY OF RESULTS!

Consolidated Franchise Association, An Independent National Association of Dunkin' Donuts Franchise Operators, Kansas City, Mo.

When a Dunkin' Donuts franchisee joins CFA, he helps himself and other Dunkin' Donuts franchisees get results. He gets things done faster and better through CFA than he and his fellow operators could do on their own.

There are at least two good reasons for this. Their collective voices joined as one openly mean more to the company than the same number of individual voices singing solo in the wilderness. And through CFA, they can obtain the expert assistance so essential in favorably presenting their common grievances and suggestions for improvement.

Early indication was given of the company's greater awareness of problems that are voiced through a single national group of franchisees. In 1970 a number of Mid-Atlantic Dunkin' Donuts franchisees were seriously concerned about the weaknesses of having to communicate their problems to the company through the zone advisory councils. They felt that the system could be vastly improved by the creation of an independent national association. Thus began CFA.

The plans to establish CFA were discovered by the company. In early December, 1970 Peter Pallantios, a member of the CFA steering committee, was contacted by Robert Rosenberg, president of the company, who exerted considerable effort to discourage the formation of CFA. But the planning continued. Having failed in its effort, the company responded later that month by calling a meeting of the company's various zone advisory council chairmen, and certain alternates, with the company's board chairman and president, at its national marketing seminar in Florida. The purpose of the meeting was to analyze the advisory councils and their effectiveness in addressing the major issues in franchisor-franchisee relations. Out of that meeting was born the President's Committee, presently called the National Advisory Council Chairman's Committee, or the NACCC.

The first meeting of the NACCC was held January 29, 1971, at company headquarters in Randolph, Massachusetts. Eleven issues were then identified as requiring a new or revised policy, or clarification of existing policy. (See Dunkin' Donuts News, February, 1971, p. 1) Eight of these issues were essentially identical to common grievances and problems specified by the CFA steering committee in November, 1970. These common grievances and problems were concerned with the following areas; renewals of franchises, leases, etc., prior to expiration; notification of local operators regarding the opening of new stores, and the establishment of a policy regarding purchases of additional stores; the establishment of a proximity grievance procedure; the correction of original construction and sign deficiencies; the advertising of Dunkin'

Donuts stores for sale; the cost of living increase on store rentals; the use of advertising fund revenues; and policies with respect to remaining non-4.5% stores.

Probably the most important developments of this initial activity was the adoption of the $2,000 ceiling on cost of living increases in newly signed store leases, as urged by CFA, and the adoption of a nationwide program by Dunkin' Donuts to correct original construction deficiencies and to aid in sign repair and maintenance. This action by the company, as well as action on the other six issues identified, was very substantially motivated by CFA.

The budding association was beginning to show some weight in speaking out for the franchisees. It is recognized that the company has not, as yet, cured the cost-of-living increase complaint that still exists in many older store subleases. This is one of the issues that will probably be resolved by the court in the Dunkin' Donuts Philadelphia class action. Had CFA the initial strength to persuade the company to make some reasonable revision of the cost-of-living increase clause in existing subleases, and to make some reasonable accommodation on certain other grievances, perhaps the Philadelphia class action never would have been filed! It is the aim of CFA to get things done without having to file lawsuits.

Over the years, CFA has grown in both membership and influence. It may be difficult, sometimes, for the average franchisee to appreciate the benefits he has received from CFA's existence and activities. Most particularly is this expected to be true as to CFA's recent successful efforts in persuading the company to adopt a position indicating a willingness to submit franchisee grievances to binding arbitration. Through an arbitration process, the franchisees should have an excellent tool not only to resolve their individual grievances, but also to resolve common problems. Common problems might include, for example, complaints that company promotions or operating procedures are designed primarily to increase gross revenues, and resulting percentage payments to the company, and not to increase operator profits. The example cited is in recognition of what we all hope is a serious complaint of past history. We hope the company will succeed in its present stated policy of trying to substantially increase operators' net profits.

In mid-1974, CFA initiated correspondence with the company in an attempt to persuade the company to adopt binding arbitration as a means of resolving franchisee grievances. The initial company response was that consideration would be given to the suggestion, but that it would probably be a year before any decision would be made. Copies of the correspondence exchanged were published in CFA News Letters.

CFA persisted. Early in 1975, the arbitration subject was placed on the agenda of the company's Midwest Advisory Council, through CFA efforts. Prior to the meeting, council members and the company were both furnished by CFA with comprehensive authoritative materials concerning the arbitration of franchise disputes. Both before and after the meeting, press releases were furnished the media, and CFA News Letters featuring articles on arbitration were published. CFA arranged for the Regional Director of the American Arbitration Association's Chicago office, and CFA's own general counsel, to make verbal presentations about arbitration at the Council's meeting. CFA's general counsel also prepared and distributed at the meeting an extensive written presentation. It was established that the company, as a member of IFA (International Franchise Association), had an ethical obligation to submit franchisee grievances to arbitration, if they could not be mutually resolved by the parties. The meeting was attended by the company's executive vice-president, its treasurer, and its general counsel. After the presentation and extensive discussion, in which the company participated, the council voted 12-1 for a resolution requesting the company to adopt a formal plan for the arbitration of disputes with franchisees. The trade media gave prominent publicity to the CFA arbitration presentation. All of the planning and preparation of correspondence, news letter articles, news releases, etc. were under the direction of CFA's general counsel. As a result of the successful work by CFA, the company immediately announced that it would consider the binding arbitration of franchisee grievances on a case by case basis.

CFA published in a news letter information concerning the procedures a franchisee should follow, up through requesting arbitration, in seeking a fair and expeditious resolution of his complaints against the company. The hearings in

one arbitration involving a former Dunkin' Donuts franchisee and the company have been completed, but no decision, as yet, has been rendered. CFA is not aware of any arbitration proceedings between a present Dunkin' Donuts franchisee and the company. However, the attorney who represented the former franchisee in the arbitration proceeding previously mentioned has advised CFA that he represents other Dunkin' Donuts franchisees, and that he strongly favors binding arbitration as a means of resolving disputes between a present franchisee and the company. The attorney cited the speed and informality of the process, all of which he felt contributed not only to an impartial resolution of the issues, but to a rapid healing of wounds that might not otherwise be achieved if the franchisee filed suit in court, or the franchisee decided that he'd rather "sit and stew" than sue.

The value of CFA's successful efforts cannot be measured by the number of arbitration proceedings that are held, but rather by the effectiveness of CFA's efforts in making the company and its officers and employees more respectful of the right of Dunkin' Donuts franchisees to obtain a prompt and fair resolution of their grievances, and to thereby resolve those grievances *before* they are submitted to arbitration. As a direct result of CFA's efforts, there is less reason than ever before for any Dunkin' Donuts franchisee, CFA member or otherwise, to sit and stew about grievances with the company.

There has been a noticeable improvement in company response to franchisee grievances in recent months. This is undoubtedly true in material part to CFA's existence and constructive activities, not only on the arbitration issue, but in other areas as well. There are certainly other contributing factors. In order to sustain and strengthen the efforts by CFA, greater membership and support from Dunkin' Donuts franchisees is essential.

Are you a paid-up member of CFA?

QUESTIONS AND ANSWERS ABOUT CONSOLIDATED FRANCHISE ASSOCIATION

Question: What is the Consolidated Franchise Association?

Answer. Consolidated Franchise Association, or "CFA," as it is more commonly called, is an independent national association of Dunkin' Donuts franchisees. Its sole purpose is to provide a more profitable and enjoyable business for all Dunkin' Donuts franchise operators.

Question. When and why was CFA formed?

Answer. CFA was formed in 1970 by a group of concerned and interested DD franchisees in the Mid-Atlantic Zone who were very discouraged by their efforts to communicate and solve their problems with the company through the company's advisory council system. It has continuously functioned to try to advance the interests, not only of its members, but of all Dunkin' Donuts franchise operators generally.

Question. What are the major goals of CFA?

Answer. The following major goals were adopted by the Board of Directors of CFA May 28, 1975:

1. To cause Dunkin' Donuts to institute a fair and equitable procedure, such as arbitration by a neutral party, to help resolve franchisee-franchisor disputes.

2. To cause Dunkin' Donuts to adopt a fair policy with respect to the locating of new stores and the operation of company stores.

3. To give franchisees control of promotional programs and advertising administrative costs, and to use a substantially greater portion of advertising revenues received from franchisees for purposes intended to provide more direct and immediate benefits to the franchisees.

4. To expand and improve the CFA insurance program.

5. To provide franchisees with greater assurance than presently enjoyed of renewal of their Dunkin' Donuts licenses and store leases, with no change in provisions other than those specifically advocated by CFA.

6. To provide greater freedom and fewer restrictions in the sale and transfer of franchise and lease agreements.

7. To limit cost of living increases on leases,* and tie the bases on percentage rent over-rides to the cost of living index.

*This is a reference to all leases, not just those more recent versions containing ceilings on cost of living increases.

8. To obtain increased services from Dunkin' Donuts, Inc., in exchange for the various fees franchisees pay to the company.

In addition to adopting the foregoing major goals, CFA has, from time to time, published position papers on issues of interest to DD franchisees.

Question. Who are the officers and directors of CFA?

Answer. The officers and directors are:

JIM CERAJEWSKI, Hammond, Indiana, Chairman of the Board and President.

PETER PALLANTIOS, Trenton, New Jersey, Board Member and Vice-President.

BILL HUTTENBERGER, Easton, Pennsylvania, Board Member and Secretary.

JOHN PLUHACEK, Willingboro, New Jersey, Board Member and Treasurer.

BOB BARRON, Elgin, Illinois, Board Member.

AL GOTTLIEB, Woodbury, New Jersey, Board Member.

JOHN RADER, Florham Park, New Jersey, Board Member.

There is presently one vacancy on the Board of Directors. It is presently anticipated the vacancy will be filled until the expiration of the present term by a member operator from the Dunkin' Donuts Southeast Zone.

Question. Who belongs to CFA?

Answer. There are presently 154 separate Dunkin' Donuts operators, representing about 300 individual stores, who are members of CFA. These members are located in twenty different states. New Jersey has the largest number of members. Michigan is next. Florida and New York are tied for third and fourth place.

Question. Why is there a need for CFA when we have company sponsored advisory councils?

Answer. The answer is twofold.

First, as independent businessmen, we have substantial investments of both time and effort in our Dunkin' Donuts shops. We need some means to let our voices be heard concerning decisions by the company that affect the way we run our shops. This is best accomplished by an independent association of DD franchisees.

Second, the company and we are both interested in seeing our shops realize greater bottom line net profits, and in maintaining and enhancing the Dunkin' Donuts public image. But the company prospers primarily from our gross sales, not our net profits. Many decisions have been made, especially in the area of promotions, that have been suspect of being aimed primarily at increasing our gross sales (and percentage payments to the company), and only secondarily at increasing our net profits. We have to remember, company executives are not only under pressure from us, but under perhaps even greater pressure from the company's stockholders to increase the company's net profits and dividends. These pressures result in conflicts. We have to be able to speak with strength as a united front if we want to avoid getting the short end of the stick in the resolution of the ultimate conflicts.

Advisory councils are only a half-step in the right direction. There are undoubtedly many conscientious and well-meaning franchisees who serve as advisory council members. But the councils are handicapped by their complete dependence on the company for support. Their only source of funds and operational support for holding meetings or maintaining any other activity is the company. Meetings are held when and where the company decides. Minutes are written by company personnel. Independent assistance from professionals, such as lawyers' accountants, association managers, marketing or advertising experts, etc., is not available. There is no means of support for an independent franchisee controlled news letter, legal bulletin, or other publication. There is no permanent staff for maintaining day to day operations. A completely independent national franchisee association, funded entirely by its members, would not be so handicapped. CFA is the only such association of Dunkin' Donuts franchisees.

The company has a staff of professional, technical and administrative personnel to assist it in its relations with us. We should have this same type of assistance, albeit on a smaller scale, to help us deal more effectively with the company, and to otherwise promote the interests of the franchisees in areas where we cannot rely, or prefer not to rely, on the company.

Question. What are some of CFA's accomplishments?

There are various accomplishments attributable solely to CFA's efforts. These include the following: a substantial reduction in many members' store insurance premiums; the formation of the National Advisory Council Chairman's Committee; the $2,000 ceiling on cost of living increases in current store subleases; the publication and distribution of news letters, legal bulletins and other informational material of particular interest to Dunkin' Donuts franchisees; the sponsorship of national and regional seminars; and, most recently, the stated willingness of the company to arbitrate many franchisee grievances rather than require the franchisee to go to court.

There are numerous other accomplishments where CFA's efforts undoubtedly contributed toward the realization of benefits by all DD operators. We have seen more improvement in general relations between the company and DD franchisees since the formation of CFA in 1970 than in the preceding years in which the company was franchising, in the opinion of many experienced franchisees. The common attitude of company representatives to franchisee complaints of gross injustices used to be "If you don't like it, sue us!" This attitude is no longer so common. Formerly ignored construction deficiencies are now being corrected. Franchisees are being consulted on premium promotions. More definitive quality specifications for Dunkin' Donuts products are now available. In recent months the company has been pushing the formation of purchasing groups. The company now expresses interest in shop profitability. These are all areas where CFA has publicly expressed concern. Such movement does not occur in a vacuum. Certainly, not all the credit is claimed by CFA. The threat of litigation, and the Philadelphia class action, have undoubtedly influenced the company and caused changes in Dunkin' Donuts policies and relationships with franchise owners. The efforts of many franchisees through advisory councils and other company sponsored groups have brought improvements. But when many franchisees speak as one through an association, and they do so in a more effective manner with the assistance of professional counsel, that movement occurs much faster than if they had acted, or failed to act, individually.

Question. What benefits are derived from CFA membership, and what is the cost of joining?

Answer. The principal benefit is that, by increasing CFA's membership, you increase its strength to work for all Dunkin' Donuts franchisees. You increase the weight of its voice in communicating with the company. You increase its ability to provide improved news letters, legal bulletins, and seminars for its members' benefit. You increase its ability to add even more services for its members. The cost is $100 per year, or only about $2 per week! A recent survey of CFA members indicates they are more than satisfied with this nominal investment.

Question. Is CFA a party to any litigation against the company?

Answer. Absolutely not CFA's only "involvement" of any nature in any litigation to date has been to publish information of interest to its membership about franchise litigation. There have been articles in news letters and legal bulletins concerning litigation between the company and Dunkin' Donuts franchisees. Recent articles about the Dunkin' Donuts Philadelphia class action have been published in the CFA Legal Bulletins. All litigation articles have been written in a professional manner by CFA's General Counsel. Many members have expressed appreciation upon receiving this relevant information that, for all practical purposes, is available to them only through CFA's publications.

It is true that three of the eight members of the CFA Board of Directors are individually involved as plaintiffs in the Philadelphia class action. This is because they were elected by the CFA membership in a completely democratic election. All Board decisions are made on the basis of the best interest of all CFA members, not just the minority directly involved in the litigation.

Question. What position has CFA taken with respect to the Dunkin' Donuts Philadelphia Class Action?

Answer. The only position CFA has taken on this litigation is that it has a responsibility to try to keep its membership informed about the status of the proceedings.

STATEMENT OF MARK J. KLEIN, GENERAL COUNSEL, CONSOLIDATED FRANCHISE ASSOCIATION, AN INDEPENDENT NATIONAL ASSOCIATION OF DUNKIN' DONUTS FRANCHISE OPERATORS

Mr. Chairman, Members of the Subcommittee. Franchisees have long awaited the passage of Federal legislation that would help remedy some of the abuses to which they have been subjected. I have spent many hours since 1967 representing franchisees and their associations in trying to help them, through both litigation and communications directly with their franchisors, resolve problems with their franchisors. It is with great hopes of obtaining some federal legislative relief, and of contributing to the passage of that legislation, that this statement is offered.

My introduction into franchising, as an attorney, came about in 1967 as a result of a very shocking and unjust franchise termination. Another attorney with whom I was then associated, Sheridan Morgan, and I had been retained to represent one Peter Price, the original franchisee of an International House of Pancakes ("IHOP") restaurant in Overland Park, Kansas. Mr. Price had been terminated by his franchisor, International Industries, Inc. ("International") after the following incident. Price discovered that he was paying excessive prices for dairy products from his "approved" dairy supplier, and took action that resulted in the termination of a kickback scheme whereby International received a rebate of 6% on all purchases of dairy products by IHOP franchisees in the Kansas City area.

Mr. Price, who was then in his early twenties, had purchased his franchise only shortly before with money borrowed from his recently widowed mother. The funds came from the modest estate of his father. The purchase was made in hopes of providing support for both Mr. Price and his mother. It turned out he was the victim of what, in our opinion, was a scheme that resulted in overcharges on almost everything he needed for the operation of his IHOP, all of which he had to purchase or lease from International or an "approved" purveyor. As a result of these overcharges, he had fallen behind in paying his financial obligations to International. Patience was exercised until he started getting bids from various dairies, and requested International, by letter, to change dairy suppliers to lower costs.

The ax fell suddenly and swiftly. He was served notices of termination and eviction (International was his landlord), and arbitration was demanded (in Los Angeles) with respect to amounts claimed due by International. The attorney who represented him in his franchise dealings, Barton Cohen of Overland Park, Kansas, wrote to International's attorney in hopes of selling the restaurant back to International. There was no response, only swift action resolutely followed to evict Mr. Price. As a result of this venture into franchising, which I believe lasted less than one year, Mr. Price lost about $35,000. This was the greatest portion of his father's estate.

The story, fortunately, did not end there. After his eviction, Mr. Cohen immediately referred Mr. Price to Mr. Morgan, and we filed an antitrust suit against International alleging an illegal tying arrangement. In 1970, after a few thousand hours of work preparatory to trial and trying to avoid arbitration in Los Angeles of amounts still claimed due by International, the suit was settled. Mr. Price, even after paying attorney's fees, was made whole.

Based upon my memory of circumstances in the franchising industry during that era, there were many other Peter Prices, few of whom either sought or were able to obtain equitable relief or reimbursement for their losses through legal action.

The Price case, as I said, was my introduction into franchising as a lawyer. My aggregate experience in the franchising area now includes the following: attorney for the class of plaintiffs in the IHOP class action, presently before the U.S. District Court in Kansas City, Missouri (denominated MDL No. 77),

and extensive participation in pre-trial discovery and settlement negotiation procedures; representation of several of the moving parties in the IHOP class action; representation of numerous other individual IHOP, Dunkin' Donuts, Wiener King and 7–11 franchisees concerning their franchise relationships or litigation with their franchisor; general counsel to Consolidated Franchise Association ("CFA"), an independent national association of about 200 Dunkin' Donuts franchisees; special counsel to the National A & W Franchisees Association; and formerly assistant general counsel of International Franchisees, Inc., a former national association of IHOP franchisees now merged into IHOP Franchise Association.

In the foregoing capacities, I have acquired a substantial amount of experience working with both franchisees and franchisors. Hopefully, my statement will be of assistance to you in considering S. 2335, the "Fairness in Franchising Act," which I will henceforth refer to as "the Bill."

It is intended that my statement be read in conjunction with the statement concurrently filed by Mr. James Cerajewski, the president of CFA, and it is suggested that his statement be read first as background for certain matters stated herein.

I. THE PRESENT STATUS OF THE LAW, AND ITS INTERPRETATION BY THE COURTS, IS INADEQUATE TO PROTECT THE RIGHTS OF FRANCHISEES FROM ARBITRARY AND UNREASONABLE TERMINATIONS. RELIEF THROUGH FEDERAL LEGISLATION IS ESSENTIAL

In 1968, Mr. Morgan and I were retained by Mr. Robert Helfenbein, the operator of two IHOP restaurants, one in Des Moines, Iowa, the other in Kansas City, Missouri, who was also a client of Mr. Cohen. Mr. Helfenbein, like Mr. Price, had great difficulties in meeting his financial obligations to International because of the massive scheme of overcharges. In addition, he refused to be forced to buy all of International's tied products and services, having determined that to do so would have meant economic suicide. He was evicted from his Des Moines IHOP. His eventual removal from the Kansas City IHOP was delayed until settlement of the IHOP class action, despite the denial of an injunction by the trial court pending trial of Mr. Helfenbein's antitrust suit against International, and the refusal of the U.S. Court of Appeals to reverse the trial court.

One of the principal reasons we were unable to enjoin International from terminating Mr. Helfenbein and pursuing summary eviction procedures in local courts was stated as follows in the Eighth Circuit decision:

"* * * There is no authority under the federal antitrust laws to enjoin state enforcement or remedy for collection of ordinary debts incurred for goods delivered or services rendered. As the Supreme Court said in *Bruce's Juices, Inc.* v. *American Can Co.*, 330 U.S. 743, 750 (1947): 'The Act prescribes sanctions, and it does not make uncollectivity of the purchase price one of them.' See also *Kelly* v. *Kosuga*, 358 U.S. 516 (1959)."

Helfenbein v. *International Industries, Inc.*, 438 F.2d 1068 (8th Cir. 1971), cert. den. 404 U.S. 872. To put it in a nutshell, the federal antitrust laws are considered only a sword, not a shield, as far as past offenses and subsequent consequences are concerned. An injunction under Section 16 of the Clayton Act (15 U.S.C.A. Sec. 26) is obtainable only to prevent the commission of an act which itself is prohibited by the federal anti-trust laws.

This background introduces us to one of the very important reasons for passage of federal[1] legislation to prevent abuse of the right of franchisors to terminate or refuse to renew franchisees, most particularly those who, like Dunkin' Donut and IHOP franchisees, are also the tenants of their franchisors. According to a survey conducted about 1970, about 40% of the fast food franchisors surveyed controlled the land and building, by ownership or master lease, on which their franchised outlets were located.[2] Termination of the franchise is

[1] Reference is made here to the need of *federal* legislation without further comment. I wish to support and adopt the arguments advanced in the Statement of Timothy H. Fine previously filed in behalf of the National Franchise Association Coalition, starting at page 3.

[2] U. B. Ozanne and S. D. Hunt, *The Economic Effects of Franchising*, at 4-29 to 4-30 (1971).

ordinarily grounds for termination of the lease. The control of real estate is therefore a very important factor when considering remedies for franchise abuses.

The right of termination is made especially effective by summary dispossess proceedings under state law. Under most state unlawful detainer and forcible entry statutes, the sole issue is right to possession. The right to present counterclaims or affirmative defenses is denied. The presentation of equitable defenses is ordinarily denied, or strictly limited. See, e.g. *Union Oil Co.* v. *Chandler*, 4 Cal. App. 3d 716, 84 Cal. Rptr. 756 (1970); *White* v. *Ziegenhardt*, 339 Mich 195, 63 N.W. 2d 625 (1954); *Drzewiecki* v. *Stock-Daniel Hardware Co.*, 293 S.W. 441 (Mo. App. 1927); Note, *Lease Termination: Use of Summary Dispossess Proceedings to Effectively Terminate A Franchise*, 33 Ohio St. L. J. 705 (1972).

There is a frightful collection of franchisee termination cases that apty illustrate the plight of the franchisee in obtaining judicial recognition of his equities.[3]

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[3] Plaintiff auto dealers brought action against the manufacturer and another dealer, after plaintiffs' dealership were terminated, charging violations of §1 and §2 of the Sherman Act. *Held*, defendants' motion to dismiss granted; facts alleged show no injury to public, or restraint of trade, or monopoly. *Schwing Motor Co., v. Hudson Sales Corp.*, 138 F. Supp. 899 (D Md. 1956), *aff'd* 239 F. 2d 176 (4th Cir. 1956), *cert. denied*, 255 U. S. 823 (1957).

Defendant's division manufacturing radios and televisions terminated, on ten days' notice, the plaintiff's "regional merchandiser's agreement." When plaintiff brought suit to resist termination, the court held that he had no right under the contract to buy certain inventories and that the agreement was terminable at will without regard to good faith. *Rubinger v. International Telephone & Telegraph Corp.*, 193 F. Supp. 711 (S.D. N.Y. 1961), *aff'd* 310 F. 2d 552 (2d Cir. 1962), *cert. denied*, 375 U.S. 820 (1963).

Plaintiff's beer distributorship for Stroh's Brewery was terminated, whereupon Kohn opened up a warehouse and began acting as Stroh's distributor in the area. Plaintiff's managers, salesmen, and drivers quit their jobs at the same time and started working for Kohn. Held, no violations of the federal antitrust laws. Mere tortious behavior is not an antitrust violation; nor is the replacement of one distributor with a new distributor, where no restraint of trade results. *Ace Beer Distributors, Inc. v. Kohn, Inc.* 318 F. 2d 283 (6th Cir. 1963), *cert. denied*, 375 U.S. 922 (1963).

Defendant had the right to terminate the distributorship on three days' notice, under clear and unequivocal contract language; summary judgment for defendant. *Jay-El Beverages, Inc. v. Miller Brewing Co.*, 461 F. 2d 658 (3d Cir. 1972).

Where provision in the franchise agreement permitted termination by either party "at any time with or without cause," cancelling franchisor with superior bargaining power did not breach contract or act in bad faith. Plaintiff unsuccessfully raised U.C.C. arguments including unconscionability. *Artman v. International Harvester Co.*, 355 F. Supp. 482 (W. D. Pa. 1973).

Clause providing for termination on ninety days' notice was not unconscionable. Plaintiff tried to use both contract and antitrust arguments and lost on both. *North Penn Oil & Tire Co. v. Phillips Petroleum Co.*, 358 F. Supp. 908 (E. D. Pa. 1973).

Termination for plaintiffs' failure to stay open on Christmas day, as defendant required, was approved by the court. Plaintiff's antitrust argument rejected on ground that plaintiff and defendant were not two separate entities which could form a conspiracy; plaintiff's public policy argument was rejected on ground that Pennsylvania had no public policy against such termination. *Goldinger v. Boron Oil Co.*, 375 F. Supp. 400 (W.D. Pa. 1974).

Where defendant producer of a certain petroleum product terminated its relationship with the plaintiff distributor, and sold the product directly to a major account (Chevrolet), thus eliminating plaintiff as a middleman, defendant was granted summary judgment on plaintiff's charges under Sherman and Clayton Acts. Even if there were "inequities" the court said, there was nothing destructive of competition when a manufacturer made such changes in his distribution system. *B & B Oil & Chemical Co. v. Franklin Oil Co.*, 293 F. Supp. 1313 (E.D. Mich. 1968).

A contract provision allowing termination upon proper notice is absolute and not subject to challenge on grounds of unreasonableness, unfairness, lack of good faith, bad faith, motive, intent, or detriment to the plaintiff. *Martin v. Ford Motor Co.*, 93 F. Supp. 920 (E.D. Mich. 1950).

Plaintiff subfranchisee tried to challenge subfranchisor's forced repurchase of a root beer franchise. The plaintiff won a jury verdict on both his antitrust and his contractual arguments, but the court granted judgment n.o.v. for he defendant. *BBCI, Inc. v. Canada Dry Delaware Valley Bottling Co.*, 393 F. Supp. 299 (E.D. Pa. 1975).

In applying New Jersey law, the court decided that this sales relationship was *not* a "franchise" within the New Jersey Franchise Practices Act. Under New Jersey common law, the contract clause giving a right to terminate on fifteen days' notice, without cause would not be void for "economic duress" due to defendant's superior bargaining power. *Business Incentives Co., Inc. v. Sony Corp. of America*, 397 F. Supp. 63 (S.D. N.Y. 1975).

In an ejectment action by plaintiff lessor, the court gave judgment to the plaintiff, treating the case as a straighforward lessor-lessee siuation. Defendant argued U.C.C. unconscionability and argued that the franchisee needs protection from manipulation by powerful franchisor. The court responded by saying it would not engage in the "fantasies" which some other courts had used to protect franchisees. It noted that freedom of contract is the basis for the "vitality of our marketplace." *Texaco, Inc. v. A. A. Gold, Inc.*, 78 Misc. 2d 1050, 357 N.Y.S. 2d 951 (Sup. Ct. 1974) aff'd mem. 358 N.Y.S. 2d 973.

(Continued)

What you can't see from reading the cases is the tremendous advantage the franchisor has in terms of both finances and expertise in one on one legal conflicts with its franchisees. The franchisee's attorney may have little background in franchising compared to the franchisor's attorney. When a franchisee dares go to court to battle a franchisor, the franchisor will often try to overly impress the court with the testimony, presence and affidavits of its top executives. In one 1975 case before a master in Worcester, Massachusetts involving an IHOP client of mine, International was represented during the whole week long hearing not only by its local counsel, but also by its general counsel, another of its corporate counsel, and its treasurer. At an earlier hearing the President of its IHOP division appeared. Affidavits of senior executives lauding the intents and procedures of the franchisor flow profusely. Sometimes, however, they are not very accurate, or are inconsistent with statements filed in other matters.

Consider, for example, an affidavit filed by Al Lapin, Jr., as president of International, in the Peter Price case, wherein he states, in defense of International's Los Angeles arbitration situs (at page 2):

"* * * The requirement for arbitration of disputes has been inserted by defendants in all of their License Agreements solely in order to assure to all parties a fair, impartial, expeditious determination of all disputes by arbitration panels composed of attorneys and technical experts in the food and restaurant industries, at a forum which is uniformly the most proper upon a balancing of all consideration and conveniences."

And at page 8:

"Separately from the question of choice of forum, the uniform provision of every License Agreement for the submission of disputes to arbitration represents a conscious effort to provide for the resolution of disputes in the manner deemed to be most efficint, expeditious and fair to all concerned therein. Most of the restaurants in the franchise chain are located in major metropolitan areas, whose courts of law are generally beset by crowded calendars and consequently substantial delays in obtaining resolution of actions brought therein; whereas the relationship between a franchisee and our company, which is generally a continuing one despite the existence of a temporary dispute, would be far better served and appreciably enhanced by the prompt and expeditious resolution of such disputes between us. Arbitration of such disputes under the Commercial Arbitration Rules of the American Arbitration Association can usually be secured and brought to resolution within two to three months after arbitration proceedings have been commenced. The less formal and rigid atmosphere of an arbitration hearing, the more flexible nature of the hearings, and the somewhat broader powers of the arbitrators to achieve substantial justice are all more highly conducive, than would be a contested and adversary court trial, to the settlement of disputes in a manner promotive of amicable continuing relationships among the disputants."

Compare Mr. Lapin's remarks before the Anti-Trust and Monopolies Subcommittee of the Senate Judiciary Committee in hearings on the Franchise Competitive Practice Act of 1967, Senate Bill 2321, to wit (at page 187 of printed record):

"Let me discuss one other provision of the bill: Section 5. This section states that if the franchise agreement contains a formula for fair and equitable arbitration which provides for the items covered by Sections 3 and 4 of the bill,

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(Continued)

In an action by lessor under forcible entry and detainer statute; defendant's default in rent and other payments entitled plaintiff to possession, and defendant would not be allowed to raise antitrust issues in defense. *Clark Oil & Refining Corp. v. Thomas*, 1975-2 CCH Trade Cases (App. 1975).

Following the rule of the *Thomas* case above, the court would not permit defendant to raise antitrust issued in defense where plaintiff's right to possession was based on plaintiff's exercise of its right to terminate the lease at end of term. *Clark Oil & Refining Corp. v. Banks*, 1976–1 CCH Trade Cases, par. 60,703 (Ill. App. 1975).

The following cases indicate that even under the Auto Dealer's Day in Court Act, 15 U.S.C. § 1221-25 (1970), Auto dealers may be unable to challenge terminations made under arguably unfair circumstances:

Ford's field manager at one point said "Look, Kotula, if its (sic) the last thing I ever do, it will be to make you wish you were never a Ford dealer in your life." 338 F. 2d at 736. Held, the termination was not causally connected with this and other alleged coercive or intimidating acts, and the termination would be upheld. *Kotula v. Ford Motor Co.*, 338 F. 2d 732 (8th Cir. 1964), cert. denied, 380 U.S. 979 (1965).

Manufacturer first urged plaintiff to make unnecessary expenditures, but later terminated him; termination upheld. *Walker v. Ford Motor Co.*, 241 F. Supp. 521 (E.D. Tenn. 1965).

then Sections 3 and 4 of the bill shall not be applicable. I do not believe that this will be satisfactory to either party. Long delays in arriving at decisions will be experienced, litigation generally will follow, and all during this time the unsatisfactory franchises will still be in operation to the detriment of the franchisor and the other franchisees. It is an unworkable approach. Disputes should be left to the parties.

"We have found the answer to lie, not in arbitration after the fact, but in care and evaluation, at the very outset, in the selection of the franchisee. This, coupled with full disclosure leads to a happy marriage between franchisor and franchisee. This cannot be legislated. The courts are the proper arena for disputes. A contract soundly conceived, freely negotiated, and entered into with full understanding of the parties, seldom ends up in court. This should be the case with the franchise system, too. This bill attempts to legislate against the vast majority of franchisors in order to punish the few who enter into the marriage fraudently."

Undoubtedly, the franchisers have been very successful in impressing local judges with such tactics.

In numerous instances involving Dunkin' Donuts franchisees, such as Mr. Richard Bolinger, Jr. (See Exhibit 5) the franchisee was not able to timely pay his bills primarily through the fault of his franchisor, not himself. He had to pay excessive rent to the franchisor. He had to pay excessive amounts to his franchisor for equipment and signs. He had to pay for services that either weren't furnished, or were grossly deficient. He had to contend with construction deficiencies that seriously interfered with the operation of his shop. He had to contend with subsequently built Dunkin' Donuts shops that substantially reduced the market of customers he thought he was originally buying. He had to contend with franchisor-owned Dunkin' Donuts shops in his area that sold donuts at prices with which he couldn't compete. He had to subscribe to franchisor initiated promotions that may have increased his volume of sales, but at a net loss to him. He had to do his best with a poor site selected by his franchisor. Any one or more of these factors may have been present. Yet his only remedy was to file suit for damages against his franchisor, while the franchisor could evict him under summary disposses procedures.

The franchisee's problem is further compounded by difficulties in obtaining competent assistance from a lawyer ready, willing and able to devote himself to the mountainous task of trying to help the franchisee solve his dilemma. This is not a very desirable type of business for the ordinary lawyer. The franchisee is down and out, financially and spiritually. He is neither willing nor able to finance and suffer through extensive litigation against an opponent with vastly superior economic resources. And even if the attorney were successful, after countless hours of effort, in enjoining a termination, who is going to pay him? Even under the antitrust laws, the franchisor could not be required to pay the franchisee's legal fees attributable to obtaining the injunction. *Calnetics Corp.* v. *Volkswagen of America, Inc.*, ——F.2d——, 1976–1 Trade Cases Par. 60,757 (9th Circ.) ; *Alyeska Pipeline Service Co.* v. *Wilderness Society*, 421 U.S. 240 (1975).

In these situations, the franchise is sometimes sold back to the franchisor, or another party, and is sometimes abandoned. There are some evictions by summary dispossess proceedings. Relatively few franchisees have resisted, from my experience.

In resales to the franchisor, sometimes the franchisor will refund the original purchase price, less the franchisee's substantial indebtedness to the franchisor. Other times the franchisor will pay little or nothing to the franchisee, other than forgive his debts, and sometimes even do less than this. On resale to the franchisor, it is my general experience that the franchisee must release the franchisor from all claims, thereby depriving himself of any reasonable opportunity to obtain reimbursement for his losses via litigation. It is ordinarily a very expensive lesson to the franchisee.

These resales back to the franchisor are the justification for franchisor's claims that there are very few terminations. But the threat of termination, either express or implied, is always there.

The threat of termination, with little hope for success in obtaining relief via an equitable defense or an injunction, coupled with the franchisee's financial inferiority to the franchisor, puts the franchisee at a hopeless disadvantage in

the greatest majority of cases. No one expects the Congress to equalize the financial resources of the parties. But the Bill, through its prohibitions and its remedies, most particularly the provision of injunctive relief and attorneys' fees, should help remedy the legal disadvantage.

Should the Bill be passed, and the Congress clearly spells out its intent that franchisees should be afforded, in effect, an opportunity to raise equitable defenses to termination and summary dispossess proceedings, then franchisors will be much more hesitant in exercising termination powers and refusing to renew franchises in situations where it appears that the franchisor itself is at fault.

It is my experience that franchisors often set prices for rent and services, and even for some tangible items, sold to franchisees at what the franchisor feels the market will bear, regardless of any determination of a fair or competitive price.[4]

For example the 5.2% (or 6.2% in some cases) service fee International charges its IHOP franchisees covers a conglomeration of services, such as bookkeeping. It is not merely a "royalty." Store rent is often excessive. There is usually a lot of leeway for the franchisor to make "adjustments" where its calculations of "what the market would bear" fall short. Were it more difficult for the franchisor to terminate in such situations, we would find it more willing to make adjustments in the price of goods and services it furnishes to the franchisee.

This should work no great hardship on the franchisor. Such adjustments may have to be made in reselling the franchise to subsequent franchisees anyway. The franchisor is just being deprived of the unconscionable profits from reselling the same store over and over again.

II. THE RETENTION OF SMALL, INDEPENDENTLY OWNED BUSINESSES AS A VIABLE FACTOR IN THE NATIONAL ECONOMY IS IN THE BEST INTEREST OF THE COUNTRY AS A WHOLE. THE FAILURE OF CONGRESS OR THE COURTS TO EFFECTIVELY PROHIBIT UNREASONABLE OR ARBITRARY TERMINATION OF FRANCHISES AND FAILURES TO RENEW WILL RESULT IN THE CONCENTRATION OF CONSTANTLY INCREASING AMOUNTS OF AMERICAN BUSINESS IN RELATIVELY FEW LARGE CORPORATIONS, AND DECIMATE THE NUMBERS OF SMALL BUSINESSMEN THROUGH "CREEPING GOBBLISM"

In Klor's Inc. v *Broadway-Hale Stores, Inc.*, 359 U.S. 207, it was held (at pages 212–214):

"Plainly the allegations of this complaint disclose such a boycott. * * *

"As such it is not to be tolerated merely because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy. Monopoly can as surely thrive by the elimination of such small business men, one at a time, as it can by driving them out in large groups. In recognition of this fact the Sherman Act has consistently been read to forbid all contracts and combinations which 'tend to create a monopoly,' whether 'the tendency is a creeping one' or 'one that proceeds at a full gallop.' *International Salt Co.* v. *United States*, 332 U.S. 392, 296 * * *."

The implication is clear. Small businesses *are* an important segment of the American business community. Congress, through passage of the anti-trust laws, has indicated its concurrence. But what is going to happen to these small businesses if franchisors are left unrestrained in their power to terminate and fail to renew franchises? The loss will not be exclusive to the individual franchisees who have lost their businesses. All of us will suffer from the resulting decrease in competition. The gradual gobbling up of small businesses by the large franchisors is what I will refer to as "creeping gobblism."

In 1970, the Senate Select Committee on Small Business reported:

"Franchising is a marketing concept. It is a system of distribution which accounts for a very substantial portion of our current business economy.

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[4] See, for example, the April 17, 1973 deposition of Al Lapin, Jr. (Ex. 10 B), Vol. II, pp. 37–41 where he discusses in detail the various services offered by International to IHOP franchisees, and how the prices were established. It is my understanding, based on discussion with Tom Stevens, one of plaintiffs' attorneys in the Dunkin' Donut class action, that originally this was the methd Dunkin' Donuts used to set store rentals, and that a specific formula was later established. Mr. Stevens' information was based upon knowledge gained in litigation discovery.

"As pointed out earlier, statistics are scarce and those that are available are not necessarily accurate. Yet we can safely estimate that franchising has reached a level of at least $90 billion in annual sales and may now be approaching $100 billion. There are somewhere between 450,000 and 600,000 franchise units operating in the country today. Franchising is rapidly expanding and is providing vast new opportunities for business ventures.

"* * *.

"Recently, large established corporations began to invade the franchise field, buying up successful franchisor organizations * * *.

"The entrance of these large corporations into franchising will undoubtedly change the market structure of franchising. The large firms may provide more stability but they may also reduce competition by intensifying concentration and integration. This is an open question and needs more study.

"A similar trend that appears to be developing is the practice of buying up or acquiring successful franchises by the franchisor.

Such a practice could also produce unhealthy competitive results and it is not known how extensive the practice is. This, too, should be a subject for further study.

"* * *.

"New franchisees are coming into the system at the rate of approximately 40,000 per year. During the past 5 years, the number of companies offering franchises has more than tripled.

"Within the next 10 years, there may be approximately 500,000 new franchisees doing business. If this rate of growth continues through the seventies, franchising will account for $165 billion in annual sales by the end of the decade.

"Franchising sales now account for about 26 percent of all retail sales. * * *" Senate Committee on Small Business, *Impact of Franchising on Small Business*, Report No. 91–1344, 91st Cong., 2d Sess. (1970).

More relevant information was provided by the Ozanne and Hunt Survey of fast food franchisors, from which the following facts and conclusions are drawn:

1. During the 1960's, franchised units grew from 16,200 in 1960 to 38,100 by the end of 1970. During the same period company-operated units rose from only 200 to 4,000, and as a percentage of total units from 1.2% to 9.5%.

2. The trend toward increased company ownership was expected to continue because the growth of a franchise system would enable it to finance more company-operated units.

3. Franchisers were asked "what percentage of total units should ideally be company operated (?)" The mean response was 42%. 18% of the franchisers responded that *all* units should be company owned! As to this 18%, the authors commented "Obviously, these firms are in franchising because they do not (or did not) have the necessary capital to expand solely through company-operated units." (What will happen when they finally obtain this capital?)

4. Census figures showed that the total number of restaurant and especially food stores of all types increased only 2.8% between 1960 and 1969, but that franchised units grew by 116%.

5. Sales of franchised units grew from $1.62 billion in 1960 to $5.40 billion in 1970, an increase of about 250%. Sales of company-operated units rose from $40 million in 1960 to $940 million in 1970, an increase of about 2,350%.

6. Although company-operated units are only 9.5% of all units, they have 14.8% of all sales. (This means either that the company is keeping the best locations for itself, or that company stores are better managed. From what knowledge I have of company operations, the former seems much more likely than the latter.)

Ozanne and Hunt, *The Economic Effects of Franchising*," pp. 2–3, 2–4.

The Senate committee report and the Ozanne and Hunt survey are several years old now. During the intervening years, we have all noticed that the rapid growth of franchising has continued unabated, thereby laying a growing foundation for creeping gobblism.

As to the growth in the number and percentage of company-operated units, I do not presently have current figures. I do know the situation with Dunkin' Donuts, which Jim Cerajewski discusses in his statement, and which is the

subject of comment in the company's 1974 and 1975 annual reports. The company specifically states that it is concentrating more on the growth of company-operated units because it can realize greater profits from this source than from franchised units. The number of shops "permanently" operated by the company increased from 8 at the end of fiscal 1973 to 19 at the end of fiscal 1974, and to 48 at the end of fiscal 1975, an increase of some 500% in two years! (The Dunkin' Donuts fiscal year ends the last Saturday in October.) During the same period the total number of Dunkin' Donuts shops increased from 736 to 820, an increase of about 11%. The increase in shops permanently operated by the company included 33 shops acquired from franchisees.[5]

The franchisors would prefer that the whole issue regarding terminations and renewals be left to their paternal benevolence. They insist that they must retain virtually unlimited control over the franchisees in this regard to protect their trademarks under the Lanham Act, and that they have not abused their right of termination and renewal. Their reasoning is countered elsewhere in this statement. Let's examine what could happen if their power is left unchecked.

Franchising of IHOP restaurants began in 1959 with the sale of rights to the Louisville, Kentucky marketing area. The original growth of the IHOP concept in several parts of the country was through about 6 or 7 area franchisees, whose obligation it was to build, and supervise the operation of IHOP restaurants in their respective areas. Area franchises were sold between 1959 and 1962. When International determined in 1962 that the area franchise concept was "not to be a viable way to distribute," the area franchises, with one exception, were "eliminated * * * as quickly as we could." [6]

The last of the area franchises was acquired in about 1969. This was Restaurant and Waldorf Associates, the area franchisor for the New England area, Restaurant and Waldorf Associates was then a rather sizable company itself, with many different food service operations in several different parts of the country. The acquisition came as a result of either litigation, or threat of litigation, by International, in an attempt to terminate the area franchise.

The one IHOP area franchisee remaining today is the sub-licensor for the Florida area, a corporation that was owned (at least, as of April 17, 1973) by Mr. Abe Finkel and Mr. and Mrs. Al Lapin, Jr. Mr. Finkel, in about 1965 or 1966, went to Mr. Lapin (then the president of International) and, out of gratitude for Lapin having sold him the area franchise, which had become successful, gave Lapin 50% of the stock in his corporation.[7] I assume it is only coincidental that this corporation is the sole remaining IHOP area franchisee.

If International, through deliberate effort, can "eliminate" its area franchisors, at least one of which was a sizable company itself, what's to stop it from doing the same with its individual franchisees? And if International can do this, what about other franchisors? (As a point of information, I believe there is at least one franchisor that has taken this step, Howard Johnson.)

Dunkin' Donuts states "The Company typically earns greater profits and a higher rate of return on its development and operation of Company-owned shops than in franchised shops." [8]

Doesn't management have a duty to its stockholders to continually increase its profits by reacquiring more and more shops from franchisees as the opportunities present themselves? And what is to stop zealous company executives from making use of termination powers and the power not to renew a franchisee once his term, and any options, expire? The courts have already exhibited great reluctance in protecting franchisees. They don't have the right law yet on which to hang their hat. It is high time the Congress stopped studying and started acting by passing the Bill. Creeping gobblism must be stopped *now*.

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[5] Dunkin' Donuts Annual Report 1974 (Ex. 4), pp. 4, 5, 13; Dunkin' Donuts Annual Report 1975 (Ex. 1), pp. 4, 5, 6, 8, 10, 14, 16.

[6] Depositions of Al Lapin, Jr. April 16, 1973 (I), April 17, 1973 (II), and May 10, 1973 (III) (Extracts are appended as Exhibits 10 A, B and C). See pp. I—156, 166; II—60, 75; III—90. Al Lapin was one of the founders, and the former president and chairman of the Board of International Industries, Inc., the International House of Pancakes franchisor.

[7] Al Lapin, Jr. Deposition (Ex. 10 B), Vol. II, pp. 121–125.

[8] Dunkin' Donuts Annual Report 1975 (Ex. 1), p. 8.

III. THE UNYIELDING DEMAND OF THE FRANCHISORS TO RETAIN UNFETTERED CONTROL OF THE FRANCHISEES THROUGH POWERS OF TERMINATION AND FAILURE TO RENEW IS WITHOUT JUSTIFICATION. TRADEMARK RIGHTS CAN BE ADEQUATELY PROTECTED BY JUDICIOUS SELECTION OF FRANCHISEES IN THE FIRST INSTANCE, BY THE PROMULGATION OF STANDARD OPERATING PROCEDURES IN COOPERATION WITH FRANCHISEES, AND BY PROMPT, FAIR AND NON-DISCRIMINATORY APPLICATION OF THOSE STANDARDS. THE RETENTION OF EXCESSIVE CONTROL BY FRANCHISORS OVER FRANCHISEES THROUGH POWERS OF TERMINATION AND FAILURE TO RENEW PROMOTES A CONTINUATION OF FRANCHISE ABUSES

On April 20, 1966, Al Lapin, Jr., as president of International, addressed a panel of security analysts in New York, and made the following remarks:

"The moment someone decides to become a franchisor—whether his product is gasoline or cars; or as in our case, meals, he's got to ask himself one very basic question.

"That questions relates to the control the franchisor exerts over the franchisee. It is not a question of "How Much Control?" because control, like marriage or pregnancy, is a matter of "whether or not." Either you have it or you don't; in our philosophy there can be no degrees.

Controls Very Necessary

"At International Industries we have control.

"To some people, it's an ironic thing for a man to invest $40,000 ($25,000 of which is cash and is probably his life savings) for an International House of Pancakes franchise license, and then to be told in effect, "Thank you very much. Now, here's what you're going to do; this is the way an International House of Pancakes restaurant is run." Some prospective franchisees resent this. We try, through our psychological testing, to weed out such a prospect. No matter how well qualified he may be, the man who wants an International Industries franchise and gives, as his reason, the fact that he does not want to take orders, does not become an International Industries franchisee.

"Our operating manual is our bible. It must be the bible of each operator of each of our 144 restaurants throughout the United States and, in turn, each operator must make the employees' section of this manual the bible of each employee.

"And so, when you sit down at an International House of Pancakes, the waitress will come to your table and say "Hello, my name is Mary (or whatever her name is). How many would like coffee?"

"She says this, or faces the penalty of instant dismissal.

"At International Industries, control means that you will find the same menu, with meals made of the same high quality ingredients, and prepared and served in the same manner whether you're in St. Louis or Santa Monica, Chicago or Ft. Lauderdale, West Hempstead or West Los Angeles—in any one of the cities in each of the 26 states where we now have locations.

"And so to summarize, International Industries, Inc., as a franchisor, writes its own operating rules; insists, and sees to it, that these rules are followed; and turns away prospective franchisees who have the money for a franchise but lack the willingness to the job the International Industries, Inc. way.

"These controls are not luxuries which we, as a successful franchisor can afford. The fact is that we can't afford not to have them. They are among the major reasons for our success in each of our corporate roles."

An Address to a Meeting of Security Analysts by Al Lapin, Jr., President of International Industries, Inc., New York, April 20, 1966 (Ex 9), pp. 5–6.

The philosophy of International at that time was just as Mr. Lapin stated, to absolutely control every aspect of an IHOP franchisee's operations of his IHOP. To cement that control, International inserted in the standard form of licensing documents it "negotiated" with its IHOP franchisees, which documents included a sublease of their restaurant premises, two particular provisions. One required that all disputes relating to the franchise relationship, including "any claim that this agreement is invalid, illegal, or otherwise voidable," should be arbitrated *in Los Angeles California*. The other gave International the right to reacquire possession of the franchised premises upon defaults through summary dispossess proceedings. The wording of the agreement

to arbitrate effectively foreclosed judicial relief from arbitration unless the franchisee could prove fraud in the inducement of the arbitration clause itself. Sec. 2, U.S. Arbitration Act, 9 U.S.C.A. Sec. 2; *Prima Paint Corp.* v. *Flood & Conklin*, 386 U.S. 952; *Moseley* v. *Electronic & Missiles Facilities*, 374 U.S. 167. This is an extremely difficult task.

During the 1960's, International was a tyrant to its franchisees, in my opinion. Virtually everything a franchisee needed for the operation of his IHOP had to be purchased or leased from International or an "approved" purveyor. International admitted that it had arrangements to obtain rebates from many of the "approved" purveyors up until about 1969. The result was excessive costs to franchisees. Some franchisees were able to succeed despite the excesses. Many, however, succumbed, and were either evicted or resold their franchises to International. Some locations, over a relatively short period of time, had 3 or more franchisees.[9]

During this period, International jealously guarded its revenues in each of several areas from its franchised outlets, or "profit centers" as Mr. Lapin referred to them in his April 20, 1966 report to security analysts (Ex. 9, at pages 7–8). One of the principal duties of IHOP co-ordinators (International's field representatives who inspected IHOP restaurants) was to police the purchase of food items and supplies from "approved" purveyors. Franchisees who purchased from other purveyors were threatened with prompt eviction if they didn't abide by IHOP purchasing standards. Indeed, Mr. Price, whose indebtedness to International was not excessive in relation to what we understood other franchisees owed, was in fact very summarily evicted. His impertinent suggestion of a change in dairy suppliers cost International a lot of rebates.

The franchising atmosphere has improved since the 1960's. In my opinion, this has been a response primarily to two factors; the the filing of numerous franchise class actions, and the growth of independent franchisee associations. Indeed, Dunkin' Donuts didn't shift from its 19 year policy of concentration on expansion to a policy of concentration of increasing store profits until after the filing of a franchisee class action against it, and CFA started showing some strength.

Although seemingly reduced in number, the abuses remain, along with those tools of abuse, the power over the terminations and renewal. Consider the following examples of abuse:

Example.—Tom Schwarz, Executive Vice-President of Dunkin' Donuts, recently advised at least two Dunkin' Donuts franchisees that, once the Dunkin' Donuts class action is over, the company will do everything it can to remove the franchisees who filed the suit from the system.

Example.—Ira Nottonson, then legal counsel for International, advised me in 1974 that if Elliott Taylor, an IHOP client of mine from the Boston, Massachusetts area, pushed the arbitration of certain grievances he had against International, International would probably take steps to evict him for financial delinquencies.

Example.—Joseph C. Venziano, a Dunkin' Donuts franchisee from Memphis, Tennessee, very recently advised me (in part by letter, in part verbally) that, under threat of termination of his franchise by Dunkin' Donuts, he had agreed to sell his store to Mrs. Calvin Davis, but that Mrs. Davis backed out after she was treated very rudely by Dunkin' Donuts officials at Dunkin' Donuts University where she was taking preparatory training.[10]

Example.—The Dunkin' Donuts Franchise Agreement provides no right or renewal or equity upon expiration, and "the franchisor recognizes no limitations on its right to renew or refuse to renew the franchise and/or any related agreement." [11] The only recognition Dunkin' Donuts has given to renewal rights is in an offer to its francisees to grant a 5 year renewal and institute an annual ceiling on Consumer Price Index increases in store leases in exchange for a complete release from any claims the franchisee may have against the company at the time of execution of the release, including rights in the Dunkin' Donuts class action. Renewal of the lease was conditioned upon several factors, such as payment of all costs by the franchisee incident to remodeling his

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[9] See historical record of IHOP franchisees at each separate IHOP restaurant, through early 1973, appended as "Exhibit 11."

[10] See statements of Mr. Venziano and Mrs. Davis appended as Exhibits 12 and 13.

[11] Dunkin' Dnuts Michigan Disclosure Statement (Ex. 7), p. 32, 36.

store, including exterior remodeling normally the responsibility of the lessor, and execution of a new release at the time of renewal that would effectively insulate Dunkin' Donuts from exposure to any lawsuits whatsoever by franchisees during the last few years of their initial terms.[12]

As long as the unrestricted powers of termination and renewal remain, the chance for a return of an era of gross and numerous abuses remains. History does repeat itself, especially after it is forgotten or ignored.

The only reason the franchisors don't want to give a court the power to review all of the equities behind a termination or a failure to renew is that they want to retain their present advantage of being able to rid themselves of an unwanted franchisee summarily, and only have to answer in damages to a severely weakened franchisee afterwards.

They want to retain leverage and every vestage of control over the franchise so as to make the franchisee more subservient to their dictates. Through this control, they can better encourage the franchisee to buy products and services from the franchisor, to participate in promotions of questionable value to the franchisee, to put up with the failure of the franchisor to perform required services, etc., all with a substantially reduced amount of flak from the franchisee.

The Eleventh Article of the International Franchise Association ("IFA") Code of Ethics encourages binding arbitration of franchise disputes.[13] A fairly conceived binding arbitration clause in franchise agreements would substantially reduce that control. As a result, this provision of the IFA Code of Ethics is generally ignored. In fact, it appears some IFA members aren't even aware of its existence. In 1975 I represented the National A & W Franchisees Association in negotiations at a meeting in Los Angeles with the President (Jim Lynch), legal counsel (Gerard Bastiaanse) and other executives of A & W International, Inc. over some long-standing unresolved disputes. I suggested that, in the event we couldn't resolve our differences by negotiation, the issues be resolved by binding arbitration in accord with the IFA Code of Ethics. Although the A & W franchisor was an IFA member, its representatives weren't the least bit familiar with the arbitration position of the IFA. It is merely a cosmetic for public relations purposes.

The franchisors demand that they retain those very powers over terminations and renewals, without legislation restrictions, that permit them to be tyrannical, paternally benevolent, or somewhere in between, whatever behavior suits their purpose at the moment. They express great distrust of their franchisees in the protection of their trademark rights.

What they fail to recognize is that, when they sell a franchise, they sell certain limited rights in their trademark. No matter what language of limitation may be included in the franchise agreement, the right to use that trademark is being shared to some degree with the franchisee. The franchisee himself has responsibility to protect that trademark in his own self-interest.

Granted, trademark priviliges may be abused by individual franchisees. But, in the nine years I have been closely associated with franchisees in several different systems, I have become convinced that, as a group, they abhor the individual abusers. They want the franchisor to initiate reasonable standard operating procedures, controls and restrictions, and to see that these procedures, controls and restrictions are enforced.

However, as independent businessmen who have substantial investments of both time and money, not only in their individual businesses, but in the good name of their entire franchise system, the franchisees want and deserve the opportunity to both communicate their views on standard operating procedures, controls and restrictions, and to have an impartial arbiter have binding authority to resolve all grievances between them and their franchisor, including claims that procedures, controls and restrictions instituted by the franchisor are unreasonable, illegal or arbitrary, without having to file a lawsuit.

It is not necessary for the franchisors to have absolute powers over terminations and renewals in order to protect their trademark rights. Such rights can be amply protected by acting in cooperation with the franchisees.

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[12] October 21, 1975 sample form of letter from Robert M. Rosenberg, President of Dunkin' Donuts Incorporated, and attachments. (Ex. 14).

[13] The IFA Code of Ethics, Article XI, states: "XI. A franchisor shall make every effort to resolve complaints, grievances and disputes with its franchisees with good faith and good will through fair and reasonable direct communication and negotiation. Failing this, recourse should be made, if possible, to arbitration, with litigation pursued only as a last resort."

The franchisor must start by being selective in selling franchises. Poor prospects must be weeded out before they shell out their money to the franchisor. The franchisor should also take the next step, adopt a fair and equitable binding arbitration procedure to resolve disputes with its franchisees.

The franchisees of each franchisor should form, if they don't already have one, or join, if they do, an independent franchisee association. A company-sponsored advisory council, in its usual form, will not suffice. Only through an independent association can the franchisees independently communicate with each other and their franchisor, and hire the expertise to do so effectively. The franchisor should recognize and deal with the association as the representative of its members.

The Congress must also act by passing the Bill to protect the franchisees from unreasonable and arbitrary terminations and refusals to renew.

If all of the foregoing steps take place, we will indeed find not only that the franchisors don't need their present powers of termination and refusal to renew to protect their trademark rights, but that the small franchised businessman will become an even stronger contributor to the value of franchise trademarks and to the economy and welfare of our country.

IV. SUGGESTED IMPROVEMENTS IN THE BILL

CFA adopts the suggested improvements referred to in a separate statement to be filed in behalf of the National Franchise Association Coalition ("the NFAC"), with the following revisions, and additions.

The "legitimate business reason" justification for failure to renew in Section 6(b) (1) (B) should be removed. It is subject to extremely broad interpretation. In effect, it gives the franchisor the power of eminent domain over its franchisees. A franchisee ordinarily invests time and effort in a business to earn income, not to sell it when the purchase appears advantageous to the franchisor. How do you set a "fair market value" for a business when you don't have a willing seller?

Section 3(4) (B) should be deleted. Section 3(4) (A) is sufficient to comprehend any exercise of bad faith by the franchisee that may justify termination or failure to renew. The term "bad faith," in and of itself, is excessively broad.

Both the provision recommended in paragraph (2) of the NFAC recommendation regarding binding arbitration, and the reference to binding arbitration in Section 8 (b) of the Bill, should be limited to arbitration at a situs convenient to the franchisee.

V. CONCLUSION

Passage of the bill, with improvements as suggested herein, is esesntial to reduce the amount of franchise abuses arising from the present powers of the franchisor to terminate and refuse to renew franchise agreements, and to reduce the incidence of vertical integration of small business in this country. In no way, shape or form will the ability of the franchisors to protect their trademarks be reduced, should the Bill be passed. To the contrary, passage of the Bill should help in a substantial way to enhance the contribution the small franchised businessman contributes to the value of franchise trademarks, and to the economy and welfare of the country.

CONSOLIDATED FRANCHISE ASSOCIATION ("CFA") EXHIBIT LIST

Exhibit No.	Description of Document
1	Dunkin' Donuts Annual Report 1975.
2	"CFA In Action . . . A Story of Results!"
3	"Questions and Answers about Consolidated Franchise Association."
4	Dunkin' Donuts Annual Report 1974.
5	Statement Regarding Personal Loss and Mistreatment by a Franchisor—Richard F. Bolinger, Jr.
6	Dunkin' Donuts News (Believed to be dated sometime in 1971—date is not legible or not imprinted on copies pages).
7	Dunkin' Donuts Michigan Franchise Investment Law Offering Circular.
7A	Dunkin' Donuts standard form of franchise agreement.
7B	Lease of Dunkin' Donuts Shop (standard form).
7C	Dunkin's Donuts standard form of Equipment Agreement.

CONSOLIDATED FRANCHISE ASSOCIATION ("CFA") EXHIBIT LIST—Continued

Exhibit No.	Description of Document
8	Appraisal of Vernon E. Lee to Mr. James Cerajewski, dated March 20, 1976.
9	An Address to a Meeting of Security Analysts by Al Lapin, Jr., President of International Industries, Inc., New York, April 20, 1976.
10	Extracts from Depositions of Al Lapin, Jr., In Re International House of Pancakes Franchise Litigation, MDL Dkt No. 77, U.S. District Court for the Western District of Missouri, Western Division, taken:
10A	April 16, 1973.
10B	April 17, 1973.
10C	May 10, 1973.
11	List of International House of Pancakes restaurants, with chronological history of operators.
12	Letter from Joseph C. Venziano to Consolidated Franchise Association, January 22, 1976.
13	Statement of Calvin and Teresa Davis (March 17, 1976) and letter from Calvin and Teresa Davis to "Mr. Rosenberg" dated February 27, 1976.
14	Form of letter from Robert M. Rosenberg, President, Dunkin' Donuts Incorporated transmitting to Dunkin' Donuts franchises an offer to revise their franchise agreements and shop leases and a general release form.

NOTE.—(The exhibits are in the committee files.)

STATEMENT OF ROGER L. BROWN, PRESIDENT OF AFRI-KINGDOM, INC.

My name is Roger L. Brown and I live in Elk Grove, Illinois. After a career as a professional football player with the Detroit Lions and the Los Angeles Rams, I retired and entered business. I was very much interested in the fast food franchise business. Being black, it was not an easy industry for me to get into with the established franchise companies; few of whom were expanding within the black community. Consequently, I set about forming my own franchise company built around a fried chicken product, hoping to expand my franchise system on a nationwide basis, in the black community. The name of our company was Afri-Kingdom, and we solicited the sale of franchises to black enterpreneurs, starting in the Chicago area.

I was the president of Afri-Kingdom, a Delaware corporation, which was formed on June 10, 1969, until it became defunct, in 1975. Afri-Kingdom gave franchises to operate fast food restaurants based around the central product of fried chicken. The franchisees each received a franchise for a term of twenty years, for a franchise fee, purchase of equipment and a three percent (3%) royalty under the franchise contract. Also, the franchisee leased his franchised premises from Afri-Kingdom and paid a base (minimum guaranteed) rent against a percentage rent, amounting to 8% of gross sales. The lease provided the restaurant could only be operated as an Afri-Kingdom franchise, and any default in the franchise agreement also became a default in the lease. The franchisees also paid 3% of their gross sales for advertising. Afri-Kingdom had a total of six franchises at its most successful point, all within the Metropolitan Chicago, Illinois area. The company went into financial difficulty and, by approximately February of 1975, the company was unable to give any services to its franchisees. Afri-Kingdom was adjudicated a bankrupt on November 25, 1975, and in two sales, December of 1975 and February of 1976, all of the trustee in bankruptcy's right, title and interest was sold. An individual who had nothing to do with Afri-Kingdom and who was not in a position to render any services to its franchises, was the purchaser of the trustee's right, title and interest.

In addition to collecting the rent under the leases, this individual has also made demands upon the franchisees that they continue to pay him royalties under the franchise agreement, even though the franchising company is now defunct and has no employees, and is giving no services and, in fact, has not, since February of 1975. While the bankruptcy court indicates the sale of the franchise agreement was without any adjudication as to the rights of the franchisees to make claims against Afri-Kingdom, the purchaser has simply gone about attempting to collect royalties without offering the services for which the royalties were to be paid. When one franchisee offered to stop using the trademark and trade name of Afri-Kingdom, but to continue under the lease, the purchaser of the bankrupt franchisor's assets refused, and stated he would enforce the royalty provisions of the franchise agreement.

I think my unfortunate history with Afri-Kingdom illustrates the substantial risk franchisees take in entering into franchise relationships. Even though the franchisees of Afri-Kingdom have managed to keep themselves going as businesses, the franchisor went under and is unable to provide them with any services. Nevetheless, the franchisor's successor in interest is able to exact royalties from the franchisees and presumably, at the end of the franchisees' leases, he will be able to evict them and simply take over their premises, simply by failing to renew their franchises. There is no question in my mind that this would be unfair to the franchisees. There also is no question in my mind that so long as Afri-Kingdom, as a franchisor, had the right to terminate franchisees for just cause, or had a right not to renew the franchisee for just cause, that would have been adequate protection for the franchisor. I think the Honorable Subcommittee should understand that hundreds of franchisors such as Afri-Kingdom have failed and that franchising has hurt more franchisees than it has helped. Most of the corpses have long since been buried and few people can remember the names of failed franchisors, except for those franchisees who lost their investments. Therefore, the measure of whether or not a franchisee should have a right to be protected from unfair termination or refusal to renew cannot simply be measured in terms of whether or not an individual franchisee or all the franchisees of a particular franchisor have made a profit on their investment. When the franchisee goes under, he is still hooked on a long-term lease and a commitment to pay substantial sums of money to the franchisor. When the franchisor fails, the franchisee is still apparently tied to the same obligations, even though he is receiving nothing for his money. This is because the franchisee has not only made an initial investment but a substantial continuing commitment which he cannot escape, even if the franchisor goes bankrupt. There is no question that franchisees have an equity in their business and should not be deprived of that equity, except where the facts justify that, and only when those facts can be established by the franchisor in a court of law. I feel sure I am not the only franchisor who would support S. 2335 but those of us who have failed, regardless of the number of franchisees that have been hurt along with us, are just not included in the statistics being presented to the Subcommittee by the opponents of the proposed legislation. I support, in principle, the legislation proposed, and feel that it gives adequate protection to the relative investments of both the franchisors and their franchisees.

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