WHAT'S NEW AND WHAT'S NEXT: 
THE NEW ADMINISTRATION AND BEYOND

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WHAT'S NEW AND WHAT'S NEXT:
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Predicting changes to the political, legal and economic landscape over the first six months of the Trump administration and what may happen next has proven to be quite a challenge. In this paper, we provide you with a snapshot at the six-month mark of where we are on certain areas important to franchising such as joint employer liability, SBA regulations accounting standards, and the FTC Franchise Rule review process. To contrast and compare, we have included a section on how Australia is addressing some of these issues. Finally, we also explore how President Trump’s mandate to reduce regulations may impact franchising.

I. UPDATE ON JOINT EMPLOYER ISSUES

The emergence of joint employment liability in the franchise context has become a major issue in recent years. The legal theory of joint employment had traditionally been based on whether or not a party had direct and immediate control over the employee.¹ That changed beginning in 2010 with a report that heralded joint employment as a tool to address what were perceived to be growing fissures in the workplace that adversely affected employees and their rights.² Regulatory developments changing the measures for determining joint employment liability spread through federal agencies including the National Labor Relations Board (“NLRB”) and the Department of Labor (“DOL”).³ Private litigants joined in the fray as well.

Many believed that the ominous specter of joint employment would disappear after the November 2016 election in light of the anti-regulatory stance of the new administration. There has been some change on the regulatory side, but litigation rages on in the courts.

A. Subway Protocol

Before addressing developments in the regulatory and legislative arenas and in the courts, it is interesting to analyze one approach taken by a large franchisor last year to cooperate with the DOL in its quest to address perceived violations by franchisees.

On July 26, 2016, Doctor’s Associates, Inc., the franchisor of the Subway system (“Subway”), entered into a Voluntary Agreement with the DOL’s Wage and Hour Division. The Voluntary Agreement provides for the following:

• Compliance assistance and training materials

The Wage and Hour Division committed to developing materials to assist compliance for the franchise restaurant industry and Subway agreed to provide input for the materials and to

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¹ Browning-Ferris Industries of California, Inc. d/b/a BFI Newby Island Recyclery &FPR-II, LLC d/b/a Leadpoint Business Services, 362 NLRB 186, Case 32-RC-109684 (August 27, 2015)
² Dr. David Weil, Improving Workplace Conditions Through Strategic Enforcement, A Report to the Wage and Hour Division (Boston University May 2010) (“Weil Report”)
³ The history of these developments has been examined in detail in S. Hagedorn, M. Lotito, J. Matter and A. Wit, Update on Joint Employer, 50th IFA Annual Legal Symposium, May 7-9, 2017, Washington, DC and C. Wallace, J. Shrimp and S. Grueneberg, Walking the Line: Best Practices for Advising Franchise Clients on Avoiding Employment Risks, 38th ABA Forum on Franchising, October 14-16, 2015, New Orleans, Louisiana
distribute them to its franchisee, development agents and managers. Subway also agreed to invite Wage and Hour Division representatives to make presentations at its franchisee meetings.

• Data-sharing and technology

The Wage and Hour Division will help Subway understand and use its publicly available information on concluded cases and Subway will provide to the Wage and Hour Division copies of any disclosure information it files annually with government agencies. Both parties agreed to analyze publicly available data and explore ways to develop technology to assist franchisees in complying with labor laws.

• Regular meetings to share information, evaluate compliance trends and solve problems.

Both parties agreed to attend meetings every three months to share information about cases, to identify training opportunities, to discuss new regulatory developments and identify new ideas to encourage compliance.

• Communicating about investigations

This section states that, when circumstances warrant, Subway may inform franchisees about the authority of the Department of Labor to investigate and gather data about wages, hours and employment practices, to inspect an employer’s premises and records and to question employees.

• Emphasizing consequences for noncompliance with the FLSA

Subway requires franchisees to comply with applicable law in its Franchise Agreement, and may terminate a franchisee, deny a franchisee the opportunity to purchase additional franchises or otherwise discipline a franchisee based on the franchisee’s history of FLSA violations.

The Voluntary Agreement concludes with the Wage and Hour Division reserving its prosecutorial discretion to investigate and seek remedies for any violations of the FLSA or other laws and states that the Agreement does not waive any liability Subway may have for violation of the FLSA or such other laws.

The Voluntary Agreement reflects a compliance strategy that was originally discussed in the 2010 report written when its author, Dr. David Weil, was a professor at Boston University. The report was an examination of what Dr. Weil described as the fissuring of the American workforce, which in turn, according to Dr. Weil, has caused a significant increase in “vulnerable employees.” The report made recommendations for enforcement strategy that emphasized including the franchisor in the enforcement strategy to encourage cooperation by the franchisee. The Voluntary Agreement does fall short of another recommendation in the report which involved the creation of a monitoring arrangement of a brand through a chain-wide agreement.

Dr. Weil later became the Administrator of the Wage and Hour Division and was one of the signatories to the Voluntary Agreement.

4 Weil Report, supra.
The International Franchise Association (“IFA”) issued a Statement\(^5\) after the Voluntary Agreement was disclosed noting its concern that other agencies or private litigants might use the Voluntary Agreement as evidence against Subway on joint employer issues. Indeed, one of the technology tools that the parties address in the Voluntary Agreement is the possibility of building alerts concerning wage and hour issues into the payroll and scheduling platform that Subway provides to its franchisees. Such services have been pivotal in private litigation alleging joint employment by franchisors and franchisees.

The concern that other agencies, such as the NLRB, could use a cooperation agreement against a franchisor was prescient. Dr. Weil is no longer the Administrator of the Wage and Hour Division of the DOL and, as noted below in section B.1., the DOL has withdrawn its earlier joint employment guidance. On the other hand, Richard Griffin, Jr., a proponent of Dr. Weil’s position, is still serving as General Counsel of the NLRB for a term that extends to November 4, 2017.

B. **Regulatory and Legislative Updates**

1. **The DOL and the NLRB**

Over the past several years, the DOL and the NLRB have been at the forefront of the changes to the standards for imposing joint employer liability on franchisors. The DOL’s Wage and Hour Division issued guidance establishing new standards on January 20, 2016\(^6\) relating to joint employment under the Fair Labor Standards Act (“FLSA”). This guidance made clear that its intent was to encourage the expansiveness of the concept generally. It differentiated between horizontal joint employment (where two or more employers are sufficiently associated with respect to the employee that they jointly employ him or her) and vertical joint employment (where the employer and an intermediary party employ the employee).

The factors highlighted in determining horizontal joint employment were:

- Who owns the joint employers
- Do the two entities share any officers, directors, executives or managers
- Is there shared control over operations
- Whether operations inter-mingled
- Supervision by one entity of the other
- Whether there is shared supervision of the employee
- Existence of a shared employee pool
- Shared customers or clients

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Agreements between the two putative employers

According to the 2016 guidance, the test for the existence of vertical joint employment is based on an “economic realities” test.\(^7\)

On June 7, 2017, the DOL withdrew this informal guidance in a relatively terse release\(^8\) as follows:

“U.S. Secretary of Labor Alexander Acosta today announced the withdrawal of the U.S. Department of Labor’s 2015 and 2016 informal guidance on joint employment and independent contractors. Removal of the administrator interpretations does not change the legal responsibilities of employers under the Fair Labor Standards Act ... as reflected in the department’s long-standing regulations and case law. The department will continue to fully and fairly enforce all laws within its jurisdiction, including the Fair Labor Standards Act...”

The DOL has also reinstated the practice of responding to specific questions posed by employers and employees by issuing opinion letters. On June 27, 2017, the DOL issued a news release to this effect\(^9\) and established a separate webpage for this purpose with instructions on submitting inquiries. This was a practice of the DOL for seventy years before it was replaced by the issuance of general guidance, such as the guidance withdrawn earlier in June 2017.

Despite this activity, many leadership positions in the DOL remain vacant as of the date these materials were prepared, including the Deputy Secretary of Labor, the Administrator of the Wage and Hour Division (previously held by Dr. David Weil), the Assistant Secretary for Policy, the Assistant Secretary of the Office of Public Affairs, the Director of the Office of Engagement, the Assistant Secretary of the Employee Benefits Security Administration, the Assistant Secretary of the Occupational Safety & Health Administration and the Director of the Office of Labor-Management Standards.

The NLRB, on the other hand, is on the way to filling the two vacancies on the Board. The nomination of Marvin Kaplan, formerly the Chief Counsel to the Occupational Safety & Health Review Commission and counsel for the House of Representatives’ Education and the Workforce Committee, was confirmed by the U.S. Senate on August 2, 2017 and he was sworn in on August 10, 2017 for a term ending August 27, 2020.\(^10\) President Trump’s other nominee is William Emanuel, a management-side lawyer at Littler Mendelson in Los Angeles. Mr. Emanuel’s confirmation was delayed due to concern by Democrats as to his management-side focus in private practice. However, the Senate will likely debate the nomination following its August recess and Mr. Emanuel’s confirmation is expected. Assuming that occurs, the NLRB will have a Republican majority. However, as of early August 2017, Chairman Philip Miscimarra is reportedly stepping down when his current five year term expires later this year. While this gives President Trump another opportunity to nominate a new Board member, that nominee will

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\(^7\) [https://www.dol.gov/whd/regs/compliance/whdfs35.pdf.](https://www.dol.gov/whd/regs/compliance/whdfs35.pdf)


\(^10\) [https://www.dol.gov/whd/opinion.](https://www.dol.gov/whd/opinion)
also have to go through the confirmation process. Therefore, there will likely be a delay in revisiting decisions on policies made during the previous administration, including those concerning joint employment.11

2. Legislative Developments

A number of states have enacted laws that clarify that the franchise relationship does not create a joint employment relationship between the franchisor and franchisee with respect to the franchisee's employees.12

On the federal side, Representative Byrne Bradley of Alabama introduced a bill titled the Save Local Business Act13 on July 27, 2017 along with 29 co-sponsors, the purpose of which is to clarify the treatment of two or more employers as joint employers under both the National Labor Relations Act (“NLRA) and the FLSA. It would amend the NLRA to provide as follows:

A person may be considered a joint employer in relation to an employee only if such person directly, actually, and immediately, and not in a limited and routine manner, exercises significant control over the essential terms and conditions of employment (including hiring employees, discharging employees, determining individual employee rates of pay and benefits, day-to-day supervision of employees, assigning individual work schedules, positions, and tasks, and administering employee discipline).

The bill would amend the FLSA to adopt the same criteria in determining joint employment. The introduction of the bill followed a hearing held earlier in July by the U.S. House Committee on Education and the Workforce during which witnesses testified about confusion over the joint employment standard and concerns that it will negatively affect decisions by business owners about expanding through franchising.

On another front, a group of thirteen Democratic members of the House of Representatives sent a letter dated May 8, 2017 to Barry J. Kearney, the NLRB’s Associate General Counsel for the Division of Advice, seeking guidance on joint employer issues. The letter refers to the confusion in the franchise community on whether or not it is possible to rely on the advice memorandum issued on April 28, 2015 concerning Freshii Development LLC.14 The advice memorandum found that the franchisor and its development agent were not joint employers of a franchisee’s employees.

The members of Congress asked two specific questions. The first was whether franchisors can rely on the Freshii advice memorandum as a blueprint for all franchise systems on the joint employment issue. The second was how much flexibility franchisors have in implementing, articulating and enforcing brand standards before they are deemed to have

11 Of interest is the fact that Richard Griffin continues as General Counsel for the NLRB. His term does not expire until November 3, 2017.
12 See https://www.bna.com/states-lock-down-673014451854.
indirect, unexercised or potential control for joint employment purposes.

C. Case Law

While there is movement to change the direction of the application of joint employment to franchisors and franchisees on both the regulatory side and in the legislature, the courts continue to struggle with the concept. Following are a few decisions that merit attention.

1. Hall v. DIRECTV LLC\textsuperscript{15}

In Hall v. Directv LLC, the Fourth Circuit Court of Appeals struggled with the issue of what test to apply. The court reversed a grant of Directv's motion to dismiss an action brought by satellite television technicians alleging failure to pay overtime and minimum wages in violation of the FLSA. Directv employs some technicians directly, but others are employed by intermediary service providers or subcontractors. Breaking with the findings of other U.S. circuit courts, the Fourth Circuit found that a claim of joint employment should survive if the two parties are not completely disassociated with respect to a worker’s employment. It decided to establish a non-exhaustive six-factor text to guide lower courts:

- Whether the putative joint employers jointly determine, share or allocate the ability to direct, control or supervise the worker
- Whether the putative joint employers jointly determine, share or allocate the power to hire or fire the worker or modify the terms of the worker’s employment
- The degree of permanency and duration of the relationship between the putative joint employers
- Whether one putative joint employer controls, is controlled by or is under common control with the other putative joint employer
- Whether the work is performed on premises owned or controlled by one or more the putative joint employers
- Whether the putative joint employers jointly determine, share or allocate responsibility over functions ordinarily carried out by an employer, such as handling payroll, providing workers’ compensation insurance, paying payroll taxes or providing the facilities, equipment, tools or materials necessary to complete the work.\textsuperscript{16}

According to the court, in order to be an employer, Directv only needed to play a role in establishing the key terms and conditions of the worker’s employment.\textsuperscript{17} Moreover, one factor alone may be enough to give rise to an inference that the plaintiffs can develop evidence that the putative joint employers are not completely disassociated.\textsuperscript{18}

\textsuperscript{15} 846 F.3d 757 (4th Cir. 2017).
\textsuperscript{16} Id.
\textsuperscript{17} Id.
\textsuperscript{18} Id.
The alleged facts that most influenced the court in its decision were the requirements in the agreements between Directv and the intermediary service providers that technicians pass prescreening tests and background checks, review training material published by Directv, become certified by the Satellite Broadcasting & Communications Association, that they purchase and wear Directv shirts, carry Directv identification cards, and display the Directv logo on their vehicles.\textsuperscript{19} Technicians were also required to receive their work assignments through a centralized system operated by Directv. The provider agreements allowed Directv to exercise quality oversight, categorize the work performed as either compensable or non-compensable and impose compensation related penalties for unsatisfactory service.\textsuperscript{20}

Directv filed a petition for a writ of certiorari with the U.S. Supreme Court on June 5, 2017, and an amicus curiae brief in support of the petition was filed on behalf of the American Hotel and Lodging Association, the Asian American Hotel Owners Association, the Coalition of Franchisee Associations, the IFA and the Restaurant Law Center. The amicus brief cited the conflict among the various circuits and the damage that is being done to the franchise method of distributing products and services.

2. \textit{Roman v. Jan-Pro Franchising International, Inc.}\textsuperscript{21}

This case, decided by the U.S. District Court for the Northern District of California on May 24, 2017, addressed the issue of the potential misclassification of Jan-Pro franchisees as independent contractors instead of employees. The structure of the Jan-Pro commercial cleaning system has three tiers – the franchisor enters into agreements with regional master franchisees who in turn sign Franchise Agreements with franchisees that service cleaning contracts provided to them by the regional master franchisees.

The court granted summary judgment to the franchisor (the regional master franchisees were not sued in the action) on wage and hour class action claims by the franchisees that the franchisor was liable for the misclassification.\textsuperscript{22}

In reaching its decision, the court applied the test of \textit{Martinez v. Combs}\textsuperscript{23} that involves three alternative definitions of the phrase “to employ”, namely:

- To exercise control over wages, hours or working conditions
- To suffer or permit to work
- To engage, creating a common law employment relationship

The court then analyzed each of these alternatives, applying the analytical framework of \textit{Patterson v. Domino’s Pizza, LLC}\textsuperscript{24} in which the California Supreme Court had acknowledged

\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} 2017 WL 2265447 (N.D.Cal. May 24, 2017).
\textsuperscript{22} Id.
\textsuperscript{23} 49 Cal. 4th 35 (2010).
\textsuperscript{24} 60 Cal. 4th 474 (2014).
the need of franchisors to impose standards to protect their brands without creating vicarious liability for the acts of their franchisees’ employees.\textsuperscript{25}

In reaching its conclusion, the court in Roman noted that although the regional master franchisees were supposed to make the franchisor a third party beneficiary to the Franchise Agreement, no such provision was actually included. Moreover, the franchisor had no right to terminate the franchisees at will. There was no evidence that Jan-Pro had any right to control the day-to-day activities of the franchisees, nor did the franchisor have any indirect control over their “wages”. The plaintiffs also contended that Jan-Pro exercised control by establishing training programs, but actually the franchisor only provided training to the regional master franchisees. The court also rejected the proposal that the regional master franchisees had become ostensible agents of Jan-Pro for lack of evidence.

3. **Ochoa v. McDonald’s Corp\textsuperscript{26}**

*Ochoa* involved claims by employees of McDonald’s franchisee that asserted wage and hour claims against McDonald’s as their joint employer. The California district court granted summary judgment in favor of McDonald’s with respect to plaintiff franchisee employees’ wage and hour claims in light of the *Patterson* decision, but declined to grant summary judgment with respect to ostensible agency claims, finding *Patterson* did not apply to those claims.\textsuperscript{27}

Central to the case was McDonald’s mandate that the franchisee use the McDonald’s proprietary software called “ISP” or “In-Store Processor” as well as a point-of-sale software called “NewPOS.” The software was pre-programmed and the franchisee did not change the programming.\textsuperscript{28} The court noted that it was “entirely possible that the alleged labor law violations at issue here would not have occurred if the ISP had been programmed differently.”\textsuperscript{29} But, according to the court, this was not enough to make McDonald’s an employer.

In addition, McDonald’s provides a voluntary software tool called R2D2 or Regional Restaurant and Data Diagnostics that is also pre-programmed to identify labor law violations. With respect to that use, the court held that because the program was used only to monitor the performance of the restaurants and could not be used to exercise control over wages, hours, and working conditions, it did not result in joint employer liability.\textsuperscript{30}

Nor were the detailed recommendations to the franchisee on employee scheduling, staffing, and discipline dispositive because these were just suggestions.\textsuperscript{31} McDonald’s hires business consultants who review data from franchisee restaurants and speak to franchisees and their managers about practices and metrics that McDonald’s wants to improve.\textsuperscript{32} Although McDonald’s “extensively monitor[ed] and evaluate[d]” the franchisee and used mystery

\begin{itemize}
\item \textsuperscript{25} Id.
\item \textsuperscript{26} 133 F. Supp. 3d 1228 (N.D. Cal. 2015).
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Id.
\item \textsuperscript{29} *Ochoa, supra* note 56 at 1237.
\item \textsuperscript{30} Id. at 1238.
\item \textsuperscript{31} *Ochoa, supra* note 56 at 1236.
\item \textsuperscript{32} Id. at 1238.
\end{itemize}
shoppers and business consultants, “mere monitoring of these customer service metrics is not active employee control.”

The facts that caused the court to keep the ostensible agency allegation alive involved the belief of the employees that McDonald’s was their employer, in part because they wore McDonald’s uniforms, served McDonald’s food in McDonald’s packaging, received paystubs and orientation materials marked with the McDonald’s name and logo and, with the exception of one plaintiff, applied for a job through McDonald’s website.

D. **Prophylactic Actions**

1. **Drafting**

   a. **Franchise Agreement**

   One of the prophylactic measures for franchise systems to consider to avoid a finding of joint employment involves making changes to the Franchise Agreement itself. Admittedly, this is a prospective solution since it will only affect future signers of the new form of agreement. Most Franchise Agreements provide that the parties are required to sign then-current form of Franchise Agreement upon renewal and transfer. Moreover, the issue of joint employment transcends the franchisor – franchisee relationship. Franchisees are just as concerned with franchisor joint employment liability. Indemnification provisions protecting franchisors only increase the cost to franchisees if a violation of labor and employment laws is found or if the employee’s action results in harm to a third party. In addition, on a macro level, joint employment harms the very structure of franchising. It makes less sense for a franchisor to continue franchising if company-owned locations provide more direct control of the employees at each location.

   Following are some categories to consider modifying in the Franchise Agreement:

   - Parties' relationship
   - Training
   - Manual description and characterization
   - POS systems and software
   - Field consultants
   - Signage

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33 *Id.* at 1236, 1239.

34 *Ochoa, supra* note 56 at 1238.

• Recruitment, hiring, discipline and firing of employees
• System standards
• Obligation to obey laws
• Indemnification
• Required insurance coverage

b. **Operations Manual**

Many franchise systems refer to their written materials that provide detailed information on the operation of the franchised business as an operations manual.

This document provides the franchisee with information that can change during the course of the franchise relationship. These include such items as standards and specifications for suppliers, equipment, services, products and other items important to the franchised business. It may include specific designated suppliers or brand-name products. In general, the mandatory provisions in the manual should reflect brand standards and not micro control over the day-to-day operations of the franchisee’s business.

Making changes to the franchise manual is closely tied to auditing the operational requirements of the franchise system to determine what controls are actually necessary to protect the franchise brand. Since many manuals have been in place for years without modification, it is frequently the case that controls that were thought to be essential are not really necessary.

Recent cases have illustrated how making manual provisions optional rather than mandatory can make a difference in whether or not the franchisor is found to be a joint employer. In *Vann v. Massage Envy*, the court noted, in granting the franchisor’s motion for summary judgment that personnel policies and procedures in the manual were optional.

This principle applies to all materials relating to employees that are provided by the franchisor to franchisees. It is advisable to emphasize that in all communications. Following is an example of language that could accompany sample documents:

Use of an employee manual in general, and this form of manual in particular, is optional. You may also be able to obtain sample employee manuals from your state or local chamber of commerce. If you choose to use either the enclosed sample or another form, you must consult with counsel of your choosing to adapt it for use at your independent business. You should modify and customize the manual as you deem appropriate to suit your business needs and to comply with the laws in your state and community. You must also make clear that you alone are the employer of your employees, and that we are not their employer. You are an independent employer who makes your own decisions and policies about...

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employment-related matters pertaining to your own employees. You may choose to use part, all or none of the contents of this sample Employee Manual. You are required to comply with all applicable laws in connection with your employees as part of your contractual obligations to us and to meet and maintain our brand standards.

Similarly the court in *Pope v. Espeseth, Inc.* relied on the following language in finding for the franchisor Fish Window Cleaning in a joint employment case: “all personnel-related documents and recommendations that Fish Window Cleaning provides … are optional and should be modified and customized as the franchisee deems appropriate to suit the individual franchisee’s window cleaning business, and that franchisees should review all sample documents Fish Window Cleaning provides and make modifications to suit their own business needs.”

2. Restructuring Franchise Programs

In addition to making revisions to the Franchise Agreement and the manual that implements protection of brand standards, it behooves franchisors to consider every aspect of their relationships with franchisees, and particularly, the franchisees’ employees.

There are several key areas to consider:

**Training** – Franchisors should consider training management level personnel of the franchisee only, and implementing train-the-trainer programs for additional personnel and additional franchise locations.

**Staffing Recommendations** – If made, these should be optional recommendations only. The final decisions on staffing should be made by the franchisee or its manager.

**Quality Assurance Inspections** – The franchisor’s field representatives should limit their interaction with the franchisee’s employees to observations only and limit conversations to management personnel.

**Field Visits** – Here again, interaction should be limited to the franchisee and its management personnel. Field representatives should avoid becoming involved in personnel decisions relating to the staff. Advice on how to handle specific employee issues has been cited as evidence of joint employment in some cases.

**Franchisees’ Communication with Employees** – Franchisees should be encouraged to remind their employees at every juncture that the employees work for the franchisee and not the franchisor. This includes paychecks, issuance of uniforms, employee application forms and notices posted at the franchised business location. If the franchisor operates a website for potential employees to use, the applicant should be required to acknowledge that the employment opportunity is for a franchisee and not for employment by the franchisor.

**Communication with the Public** – Customer service hotline personnel should be trained to communicate with customers in a way that clarifies the difference between the franchisee’s independent business operations and the franchisor’s brand.

Proprietary Software – Many franchise systems develop proprietary software for use in business operations. A review of the functions of the software should be conducted. Employee tracking and scheduling software that is mandated by the franchisor can be a significant factor in involving the franchisor in any claims by franchisees that wage-and-hour violations occurred.

E. SEIU Activities – Complaints to California and Illinois regarding Inadequate Disclosure

As a final update to issues concerning labor and employment, this section will cover certain recent initiatives of the Service Employees International Union (“SEIU”). The SEIU is a labor union founded in 1921 that has approximately two million members. Its membership primarily works in the fields of health care, public services and private services, including food service.

The SEIU has been active in supporting lawsuits and complaints filed by fast food workers with the NLRB alleging that McDonald’s is a joint employer of the employees who work in restaurants run by its franchisees. The motivation is clear. It would be substantially easier to unionize franchisees’ employees if the union could bargain directly with the franchisor with respect to all workers in the system instead of with hundreds or even thousands of franchisees in a franchise system.

In May 2017, the SEIU reportedly sent complaints to the Attorneys General of the States of California and Illinois, alleging that McDonald’s had engaged in fraudulent and deceptive practices by distorting the calculation of rental fees charged to franchisees and failing to disclose that those fees were excessive. McDonald’s franchisees are required to lease their premises from the franchisor or its affiliate. Based on publicly available franchise and SEC disclosures and a survey of McDonald’s franchisees conducted by the Change to Win Federation, the SEIU alleged that the rental fees charged McDonald’s franchisees exceeded the industry norms and included the following allegations:

• McDonald’s does not disclose to prospective franchisees how base rent for a location is calculated.

• McDonald’s rate of return from leasing activities ranges from 10.5% to 19.3%, as opposed to the average 5.3% rate of return for landlords of quick services restaurants in general.

• McDonald’s represents that the rental fees are based on site acquisition and development costs, but 71% of the survey respondents believed that McDonald’s was inflating those cost figures.

In response, McDonald’s issued the following statement:

We are confident in the legality and appropriateness of our financial relations with our franchisees and our disclosures of those relationships. We work closely with our franchisees so they have the support they need to operate their restaurants and

38 http://www.seiu.org/about.

provide great quality experiences and convenience for our customers. Our business model helps our franchisees secure prime real estate locations and reflects a significant level of company investment in the restaurant premises as well as thorough training expertise and well-established, high-quality supplier networks. As a result, McDonald’s and our franchisees foster economic growth and create hundreds of thousands of jobs in communities throughout the United States.

This is not the first foray for the SEIU targeting franchising. Among other initiatives, the SEIU filed a Petition for Investigation of the Franchise Industry on May 18, 2015 with the Federal Trade Commission (“FTC”). The Petition identified five franchise practices which the SEIU characterized as most harmful to franchisees, as follows:

- Incomplete or misleading financial performance representations made to prospective franchisees
- Significant capital investments required by franchisees during the course of the franchise relationship or as a condition of renewal of the Franchise Agreement
- Retaliation against franchisees who joined franchisee associations
- Unfair termination or nonrenewal of Franchise Agreements
- Arbitrary refusal to consent to franchisees’ requests to transfer

The SEIU urged the FTC to subpoena an extensive amount of information from at least nine of the franchise systems that it identified as the largest ten franchisors by unit count, plus the one or two highest unit count franchisors in segments identified as making the largest contribution to employment.

II. SBA LENDING STATUS

A. SBA Loan Programs That Provide Vital Support to New Franchisees Undergo Major Changes

According to the IFA:

In 2014 alone, SBA lending programs were used in the financing of nearly 30,000 new franchised units and guaranteed an estimated $6 billion in loans to new and prospective franchisees. According to a survey conducted for IFA by FRANdata, in 2014, an estimated 43% of first-time franchisees who borrowed funds from commercial lenders, and an estimated 23% of franchisees acquiring additional franchises, used SBA loan program guarantees.40

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The SBA’s loan programs provide significant and crucial capital to franchise businesses; however, even more could be utilized. There was a projected $1.3 billion financing shortfall for franchise businesses in 2014. This shortfall will result in 3,200 transactions not being financed and more than 46,600 jobs not being created or protected. And, it will result in a loss of $6.3 billion in annual economic output that otherwise could have occurred in 2014. Any actions resulting, intentionally or unwittingly, in less access to capital for franchise businesses would only increase this shortfall and increase the number of lost employment opportunities. FRANdata estimates that the portion of first time franchisees financed through SBA programs has increased since 2014.41

Although SBA programs are designed to provide financing assistance to small businesses that cannot otherwise obtain financing in the commercial market, the FY 2018 Congressional Budget Justification and FY 2016 Annual Performance Report (“SBA FY 2018 Budget Justification”),42 explains that since the Great Recession, banks have become increasingly reluctant to make loans to franchisees if they are not guaranteed by the SBA. So, with nearly one half of loans to new franchisees requiring SBA involvement, the SBA’s franchise lending requirements have become increasingly vital to the growth of franchising. Without SBA lending programs, the economic consequences for franchising could be catastrophic.

The goal of Part II of these materials is to provide an overview of recent events that have substantially changed how franchisors qualify their franchises for participation in SBA lending programs, to explain how the changes evolved, and the consequences and to identify a range of directional changes that may be adopted to address them.

1. The 2017 SBA Franchise Program Standards

After nearly two decades of SBA reviewing Franchise Agreements and related documents to determine whether controls imposed by franchisors on franchisees through Franchise Agreements were enough to make franchisors and their franchisees “affiliated,” and thus not “small businesses” eligible for participation in SBA programs, in November 2016, SBA decided to abandon its review process (“11/1/16 Notice”).43 Instead, franchisors that agreed to sign an addendum to their Franchise Agreements ("2017 Addendum") prescribed by SBA would be deemed not “affiliated” with franchisees, and their franchisees would meet the “small business” criteria needed to qualify for SBA financing programs.

41 Id.
Although the 2017 Addendum requires franchisors to modify or waive some terms customarily found in Franchise Agreements, the number of issues addressed by the 2017 Addendum was substantially fewer than the number that had been addressed in previous SBA reviews.\(^\text{45}\) However, franchisors were unable to negotiate modifications to the 2017 Addendum as they had done in previous years, and in early 2017, many prominent franchisors declared that they would not sign the 2017 Addendum and, would, therefore, no longer seek to qualify their franchisees for SBA programs.\(^\text{46}\) Other companies that had previously used the SBA Franchise Registry (“Registry”) process used “license” dealer, distributor, jobber” or similar terminology and objected to using the 2017 Addendum that only allowed use of the terms “franchisor” and “franchisee” in the 2017 Addendum.

Six weeks after the 2017 Addendum became effective, SBA sought to address most of the problems raised by complaining franchisors (“2/14/17 Notice”).\(^\text{47}\) It agreed to allow franchisors to use SBA Addenda that they had negotiated with SBA during either 2015 or 2016, (“Negotiated Addendum”) provided that no material changes had been made to those companies’ Franchise Agreements.

According to the 2/14/17 Notice,\(^\text{48}\) “The Certification (SBA Form 2463) will be executed by the franchisor and used with an SBA Negotiated Addendum to resolve any affiliation issues that arise in a particular Franchise Agreement. Specifically, the franchisor will certify that SBA has previously reviewed its 2015 or 2016 Franchise Agreement, including the SBA Negotiated Addendum, and determined that the Franchise Agreement with the SBA Negotiated Addendum did not create an affiliate relationship between the franchisee and franchisor. The franchisor will also certify that the terms of the loan applicant’s Franchise Agreement have not changed from those of the 2015 or 2016 Franchise Agreement, as such terms relate to affiliation (as defined in 13 C.F.R. pt. 121 and SOP 50 10) between the franchisor and the franchisee, and that the loan applicant’s Franchise Agreement includes the SBA Negotiated Addendum.”\(^\text{49}\)

As important as SBA lending programs are to franchising, the SBA’s criteria for franchise lending are not well understood among the franchisor community. In the pages that follow we will describe the current SBA franchise lending process relating to affiliation and business eligibility and the issues surrounding it, and approaches that have been used or proposed in the past. We will conclude with a discussion of the ideas that SBA is, or should be, thinking about

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\(^{45}\) Because franchisors were previously only required to use language in an SBA Addendum that addressed issues in their Franchise Agreements that implicated affiliation, many franchisors’ previous SBA addenda were not longer than the 2017 Addendum.

\(^{46}\) Comments of Edith Wiseman at webinar, "Are SBA Programs at Risk? The New SBA Franchise SOP and the Franchise Registry" (June 28, 2017, 2:00 PM).


\(^{49}\) Id.
in order to eliminate the current friction in the SBA franchise lending process.

2. **Background**

   In 1966, SBA adopted regulations that confirmed that franchisees were generally independent “small businesses,” were entitled to all of the benefits that the Small Business Administration Act makes available to small businesses.\(^{50}\) That decision was reflected in the Franchise Affiliation Regulation that was not modified between 1966 and July 27, 2016.

   (i) **Affiliation based on franchise and license agreements.** The restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with the franchisee or licensee provided the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Affiliation may arise, however, through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.\(^{51}\)

   The 2016 modification to the Franchise Affiliation Regulation narrowed it by deleting the final sentence of the regulation and substituting: “SBA will only consider the franchise or license agreements of the applicant concern.”\(^{52}\)

   Under the old standard, the SBA regularly issued Standard Operating Procedure (SOP) statements that explained its evolving views of how to determine whether a franchisor and franchisee meet the standards of Franchise Affiliation Regulation. The focus was primarily upon what SBA considered to be “excessive restrictions upon the sale of the franchise interest,” and Franchise Agreement terms that SBA considered to be indicia of “common management.” That focus resulted in a growing list of common Franchise Agreement provisions that SBA required franchisors to change, typically through an “SBA Addendum,” if they wanted their franchise programs to be eligible for SBA financing.\(^{53}\)

   By 2012, the list of Franchise Agreement changes SBA was requiring, and the time required for SBA to annually review them, were frustrating franchisors and their counsel. In its administration of the Registry FRANdata annually reviewed submissions of franchisors that wanted to be on the Registry, and recommended SBA Addendum language changes to franchisors that SBA had previously accepted from other franchisors to remedy problems SBA had identified. Franchisor counsel were often involved in negotiating language with FRANdata, or with SBA’s franchise counsel. By 2015, the annual approval process was taking seven weeks to seven months.

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\(^{51}\) Franchise Affiliation Regulation, 13 C.F.R § 121.103(i) (2016).


\(^{53}\) Most of those changes were discussed in a Notice published in the Federal Register on December 8, 2014.
As a consequence, IFA formed a task force of its Legal Legislative Committee to meet with SBA’s franchise counsel to understand and to ameliorate the impact of the required changes, and to find ways to expedite the review process. The task force also discussed how to become involved in discussions of future franchise affiliation SOP changes before their implementation.

However, after months of regular discussions, during which the task force had made major progress in rationalizing and clarifying in the SBA Addendum requirements, SBA decided not to participate in the publication of the revised Addendum guidelines and model language that had been negotiated between the task force and SBA (although it had already informally implemented the changes). The SBA subsequently explained that the staff was exploring alternatives to the annual filing, some of which included a certification by franchisors or their counsel that the Franchise Agreement and SBA Addendum either meets the SBA’s affiliation standards or has not changed since the last review by the SBA.

Then, the SBA published the 12/8/14 Notice requesting comments on many of the issues that had been discussed by the task force, as well as on a proposal to require alternative certifications of franchisor compliance with the Franchise Affiliation Regulation. The IFA Statement was submitted to the SBA in response to the 12/8/14 Notice on April 7, 2015. 116 other comments were also received from the franchising and franchise-lending communities.

On October 2, 2015, the SBA published proposed changes to its Affiliation Rules for franchising and other programs. In the notice SBA explained that it was seeking to streamline the process of determining affiliation and wanted to create a simple, bright-line test. The proposal focused on one issue involving franchise loans. Under the pre-existing Affiliation Regulation SBA reviewed Franchise Agreements pertaining both to an applicant for financing and any affiliates of the applicant to determine affiliation. SBA proposed to only review the Franchise Agreement of the applicant, and not agreements of its affiliates.

After the comment period concluded, SBA revised the Affiliation Regulation on June 27, 2016, not only limiting SBA’s review to the Franchise Agreement of the applicant, but also by deleting reference to other issues that would be indicia of affiliation in a franchising context. The following was deleted:

“Affiliation may arise, however, through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.” “SBA will only consider the franchise or license agreements of the applicant concern” was substituted for it.

55 See footnote number 10.
58 Id.
Then in November, the SBA’s Director of the Office of Capital Access proposed to eliminate the SBA Addendum. If franchisors would certify that their Franchise Agreements and programs met the requirement of the Franchise Affiliation Regulation, SBA would not review Franchise Agreements, Franchise Disclosure Documents or Addenda to determine whether the affiliation criteria had been satisfied. That would require franchisors to certify that their franchisees had “the right to profit from [their] efforts and bear . . . the risk of loss commensurate with ownership.”

The SBA Capital Access Office wanted to make it easier for franchisees to access capital and to fulfill the SBA’s business- and job-creation mission. It was clearly taking positions that differed from the orientation of the SBA General Counsel’s office, which wanted to retain the right to review and disapprove a list of Franchise Agreement requirements that it wanted modified or eliminated.

IFA’s SBA task force and other IFA members were consulted about the proposal, but expressed different opinions about whether it should be adopted. Those who objected were concerned about unknown liability arising from a certification of compliance, especially because the interpretation of the affiliation standards had varied so much over recent years. They feared that a subsequent interpretation of a “right to profit” or right to “suffer losses” might be adversely interpreted at the time a franchisor was sued in a False Claims Act action. Those who supported the change thought that it was a straightforward resolution of what had been a very difficult issue, and that the risk of challenge, although possible, was remote.

At the February 2016, IFA Convention in San Antonio, Texas, then SBA Administrator Maria Contreras, met with a group of IFA representatives and asked for reactions to the Capital Access Office’s formulation of the recommendation. Again, the lawyers, franchisors and franchisees present were not united in their assessment of the proposal. At the same meeting, Administrator Contreras agreed that the recent joint employer challenges to franchising were unfair and she offered to work with the Secretary of Commerce to advocate for the franchising community’s opinion about how the issue should be treated at cabinet meetings when the issue was considered.

3. Months Passed

In July 2016, SBA adopted amendment to the Franchise Affiliation Regulation that is described above, that narrowed the Affiliation review performed by the General Counsel’s office to what was written within Franchise Agreements.

Then on November 22, 2016, following the election of President Trump, the SBA announced, without requesting public comment, that as of January 1, the only way that

59 Curiously, the first three paragraph of the 2017 Addendum, adopted five months after the change to the Affiliation Regulation, “Change of Ownership,” “Forced Sale of Assets” and “Covenants” may be interpreted to directly relate to “restrictions on the sale of the franchise interest.” Moreover, because use of the 2017 Addendum and Negotiated Addenda have eliminated any review of Franchise Agreements, it is not entirely clear how SBA “considers” them in making its affiliation assessment.


61 That discussion most likely lead to the adoption of the 2017 Addendum language on employment: “Franchisor will not directly control (hire, fire or schedule) Franchisee’s employees.” 2017 Addendum, page 2. The effect of that language would be to avoid Franchise Agreement reviews by the SBA using the NLRB joint employer formulation.
franchisors could meet the SBA’s affiliation standards would be by signing a 2-page SBA Addendum (“2017 Addendum”) that was not subject to modification.

The 2017 Addendum was said to be immutable, although SBA did informally solicit opinions from IFA, franchise lenders or the franchising community about it. In the meantime, FRANdata was surveying franchisors and reported that as many as one third of them, including several very large franchisors, would not sign the 2017 Addendum in part, because it did not allow them the flexibility that addenda they had negotiated with the SBA during the previous years had given them to adapt standards to the unique circumstances of their franchise programs.62

Apparently with a focus on the need to meet the SBA’s mission of providing capital to form new businesses and to create new jobs, on February 14, 2017, the day before President Trump’s nominee, Linda McMahon, was confirmed as the new SBA Administrator, SBA issued the 2/14/17 Notice, declaring that franchisors now had an option. They could either use the 2017 Addendum to satisfy the affiliation standard, or they could use a Negotiated Addendum previously approved by SBA during 2015 or 2016, if they certified that the underlying Franchise Agreement had not changed.

B. The Inflexibility of the 2017 Addendum and the Negotiated Addendum Excluded Some Franchisors from Eligibility

Although most franchisors lauded the change in the SBA’s process for assessing compliance with its affiliation standards, franchisors that had not previously qualified for placement on the Registry, or that had recently made changes to their Franchise Agreements were left with no formal recourse for dealing with their concerns about the affiliation standards. If they refused to use the 2017 Addendum, or if their Negotiated Addenda contradicted changes to their Franchise Agreements, franchisors were left to appeal to SBA staff to try to address this standard.

Moreover, some franchisors were concerned that the language used in the 2017 Addendum or in their Negotiated Addenda was inconsistent with the terminology used in their current Franchise Agreements. Others expressed frustration that the language in the 2017 Addendum was ambiguous and feared that their efforts to clarify it, whether in their Franchise Agreements or in supplements to SBA Addenda, would not be accepted by lenders (who feared that the explanations might vitiate SBA guarantees).

C. Elimination of Registry Generated Uncertainty Among Many Franchise Lenders

Another casualty of the adoption of the 2017 Addendum was the elimination of SBA’s review of Franchise Agreements to determine eligibility requirements other than affiliation. Before 2017, SBA’s staff screened for these other eligibility standards when reviewing Franchise Agreements for affiliation issues. According to the 11/1/16 Notice: “Lenders will be responsible to ensure that the applicant meets all SBA eligibility requirements.”

The SBA Staff, speaking at a roundtable at the February, 2017 IFA Convention, explained that lenders had always been responsible for confirming that a franchise loan met

62 Comments of Edith Wiseman at webinar, "Are SBA Programs at Risk? The New SBA Franchise SOP and the Franchise Registry" (June 28, 2017, 2:00 PM).
eligibility requirements. However, lenders had become accustomed to relying upon the SBA’s review, and many were reluctant to devote the time and expense of performing an independent review. Because the consequence of making the wrong decision was elimination of the SBA’s guarantee, some lenders who had traditionally made relatively few franchise loans, told FRANdata in polls taken during webinars that FRANdata conducted about the changes in early 2017, that “they were passing on loans due to the increased responsibility and time it takes to underwrite a [SBA] loan.”

Among the issues raised by lenders were:

1. Determining whether a program was a “franchise” as defined by the FTC Franchise Rule;

2. Determining when an Addendum must be signed to qualify for SBA financing; and

3. Determining whether the franchise program otherwise satisfied SBA’s eligibility requirements. 63

Ironically, although the SBA cited to its “eligibility criteria” contained on its “Franchise Findings List,” in the 12/8/14 Notice, which by the time the 11/1/16 Notice was published, requiring lenders to confirm that eligibility criteria were satisfied, the Franchise Findings List had been removed from the SBA website. Thus, lenders were deprived of another source of information needed to qualify franchises for SBA loan programs.

Most of the franchising community lauded the end of the SBA review of Franchise Agreements and the approach to affiliation adopted through the use of an unreviewed SBA Addendum. However, many in the lending community expressed concern that they were being forced to undertake new and uncertain risks of knowing whether SBA standards beyond the affiliation standard were being met. 64

D. The Registry Undergoes Major Change and Focuses on Providing Information to Lenders to Expedite Franchise Loans

For two decades, the Registry, operated by FRANdata, a private company, had served as an interface between franchisors and the SBA as franchisors sought national clearance for their franchise programs, allowed franchise programs to avoid independent reviews by each SBA regional office in which a franchisee applicant might reside. For a fee, the Registry had reviewed subscribers’ Franchise Agreements, alerted franchisors to Franchise Agreement language that might raise Affiliation or other issues with SBA, and worked with franchisors to ameliorate those issues before submitting the Franchise Agreements to SBA for review. FRANdata published a list of franchisors on the Registry and maintained records of SBA loan qualification approvals so that they could be accessed by potential franchise lenders and by prospective franchisees. Although not required by law, FRANdata became an intermediary between franchisors and the SBA. Franchisors generally sought to be on the Registry because

63 Id.

it expedited SBA loan qualification for their franchisees.

As the SBA became more familiar with franchising, it added to the list of criteria that it decided were indicia of affiliation. Each year, Franchise Agreements were required to be reviewed to determine whether any changes in them or in SBA Franchising SOPs or other Affiliation criteria required changes to the Franchise Agreements or to the SBA Addenda that franchisors typically chose to use to accommodate the SBA. The annual review process was taking as long as seven months at the time SBA issued the 12/8/14 Notice, seeking comments about how to improve and streamline the process.

When the SBA issued the 11/1/16 Notice eliminating any review of Franchise Agreements by the SBA, FRANdata’s role in the SBA franchise loan qualification process changed dramatically. FRANdata would no longer review documents for franchisors. No documents were submitted to SBA for approval. Because there was no affiliation approval process beyond agreeing to use the 2017 SBA Addendum, most franchisors questioned the continuing need for the Registry. FRANdata had been anticipating a change and had been developing services designed to facilitate SBA and conventional lending to franchisors for several years. When lenders were left with questions about SBA criteria beyond affiliation, FRANdata stepped into the void and, using its databases, fashioned services that are designed to give most franchise lenders the comfort they need that franchise programs meet those other critical SBA requirements.

The Registry now provides detailed information about franchisors and their franchisees to lenders. Based upon FDDs in its database and prior reviews by SBA, it confirms to lenders that franchisors satisfy the FTC Franchise Rule definition. Based upon previous reviews by SBA, FRANdata confirms to lenders that franchisors have met SBA’s business eligibility requirements. It also maintains records of whether franchisors are willing to sign the 2017 SBA Addendum, or whether they are using a Negotiated Addendum and thus fulfill the affiliation requirements.

Depending upon submissions from franchisors, the Registry will also provide lenders with instant access to a range of financial information about franchisors and their franchisees, openings, closings, litigation, etc. which enables them to make quick determination about whether to extend credit to individual franchisees.

FRANdata’s Registry is a purely commercial business; it is in no way affiliated with the SBA and does not purport to speak on the SBA’s behalf. FRANdata claims to be working with 8,000 SBA, conventional and alternative members who subscribe to its services.

E. What Will Change for 2018?

During the last years of the Obama administration, different factions within the SBA advocated for different approaches to the franchise affiliation issue. The Office of Capital Access argued for simplicity and bright-line standards, and had suggested that a certification by franchisors that their franchisees could profit or suffer loss commensurate with their investments as set out in the Franchise Affiliation Regulation, would be all that is necessary for franchisors

66 See footnote number 51.
The SBA General Counsel’s office was much more concerned about terms in Franchise Agreements that it considered gave franchisors “excessive control” over their franchisees. It had insisted on a growing number of common Franchise Agreement provisions that it wanted changed as a condition of franchisors meeting the affiliation standard.

It is unclear how new SBA Administrator, Linda McMahon, will address the issue on the competing approaches to affiliation that were present during the Obama era. No new franchising SOPs, regulations or guidance have been issued since she has taken office.

Will the 2017 Valentine’s Day amendment be extended? Will a modified SBA Addendum or guidelines for an Addendum be issued along the lines that were under consideration in 2014-5? Will the SBA opt for a simple certification relating to Affiliation, and eliminate the Addendum altogether?

The SBA remains committed to providing capital for the development of new small businesses, of which franchises are a large component. In the SBA FY 2018 Budget Justification, the SBA stated that its number one strategy was “to offer loan guaranty products to assist small businesses in obtaining financing that they do not qualify for with conventional credit.” Their budget proposal would increase the funding available for Section 7(a) loan guarantees (the program used most frequently by franchisees) and the number of such loans made from $77,855,000 to $80,648,000 and from 55,000 to 60,000 respectively. The SBA has no special lending program for franchisees.

SBA loan guaranty programs play a critical role ensuring access to capital for small businesses, that in turn provide meaningful job growth and retention that drives the economy. When a small business is unable to obtain credit elsewhere on reasonable commercial terms, SBA’s loan guaranty programs provide credit enhancement that allows lenders to offer terms (e.g., longer maturities) that they could not otherwise offer through conventional financing, which enables them to make the loans.

The 7(a) loan program is the federal government’s primary small business loan program, assisting small businesses to obtain financing when they are unable to obtain traditional credit. The SBA guarantees a portion of each loan (ranging from 50 to 90 percent) that participating lenders make to eligible small businesses. The 7(a) loan program enables small businesses to obtain financing of up to $5 million for various business uses with loan maturities up to 25 years. The 7(a) loan program allows small businesses with limited or no access to traditional capital markets to secure startup and growth funding that in turn increases employment, provides services to communities, and expands the economy.

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67 FTC Franchise Rule, 16 C.F.R. § 436.1 et seq. (2007)
68 See footnote number 11.
69 These numbers only reflect SBA’s cost of providing guarantees; they do not reflect the total value of loans issued with SBA guarantees in the 7(a) program.
local tax base. Maintaining a high volume of active lenders from one fiscal year to the next creates a consistent pipeline of SBA loans for small businesses.\textsuperscript{70}

As this was being written in early August, 2017, the SBA had not announced whether or how it will revise its procedures to eliminate or to mitigate the issues described on the preceding pages. However, it was exploring different options to minimize the confusion and to give lenders the comfort they need to make SBA backed franchise loans.\textsuperscript{71} Some of the issues under consideration are similar to those raised in the 12/8/14 Notice. Others will likely reflect the problems that have been experienced by lenders and franchisors during 2017.

Issues such as whether a company is a franchisor subject to the FTC Franchise Rule and whether a franchisor satisfies eligibility requirements might be addressed by SBA publishing a list of the 2,800 franchisors that had passed the SBA’s review before 2017. The SBA might publish a list of eligibility standards and allow franchisors that have not previously passed the SBA scrutiny or those that have modified some part of their franchise programs that implicate an eligibility requirement to obtain review by the SBA.

Alternatively, the SBA could allow franchisors to self-certify that they are subject to the FTC Franchise Rule and allow lenders to rely upon that certification.

Regardless, the SBA should clarify the language of the 2017 Addendum to avoid ambiguities and to allow franchisors to explain (but not disavow) how its language applies to their agreements, e.g. when they use the term “licensee” rather than “franchisee.”

Or, the SBA could permit everyone who uses either the clarified 2017 Addendum, or the 2015 or 2016 Negotiated Addenda to continue to use them, but allow franchisors wishing to negotiate addenda in a way that is similar to what was done before 2017 to do so.

To eliminate the ongoing bureaucratic delays and burdens, the SBA could allow franchisors to continue to use Addenda negotiated after 2017, so long as they certify that no changes have been made to their underlying franchise program since it was approved by the SBA.

Or, the SBA might even go so far as to conclude that any Franchise Agreement that is subject to the FTC Franchise Rule automatically satisfies the Affiliation standard, so long as the franchisor or an affiliate does not own more than, e.g., a 50 % equity interest in a franchisee seeking SBA financing.

Regardless, the SBA might issue an SOP clarifying that lenders that rely in good faith upon an SBA Addendum and a listing of franchisors that have previously qualified for SBA lending will not be denied guarantors.

Ideally, the SBA will submit any ultimate changes they are considering to all stakeholders well in advance of their promulgation to avoid the issues that arose during 2017.

\textsuperscript{70} SBA FY 2018 Budget Justification at 27.

\textsuperscript{71} Author’s interview with SBA chief franchise counsel Stephen Olear, July 13, 2017.
III. FASB CHANGES – RECOGNITION OF INITIAL FEES

One of the holdovers of the Obama years that will affect franchising relates to financial reporting. There have been issues presented to the Financial Accounting Standards Board ("FASB"), the results of which would require the application of different accounting principles from previous practices in at least two areas related to revenue recognition: (1) how franchisors will account for initial franchise fees, and (2) how franchisors will account for marketing fund fees collected from their franchisees.\(^\text{72}\)

A. Initial Franchise Fee Issues

Currently, the “better” accounting practice is to recognize the revenues from payments of initial franchisee fees once the franchisee’s unit is opened.\(^\text{73}\) The new procedure, found in the FASB Accounting Standards Codification ("ASC") 606,\(^\text{74}\) is that the initial franchise fees are amortized and accounted for as income over the term of the franchise.\(^\text{75}\) For example, if the initial franchise fee was $50,000, under current practice, the whole $50,000 would be treated as recognized revenue once the franchisee began doing business. At the same time, pre-opening expenses incurred would be deducted from revenue, as they were incurred.\(^\text{76}\)

This decision by the FASB to amortize pre-opening revenue from initial franchise fees is peculiar because, to our knowledge, there have been few, if any, reported notorious activities of franchisors using the current method of accounting for initial franchise fees. Purportedly, when business format franchising became popular in the 1960s and early 1970s, there was widespread abuse of accounting principles by franchisors, including the practice of recognizing revenue immediately after a Franchise Agreement had been signed. This process ignored the fact that the Franchise Agreement imposed future obligations on the franchisor that had yet to be recorded against recognized revenue resulting in overstated income. Overstating income made investments in franchisors and franchisor’s franchises all the more attractive to lenders, investors and prospective franchisees. In ASC 606, the accounting principles with respect to initial franchise fee revenue were changed to curb this abuse, making the reported income more likely to present an accurate picture of the franchisor’s financial position.\(^\text{77}\)

But the standards adopted by the FASB under ASC 606 will swing the pendulum too far away from historical abuses, causing income to be understated rather than overstated. As

\(^\text{72}\) Franchisors refer to these funds as “Marketing Funds,” “Advertising Funds,” and “Branding Funds.” For purposes of this section of the paper, the terms are viewed as interchangeable, and will be referred to as “Marketing Funds.”


\(^\text{74}\) The effective date of ASC 606 is 2018 for calendar year-end public companies, with the option to adopt earlier.

\(^\text{75}\) Id.

\(^\text{76}\) This is the rule for intellectual property licenses, which are quite different from franchise arrangements. Frequently, licensors have few obligations to be performed after the license agreement is signed. Franchise Agreements, however, impose numerous on-going obligations on franchisors. Thus, franchisors are usually obliged to engage in or abstain from certain activities after opening. Licensors, on the other hand, generally play a passive role in the ongoing relationship. The FASB appears to have determined that all licenses (including Franchise Agreements) are alike.

\(^\text{77}\) See generally, FIN. ACCOUNTING STANDARDS BD., supra note 2, at ASC 606.
noted above, the changes require franchisors to capitalize initial franchise fees and then amortize them over the length of the Franchise Agreements. This means recognized revenue is reduced at the current time—when the franchise opens—but is increased on a monthly basis in the future, which may result in the franchisor’s franchise becoming less attractive to franchise prospects, to bankers considering making loans to the now-reduced income franchisor, and to potential investors.

B. Marketing Funds Accounting

The FASB’s accounting rule changes may also affect franchisor income due to changes in the accounting of marketing funds. Customarily, franchisors would set up funds to which franchisees would contribute contractually required amounts. Under that framework, the person or group who controlled the fund would be responsible for paying marketing expenses. Generally, the amount paid into the fund and the amounts paid out by the fund were not recorded on the franchisor’s records, but instead were reported separately. They were not considered assets of the franchisor, and the fund’s expenditures were not considered the payment of liabilities of the franchisor.

This arrangement assumed that the franchisees controlled the marketing fund, but, in reality, it is often unclear who controls the fund. For example, in many systems, marketing fees applied to payment of marketing expenses are totally under the control of the franchisor, although the franchisor might establish a franchise advisory marketing committee with which it consults on certain marketing related issues. In other systems, the franchisees control the funds, although the franchisor might retain veto rights with respect to some aspects of decisions made with respect to the marketing fund. And between these extremes are a plethora of other structures. Thus, the assumption of franchisee control was, in some cases, inaccurate.

In contrast, under ASC 606, the franchisor rather than the franchisee is presumed to control the marketing fund. Under the rule changes, the franchisor is required to account for the marketing fund as revenue whether or not it actually controls the fund. In many instances, the franchisor has broad leeway regarding how these funds are spent and how the fund will be operated. But often, as discussed above, the franchisee has a voice (and in some cases a commanding voice) in determining how funds are spent. Further, it is not uncommon that an outside marketing company will be hired to allocate the spending of the marketing fund. Thus, just as the customary presumption that franchisees control the marketing fund is flawed, the assumption under ASC 606, that franchisors control the marketing fund is often incorrect.

As long as marketing fund related revenues (i.e. receipt of marketing fund payments) are substantially the same as expenditures, generally there is no effect on the franchisor’s income statement. However, this is not always the case, because sometimes receipts of advertising payments are made substantially earlier or substantially later than expenditures. Moreover, putting marketing fund revenue or expenses on the franchisor’s balance sheet could affect whether the franchisor is in compliance with the ratio tests that must be met under a franchisor’s loan covenants.

On May 30, 2017, Robert Cresanti, the Chief Executive Officer of the IFA, wrote Mary Mazzella, Senior Project Manager of the FASB, asking for a meeting at which the IFA could

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78 In the Pizza Hut system, marketing funds are paid to the system’s franchisee association, and the committee which makes marketing decisions has two franchisor and two franchisee representations. In the case of a tie, the franchisor breaks the tie.
present its views and the views of many of its members as to the significance of the changes resulting from ASC 606, and asking for reconsideration of the decisions made by the FASB that affect the treatment of initial franchise fees and marketing fees.\textsuperscript{79}

Mr. Cresanti’s letter raises some of the concerns addressed above. In addition, Mr. Cresanti noted that, although ASC 606 may raise fewer issues in the context of a standard licensing agreement in which the licensor has no further obligations, it does not address a number of situations that may arise in the franchise context.\textsuperscript{80} In particular, he expressed concern that ASC 606 does not expressly explain how the revenue recognition requirements discussed above apply to the scenario in which a franchisee enters into an agreement that is likely to be modified, such as a development agreement in which the franchisee has the right to open multiple units over a number of years.\textsuperscript{81} He also noted that ASC 606 does not address the three-tiered scenario in which a franchisor delegates to a master franchisee the right to sell franchises and perform various ongoing obligations; in this situation, ASC 606 offers no guidance regarding the revenue recognition requirements as applied to the fees paid for the master Franchise Agreement.\textsuperscript{82}

Moreover, Mr. Cresanti complained that the amortization period under ASC 606 is unclear. For example, the rule does not address issues that arise affecting amortization when the franchise is sold or transferred.\textsuperscript{83} And the rule offers no guidance in terms of the role of the broker regarding further involvement with the franchisee after the sale of the franchise.\textsuperscript{84}

Finally, Mr. Cresanti noted that ASC 606 offers no guidance for revenue recognition where lengthy Franchise Agreements are not carried out in full.\textsuperscript{85} For example, if a Franchise Agreement has a thirty year term, but the franchise closes after fifteen years, then roughly half of the initial fee will remain unamortized. ASC 606 offers no instructions regarding the recognition of the remaining, unamortized portion of the initial fee.

C. \underline{A Couple of Caveats}

To many franchisors accounting principles are strange birds!

1. Presented above is a gross simplification of revenue recognition accounting, and in particular ASC 606. Accounting principles are complex, and, like franchise law, there is “folklore” that must be considered when preparing financial statements. Thus, the question remains whether any benefits will be achieved by the new ASC 606.

2. While transactional lawyers are familiar with the phrase “generally accepted accounting principles (“GAAP”), most have no idea what this means in the real world.

\textsuperscript{79} Letter from Robert Cresanti, Chief Exec. Officer and President, IFA, to Mary Mazzella, Senior Project Manager, FASB (May 30, 2017) (attached hereto as Appendix A).
\textsuperscript{80} \textit{Id.}
\textsuperscript{81} \textit{Id.}
\textsuperscript{82} \textit{Id.}
\textsuperscript{83} \textit{Id.}
\textsuperscript{84} \textit{Id.}
\textsuperscript{85} \textit{Id.}
For example, when one examines ASC 606, there are no mentions of “initial franchise fees” or “marketing funds” or “franchisor.” Thus, it is from the abstract concepts in ASC 606 that accountants must determine how a particular action should be treated for accounting purposes. GAAP is more a compilation of best practices than a mandate. In other words, there is discretion in this process.\footnote{See FIN. ACCOUNTING STANDARDS BD., supra note 2, at ASC 606-10-55-62 through 55-65.} To illustrate the variance of accounting principles, a franchisor that sells goods must determine whether to use a “first in first out” or “last in, first out” method for determining the value of its inventory. In some cases, companies simply decide not to follow GAAP, which usually requires a company to explain the basis for its decision in the notes of its financial statement. Finally, if a company is public, it must take into account the Securities and Exchange Commission’s (“SEC’s”) views on the accounting of certain matters. In short, a company may have discretion in making accounting decisions, but it is not “unfettered discretion.”

3. Without an accounting background, the lawyer trying to understand accounting principles may feel like she is trying to find her way home in the dark. And there is no “Franchise Accounting for Dummies” to guide you.

4. There are exceptions to most, if not all, accounting principles. For example, an initial franchise fee may include a requirement that the franchisor will supply, without additional cost, a particular piece of equipment. In this case, GAAP might require that a portion of the cost of the equipment not be amortized by the franchisor.

5. There are actually two boards that oversee the rules regarding the preparation of financial statements: (a) the FASB, discussed above, and (b) the International Accounting Standards Board (“IASB”), which oversees accounting principles from a more international perspective. This alternative method of preparing financial statements is the necessary and natural result of the growth of multi-national companies operating in different countries, each with its own accounting rules. One point that appeared in much of the literature is that, as to ASC 606, the differences between these two methods of preparing financial statements are not—at least with respect to the issues discussed above—particularly material.\footnote{See, e.g., Ass’n of Int’l Certified Prof’l Accountants, Financial Reporting Brief: Roadmap to Understanding the New Revenue Recognition Standards, (September 2016), available at: http://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/DownloadableDocuments/FRC_Brief_Revenue_Recognition.pdf (last accessed Aug. 25, 2017) (explaining that the “FASB and IASB have basically achieved convergence” with regard to the relevant standards). It should be noted however, that, under state and federal law, the FASB rules must be followed unless the SEC has accepted a different principle.} However, absent SEC. approval, since the FTC Franchise Rule requires that financial statements be prepared in accordance with GAAP, the differences can be problematic and expensive for foreign companies interested in franchising in the United States.

6. And, finally, never forget that the purpose of GAAP is to provide an entity with a tool that will allow it to prepare financial statements that will more accurately reflect the entity’s financial performance and position.

As of the date this paper has been submitted for publication, the IFA and FASB have been discussing how to address the concerns of the franchise community, but without changing the ASC rules themselves. As to the initial franchise fee issue, one possibility will be to allow the initial franchise fee to be included in revenue at the time the Franchise Agreement is signed if
the pre-opening expenses exceed the amount of the initial franchise fee. On the advertising fund issue, it is reported that, at this point in time, there is still open discussion regarding how to address the franchise community’s concern. One alternative might be to have franchisors form separate legal entities which will operate the marketing fund, and thus give a clear line as to how to account for these funds. Further discussion between IFA and FASB is expected to occur at the end of August 2017.

IV. INFLUENCE OF INTERNATIONAL DEVELOPMENTS ON U.S. LAW - AUSTRALIA

Although, in many respects, Australia and the United States are quite different countries, the trends in labor and employment law have shown remarkable similarity to each other, at least in the area of joint employer liability/vicarious liability.88 Interestingly, despite these similarities, the joint employer issue became a topic of general concern in remarkably different ways in each country.

In the United States, one may contend that it was a culmination of unionization efforts within the quick food service industry, coupled with some widespread perceived abuses by franchisors in this industry and the janitorial services industry that led to changes in U.S. employment laws. In contrast, in Australia, the impetus for proposed changes in its employment laws was driven largely by the public’s response to a 2015 television exposé revealing the abuses of franchisors.

It is not surprising that franchisees in franchised food-related and other retail systems try to avoid statutory requirements regarding wage levels and overtime pay. Labor rates in Australia are very high. While the U.S. is just beginning to consider increasing the national minimum wage rate to $15 per hour over the next several years, Australia, where large tips are the exception, not the rule, passed that landmark years ago. For these industries, this wage level can be financially devastating, particular for businesses such as convenient stores that are open 24 hours a day.

In Australia, one way employers have circumvented the rules has been simply to require employees to abstain from recording the actual hours they worked. In this manner, the issue never surfaces unless the underpaid employees voice their objections. Without complaints being filed by the employees, and except through audits, it would be difficult to prove that the number of hours worked and the number of hours recorded by employees were not in sync with the number of hours required to keep a business open. But why were employees not reporting the real number of hours they had worked? Certainly, a primary reason for the silence of employees has been job protection. In other words, the employees felt vulnerable.

A second way to avoid paying required wages was to require the employees to kickback to the employer a portion of the employees’ paid wages. In this way, the books of the employer would be in compliance with the Australian employment laws, but the employee would end up short-changed.

These questionable business tactics were brought center stage when a television exposé focused on the 7-Eleven system revealed that these abuses not only existed, but that the franchisor kept a blind eye toward such practices. That is, the franchisor presumably knew about these practices, but did nothing to stop them from occurring, even though Franchise

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88 Vicarious liability is a much broader term than joint employer liability because it applies not only in cases relating to labor laws, but in other areas such as the area of torts.
Agreements typically require franchisees to comply with all applicable laws.

The adverse effect of these practices on the franchise sector was heightened by the fact that the Chief Executive Officer of 7-Eleven at the time the exposé aired was also Chairman of the Franchise Council of Australia (“FCA”)—Australia’s equivalent of the IFA. Thus through guilt by association, this employment practice blackened the eye of the whole Australian franchise community.

Shortly after the exposé appeared, the CEO of 7-Eleven resigned from his position with 7-Eleven and from his role as Chairman of the FCA. Subsequently, 7-Eleven has paid to the adversely affected employees of its franchisees a substantial sum -- in the neighborhood of $100,000,000 -- to make the problem go away. The aftermath of this scandal has fallen into the FCA’s lap, which is now focusing on how to restore and protect the integrity of the franchise business model in both the public’s and government’s eyes. “Franchising” has become a dirty word.

The 7-Eleven scandal has resulted in the introduction of legislation in the Australian Parliament that would prevent many employment abuses, including those described above. If approved by both houses of Parliament, the bill that has been approved by Australia’s House of Representatives as an amendment to Australia’s Fair Work Act 2009 and is known as the “Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017” would:

- Subject to certain exceptions, make franchisors liable for failures by their franchisees to comply with employment laws;
- Ban the practices of kickbacks and falsifying employment records;
- Strongly encourage franchisors to make sure that their franchisees are familiar with applicable employment laws, and proactively monitor and enforce the workplace obligations of their franchisees;
- Recommend that franchisors enter into compliance “deeds” whereby the franchisor would commit to encourage its franchisees to comply with employment obligations;\(^{91}\)
- Encourage franchisors to better educate their franchisees as to what they can and cannot do with respect to employment law issues;
- Broaden in numerous ways the powers of the Fair Work Ombudsman to investigate employment violations and to resolve such violations;
- Clarify the liability of directors and officers for problems created by franchisee employment law violations; and

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\(^{89}\) Fair Work Act 2009 (Cth.) (Austl.).

\(^{90}\) Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 (Cth.) (Austl.).

\(^{91}\) However, the Bill does not provide a safe harbor for franchisors if they rectify employment problems in their systems. The United States government has used the same approach to prevent abuses, but this approach has not been well received because of the lack of a safe harbor.
• Increase the penalties which the franchisor may incur for noncompliance by its franchisees.

The standard for imposing liability under the act is whether the franchisor knew or should have known about franchisee violations, but there are exceptions from the imposition of this liability. Most significantly, if the franchisor can show that it did not know of the illegal practices of its franchisees and that it had no reason to know that they were occurring, then no liability will be imposed upon the franchisor or its officers or directors.

As noted above, the bill was passed by Australia’s House of Representatives, and it is predicted that it will pass the Senate as well.92 By the time this paper is published, the Bill may have already gone into effect.

The proposal under consideration by the Australian Parliament has put the FCA and franchisors in a difficult position. The franchising community would paint a picture of its support of questionable business practices if franchisors do not embrace the purpose of the law. However, compliance with the proposed legislation, while repairing the image of franchising, could impose significant financial and enforcement burdens on franchisors. For those franchisors who have in the past complied with Australia’s employment laws, the ultimate financial effect of continued compliance might not be significant. For the non-compliant franchisor, the new law could be costly.

The solution to this predicament is obvious: franchisors must either turn their back completely on their franchisees’ employment activities (see no evil; hear no evil), or, alternatively, assist and support the government in its attempts to eradicate the illicit employment activities of Australia’s business sector.

V. MANDATE TO REVIEW AND ELIMINATE U.S. REGULATIONS

A. Will FTC Franchising Rule Succumb to Trump Administration Mandated Review of Regulations?

Even before presidential candidate Donald Trump called for the elimination of wasteful, duplicative and costly regulations, the FTC was subject to executive orders, statutory requirements, FTC regulations and practices that made the Franchise Rule subject to ongoing review and scrutiny. The process of developing the Franchise Rule began in earnest in 1971 when the Commission published its first draft of the proposed Rule, which led to the adoption of the Franchise Rule in 1978.

Pursuant to a regulatory review program adopted by the FTC in 1992, in 1995 the FTC began a review of the Franchise Rule, scheduling hearings and workshops, issuing a notice of proposed rulemaking, collecting comments and ultimately producing the 2007 Amended Franchise Rule. In September 2011, the FTC released its Regulatory Review Plan93 which was designed to comply with Executive Orders 13563 and 13579 issued by President Obama, which

92 The Australia Senate has issued a report that, for the most part, looks favorably upon the Bill. Explanatory Memorandum, Senate Report – Education and Employment Legislation, Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 ss 2.11-2.12, 3.54, 5.23, 5.33, 5.44 (Cth) (Austl.).

required “periodic review of existing regulations in order to determine whether those regulations should be modified, streamlined, expanded, or repealed.” At the time the FTC administered 66 rules and guides, including the Franchise Rule, which was scheduled for review in 2018.

FTC Franchise Rule staff were to begin preparing for the Franchise Rule review just as Donald Trump took office and announced his own agenda for addressing federal regulations. President Trump came to office having pledged to eliminate wasteful and costly regulations and began his efforts on his first day in office. On the day of his inauguration, President Donald Trump’s then chief of staff, Reince Priebus, issued a Memorandum on behalf of the President to all Federal Executive Department and Agency Heads stopping any new regulations from becoming effective until they had been reviewed and approved by the Office of Management and Budget (“OMB”) Director as being consistent with the policies of the new Administration.94

Ten days later, on January 30, the President issued an Executive Order titled “Reducing Regulation and Controlling Regulatory Costs,” Section 2 of which read:

“(a) Unless prohibited by law, whenever an executive department or agency (agency) publicly proposes for notice and comment or otherwise promulgates a new regulation, it shall identify at least two existing regulations to be repealed.”

The remainder of the Order required agency heads to make sure that the cost of all new regulations had a total incremental cost of no greater than zero, unless required by law or approved by the OMB Director.

Ironically, in the wake of the Memorandum and the Executive Order described above, the FTC determined that it should not proceed with the decennial review of the Franchise Rule that it had planned. Operating with only two commissioners, one affiliated with each party, the FTC leadership was already facing unique operational challenges, none of which had been alleviated as of the time this paper was being written in July 2017.

On February 24, 2017, another Executive Order was issued.95 The Order, titled “Enforcing the Regulatory Reform Agenda”, required each agency of the Federal Government (except for those who received waivers) to designate a Regulatory Reform Officer who was to head a task force within the agency to “evaluate existing regulations and make recommendations to the agency head regarding their repeal, replacement, or modification, consistent with applicable law.”

Citing regulatory review of Executive Orders of Presidents Clinton and Obama, the Executive Order appeared to require the FTC to begin reviewing virtually every one of its 66 trade regulation rules and guides within 90 days, raising questions about whether the 10-year rotation under which the FTC had been operating was to be pursued. This requirement was announced during a federal government hiring freeze announced by the President upon his inauguration, and at a time when at least two-thirds of politically appointed leadership positions within the FTC and other federal agencies lacked nominees or confirmed leaders.

On April 5, 2017, the Acting Administrator of the OMB issued a “Memorandum: Implementing Executive Order 13771, Titled “Reducing Regulation and Controlling Regulatory Costs.”” This 21-page Memorandum attempted to explain the 3-page Executive Order. Notably, it explained that independent regulatory agencies, as defined in the Paperwork Reduction Act, including the FTC, were not among the “agencies” subject to Order 13771.

What effect has this had on the Franchise Rule? One result is that as of July 5, 2017, the FTC had not yet begun to prepare for the 2018 regulatory review. Other effects may be seen in the May 23, 2017 FTC FY 2018 Budget Justification to Congress, which explains what the FTC had accomplished during 2016 and 2017, and what it would require in 2018 to carry out its mandates.

The Franchise Rule is administered by the Bureau of Consumer Protection (BCP), which administers numerous other consumer protection programs. Its Budget Request would cut the BCP staff by 15 persons and reduce its budget by $1,057,000 from 2017 funding levels. The total 2018 Budget Proposal for BCP is $171,099,000. Neither the Budget Justification nor the Performance Plan makes a single reference to the Franchise Rule.

In its description of recent accomplishments, the Budget Justification cited a single case involving a franchise, which was listed under the category of “Scams Targeting Veterans.” That case was brought against LearningRx Franchise Corp for allegedly deceptively claiming that their brain training programs were clinically proven to permanently improve serious health conditions like autism, dementia, Alzheimer’s disease, strokes and concussions. This is a case that relates to the services delivered by franchisees, and is a consumer protection case, rather than a franchise case.

The Budget Justification is silent about a review of the Franchise Rule. However, because the FTC is not subject to the Executive Order requiring that two regulations be discarded for every new regulation, one potential threat to its continuing existence seems to have been removed.

Finally, in addition to the regulatory reviews discussed above, the Franchise Rule is subject to the Paperwork Reduction Act (PRA). Under the PRA, federal agencies must obtain approval from OMB for each collection of information they conduct or sponsor. On June 6, 2017, the FTC published a notice in the Federal Register stating that it intended to ask OMB to extend for an additional three years the current Paperwork Reduction Act (PRA) clearance for information collection requirements contained in the Franchise Rule.

“Collection of information” means agency requests or requirements that members of the

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public submit reports, keep records, or provide information to a third party. As required by section 3506(c)(2)(A) of the PRA, the FTC issued a notice on this opportunity for public comment before requesting that OMB extend the existing clearance for the information collection requirements contained in the Franchise Rule.

The FTC invited comments on: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the agency’s estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

The FTC estimates that annual FDD updates required by the Franchise Rule require three hours of attorney time and one hour of clerical staff time of franchisors, and that the attorney time required to comply with the Franchise Rule for a new franchisor is estimated to be 30 hours.

B. NASAA Franchise Committee Works on Franchise Sales Law Improvements

Regardless of what type of Franchise Rule review is undertaken at the FTC, NASAA’s Franchise Project Group chaired by Maryland Deputy Attorney General, Dale Cantone, has identified several projects that will likely lead to changes in disclosure and registration practices. They include:

- Assisting registration and review states to implement the new NASAA Franchise Commentary on Financial Performance Representations;
- Revising the NASAA state cover page;
- Updating and revising the 2008 Franchise Registration and Disclosure Guidelines, especially as they relate to filing instructions and forms;
- Unifying risk factor assessments and disclosure requirements among the states; and
- Developing an electronic filing depository for all franchise states to use.

VI. CONCLUSION

In conclusion, we do indeed live in interesting times. It is gratifying to see the interest in addressing the confusion that has been caused by changes to the joint employer analysis adopted in recent years by federal agencies. Unfortunately, without certainty, it is difficult to predict how to protect franchise systems from these claims. Similarly, changes in accounting standards originally intended to address software licenses have the potential to wreak havoc on

103 See footnote number 67.
franchise systems. There are also questions as to how the SBA will handle issues related
franchise financing after this year and whether there will be an opportunity for stakeholders to
participate in that determination. Finally, we are left to ponder whether another FTC Rule
Review process is in our near future and how long it will last.
BIOGRAPHIES

Rupert Barkoff has been practicing franchise, distribution and corporate law with Kilpatrick Townsend & Stockton in Atlanta, Georgia since 1973 and is Chairman of the firm’s franchise practice. His franchise practice emphasizes solutions to registration and structuring issues and developing individual and collective solutions to franchisor-franchisee relationship problems. He is recognized as one of the United States’ leading franchise attorneys by The Best Lawyers in America, and has been voted by his peers as one of the ten most respected franchise lawyers in the world. Mr. Barkoff served three years as Chair of the American Bar Association’s 2000 member Forum on Franchising and has been awarded the Forum’s Lew Rudnick Lifetime Achievement Award. He was the Co-Editor-in-Chief of the Forum’s Fundamentals of Franchising book, has written over 350 published pieces on franchise law, and currently serves as a columnist on franchise law for the prestigious New York Law Journal magazine. He is now an adjunct Professor of Law at the University of Georgia Law School.

Susan Grueneberg is a Partner at the law firm of Snell & Wilmer L.L.P. in Los Angeles, California and is a certified specialist in franchise and distribution law. Ms. Grueneberg serves as Chair of the Industry Advisory Committee to the North American Securities Administrators Association (NASAA) Franchise Project Group and is a Past Chair of the American Bar Association Forum on Franchising. She is also a member of the International Franchise Association’s Legal/Legislative Committee. She previously served as Chair of the California State Bar Franchise and Distribution Law Commission, the commission that oversees the certification of legal specialists in franchise and distribution law in California. Ms. Grueneberg was also a member of the California State Bar Business Law Section Executive Committee, Chair of the California State Bar Franchise Law Committee and a member of the Board of Governors of the Century City Bar Association. She has written and lectured extensively at programs conducted by the California State Bar, the ABA Forum on Franchising, the International Franchise Association and California Continuing Education of the Bar. A graduate of UCLA Law School, Ms. Grueneberg also taught at the Chinese University of Hong Kong as a U.S. State Department Fellow, and received a National Academy of Sciences Fellowship for post-graduate study in economics at the University of Beijing. Ms. Grueneberg served as the Press Interpreter for the Chinese National Basketball Teams at the 1984 Olympics. She is co-editor of the ABA publication “The FTC Franchise Rule”.

Carl Zwisler is a partner in the Washington, D.C. office of Gray Plant Mooty. He practices international and domestic franchise law. As IFA’s chief staff counsel he spoke on franchise regulatory issues at the first ABA Forum on Franchising, and he has remained involved in regulatory issues ever since, including service as chair of the IFA/SBA Franchise Registry Task Force.