U.S. Chamber of Commerce

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Federal Trade Commission
600 Pennsylvania Avenue NW
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Re: Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices

The U.S. Chamber of Commerce submits these comments in response to the Commission's franchise solicitation, which focuses on "how franchisors may exert control over franchisees and their workers."[1] The solicitation suggests a desire to effectively destroy the franchise model in the United States, an objective clearly outside of the FTC's statutory authority and unsound as a matter of policy. Accordingly, although we always appreciate the opportunity to share our views, we urge the FTC to abandon this solicitation and devote its resources to appropriate enforcement efforts that actually fall within its jurisdiction.

First, the FTC lacks the statutory or constitutional authority to promulgate a rule that would purport to govern the relationship among franchisors, franchisees, and workers. These sorts of labor issues fall far outside the FTC's statutory mandate and institutional competence. Any such rulemaking effort would face strong legal challenges and waste enforcement resources.

Second, a broad, labor-oriented rule likely would render the franchise model effectively defunct, to the great detriment of the economy, the public, and the many individuals who avail themselves of this business model. The franchise model, which dates to the 1800s, generates more than 7.3 million jobs and an economic output worth more than $1.3 trillion. For the franchise model to succeed, the franchisor must exercise some level of control over how the franchisee operates.

Third, the solicitation signals that the FTC intends to effectively turns its back on its own Franchise Rule. In the Franchise Rule, the FTC recognizes that the franchisor must "promise to exercise significant control or provide significant assistance" in the franchisee's operations. Reversing more than four decades of precedent, the solicitation strongly suggests that the FTC now wants to regulate the very essence of the franchisor-franchisee relationship. The FTC may not and should not reverse its longstanding position without a significant factual basis for finding that its existing rule harms consumers.

For these reasons, the Chamber urges the FTC to abandon this inquiry and instead to enforce existing statutes and regulations relating to franchise agreements.

[1] See https://www.ftc.gov/news-events/news/press-releases/2023/03/ftc-seeks-public-comment-franchisors-exerting-control-over-franchisees-workers.

I. The FTC Lacks the Legal Authority to Regulate the Franchisor-Franchisee Relationship.

In the solicitation, the FTC cites Section 5 of the FTC Act, 15 U.S.C. § 45, and its prohibition on both unfair methods of competition and unfair or deceptive acts, for the proposition that the FTC has the authority to "prohibit certain contract terms." The FTC, however, lacks the legal authority to regulate the essence of the franchisor/franchisee relationship.

To the extent that any rule would rely upon the FTC's authority to combat unfair methods of competition, the agency lacks the statutory authority to promulgate a competition rule that changes the nature of the franchisor/franchisee relationship, including as it relates to employment. As the Chamber has explained in more detail previously, the FTC Act's text, structure, and history, as well as recent guidance from the Supreme Court, all point in the same direction: the FTC lacks the legal authority to promulgate a competition rule, particularly one that could eviscerate a widespread and longstanding business model.[2] Nothing in the Act's text expressly gives the FTC rulemaking authority to prohibit business practices or contracts that the agency deems an unfair method of competition. Indeed, such a broad grant of statutory authority would have been extraordinary, as it would have allowed unelected commissioners, with little guidance from the President or Congress, to dictate commercial practices across virtually the entire U.S. economy.[3]

Similarly, the FTC cannot rely on Section 18 of the FTC Act, which provides the FTC with the power to "prescribe interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices in or affecting commerce (within the meaning of Section (a)(1) of [the FTC] Act)" to promulgate any UDAP rule governing the franchisor/franchisee relationship. Unfairness, in this context, has been understood to mean harm to consumers. Deception, as that term has been used, involves efforts to mislead consumers through such artifices as material misrepresentations, omissions, or false claims. The solicitation, however, wanders far from these concepts into issues such as bargaining power, hiring practices, wages, and working conditions. To repeat: these labor issues lie far outside the FTC's statutory mandate and historical competence. Furthermore, practices are unfair only if there is harm to "consumers," 15 U.S.C. § 45(m). Franchisees—the supposed victims of these practices—are not "consumers." Nor is there anything "deceptive" about contractual restraints on franchisees' business decisions, as long as the restraints are fairly disclosed. In any event, the current Franchise Rule is sufficient to prevent deception of franchisees.

Additionally, FTC interference with franchise agreements is likely unconstitutional. Under the nondelegation doctrine, Congress can delegate lawmaking authority to an agency only if it

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[2] See, e.g., prior Chamber comments at https://www.uschamber.com/assets/documents/FTC-Noncompete-Comment-Letter_FINAL_04.17.23.pdf and https://www.uschamber.com/assets/documents/210927_comments_exclusionarycontracts_ftc.pdf.

[3] The Solicitation also cites the Robinson-Patman Act as a statute that may apply to the franchise context. Because the FTC lacks the authority to promulgate any competition rules, the FTC cannot base any rulemaking on this Act. More generally, the Chamber urges the FTC to focus its resources on enforcing statutes other than the Robinson-Patman Act, which has been widely discredited by economists and scholars as an ill-conceived measure that harms consumers. See https://www.uschamber.com/finance/antitrust/antitrust-legislation-the-robinson-patman-mistake-all-over-again.

provides an "intelligible principle" by which the agency can exercise it. *Mistretta v. United States*, 488 U.S. 361, 372 (1989). Similarly, the major-questions doctrine states that Congress must "speak clearly" when delegating decisions "of vast economic and political significance" to agencies. *Ala. Assn. of Realtors v. Department of Health and Human Servs.*, 141 S.Ct. 2485, 2489 (2021). But Congress never provided an intelligible principle by which the FTC can regulate franchise agreements (beyond the malleable word "unfair"), nor has it even instructed the FTC to regulate franchise agreements or employment conditions, which are questions of immense economic and political significance because franchises employ millions of workers and generate over a trillion dollars of economic activity per year.[4]

II. Any Type of Joint Employer Rule Would Harm Consumers and the Economy

Franchises have existed in one form or another for hundreds of years.[5] The growth of this business model was attributable to pursuit of the American Dream: people wanted financial stability, mobility, and freedom, and owning and operating one's own business—instead of being someone else's employee—was an attractive option. The franchise model gave motivated individuals economic efficiencies unavailable to stand-alone business owners, which in turn helped to kickstart their success. Today, franchising remains "a bedrock of the American economy." *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 441 (3d Cir. 1997). According to Census data from 2012, franchising generates 7.3 million jobs and an economic output of $1.3 trillion.

One of the most important benefits to franchisees is the opportunity for individuals to participate in the economic upside of a business as an owner, rather than just an employee. Unlike an employee, who is typically paid a salary, a franchisee can increase the size of its income stream and earn a greater return on investment by increasing the business's profitability.

The courts have recognized the importance of franchising to capital ownership and small business formation. As Justice Potter Stewart once explained, in warning against overly vigorous enforcement of antitrust laws against franchise relationships, "[t]he franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. If our economy had not developed that system of operation these individuals would have turned out to have been merely employees."[6] Stewart cautioned that "[i]ndiscriminate invalidation of franchising arrangements would eliminate their creative

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[4] See https://www.uschamber.com/assets/documents/FTC-Noncompete-Comment-Letter_FINAL_04.17.23.pdf.

[5] Francine Lafontaine & Margaret E. Slade, Franchising and Exclusive Distribution: Adaption and Antitrust, in 2 THE OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS 386, 388 (Roger D. Blair & D. Daniel Sokol, eds., 2015) (franchising is "as old as commerce itself" and "franchising in the United States can be traced back to the mid-1800s").

[6] *United States v. Arnold, Schwinn & Co*., 388 U.S. 365, 386-87 (1967), overruled by *Cont'l T.V., Inc. v. GTE Sylvania Inc*., 433 U.S. 36 (Stewart, J., concurring in part and dissenting in part) (internal quotation marks and citations omitted).

contributions to competition and force suppliers to abandon franchising and integrate forward to the detriment of small business. In other words, we may inadvertently compel concentration by misguided zealousness."

The franchise model thus serves as a reliable means through which individuals, especially those in underrepresented communities, can break into the ranks of small business ownership. "[I]n the small business ownership realm, franchisees of color and female owners are represented at a disproportionately higher rate, thanks to the assistance the franchise business format affords."[7] In fact, as of 2012, while minorities owned only about 18.8% of all other businesses, they owned 30.8% of franchised businesses.[8] Women also have historically taken advantage of the franchise model to break into the ranks of small business ownership, with "the rate of female-owned franchises gr[owing] by around 10% from 2007 to 2012" and by 24% in the decade through 2019.[9]

Finally, the franchise relationship also benefits consumers. Among other things, the model helps to "ensur[e] consistency and uniformity in the quality of goods and services." *Patterson v. Domino's Pizza, LLC*, 333 P.3d 723, 733 (Cal. 2014). The franchise model instills confidence in the consumer that he or she can walk into any store bearing a franchisor's branding and receive the same type and quality of goods and services. As one court explained, franchising "provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain. The franchise system of operation is therefore good for the economy." *Susser v. Carvel Corp*., 206 F. Supp. 636 (S.D.N.Y. 1962).

Unfortunately, any type of joint employment rule, including one created by the FTC despite its lack of authority, could devastate the franchise model and seriously harm consumers. As the Chamber explained in comments to the National Labor Relations Board,[10] a prior, overly aggressive employment standard may have cost the economy $33.3 billion per year, and up to 376,000 lost job opportunities. By reducing or eliminating the economic upside of business ownership for franchisees, such a rule would discourage the creation of new businesses. By imposing the costs of an employee relationship on franchisors, rather than a franchise relationship, such a rule would discourage franchisors from investing in people who have an interest in working in the field. All told, any such rule is very likely to leave consumers with fewer options, workers with fewer choices, women and minorities (and everyone else) with fewer opportunities to own their own businesses, and the overall economy with less investment.

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[7] INT'L FRANCHISE ASS'N & OXFORD ECONOMICS, THE VALUE OF FRANCHISING: A REPORT FOR THE INTERNATIONAL FRANCHISE ASSOCIATION 21 (Sept. 2021).

[8] See PWC, FRANCHISED BUSINESS OWNERSHIP BY MINORITY AND GENDER GROUPS: AN UPDATE FOR THE IFA FOUNDATION 1 (Mar. 9, 2018).

[9] Eric Stites, More Women Are Embracing Franchise Business Ownership, But There's More Work To Be Done, FORBES (Jan. 31, 2020).

[10] See https://www.uschamber.com/assets/documents/NLRB-2022-0001-11425_attachment_1.pdf.

III. The Solicitation Ignores the Principles Underlying the Franchise Rule, and Regulation Would Harm Franchisees, Workers, and Consumers

The FTC should abandon the solicitation for another reason: its tenor rejects the very premise of the FTC's venerable Franchise Rule. In place since 1979, the Franchise Rule operates as a pre-sale disclosure rule that requires specified disclosures to prospective franchisees. Franchisors must "disclose material information to prospective franchisees on the theory that informed investors can determine for themselves whether a particular franchise transaction is in their best interests." *7-Eleven, Inc. v. Spear*, 2011 WL 2516579, at *4 (N.D. Ill. June 23, 2011).

The Franchise Rule recognizes that franchisors can exercise "significant control" over its franchisees. Under the Rule, the franchisor must: (1) promise to provide a trademark or other commercial symbol; (2) promise to exercise significant control or provide significant assistance in the operation of the business; and (3) require a minimum payment of at least $500 during the first six months of operations. As the FTC has explained, "significant control" can include "personnel policies," "production techniques," and "hours of operation."[11]

The Franchise Rule wisely recognizes the myriad of reasons as to why franchisors must have the ability to exercise control over their franchisees. Franchising is "all about controls" to ensure consistency across franchised stores.[12] This approach "minimizes chain-wide variations that can affect product quality, customer service, trade name, business methods, public reputation, and commercial image." *Patterson*, 333 P.3d at 739 (observing that the "franchise contract consists of standards, procedures, and requirements that regulate each store for the benefit of both parties"). Franchisors want assurance that franchisees will deliver acceptable levels of service and convey consistent marketing messages. For this reason, franchising "places franchisees under added rules and surveillance as compared with [other] markets."[13] Perhaps most importantly, such control also ensures that a franchisor does not lose its intellectual property rights; the Lanham Act requires a franchisor to maintain control over a franchisee's use of its trademark, or else risk constructive abandonment of those rights.

For all these reasons, the FTC itself has recognized that a franchisor's necessary control over a franchisee should not create an employment relationship and that, for purposes of federal law, the franchisee-franchisor relationship is exclusive of an employer-employee relationship. In its compliance guide, the FTC acknowledges that, "Bona fide employer-employee relationships are excluded from coverage under the amended Rule."[14] In court, the FTC has explained that "[u]nder the Franchise Rule, 'employee' and 'franchisee' are mutually exclusive categories."

[11] See https://www.ecfr.gov/current/title-16/chapter-I/subchapter-D/part-436 and https://www.ftc.gov/business-guidance/resources/franchise-rule-compliance-guide.
[12] William L. Killion, Franchisor Vicarious Liability-the Proverbial Assault on the Citadel, 24 FRANCHISE L.J. 162, 164 (2005).
[13] Oliver E. Williamson, Comparative Economic Organization: The Analysis of Discrete Structural Alternatives, ADMIN. SCI. Q., Vol. 36, no. 2, 1991, at 283.
[14] See https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf.

The Commission also conceded that "employer-employee relationships do not satisfy the definitional elements of the term 'franchise.'"[15]

Despite the FTC's past acknowledgement that the Franchise Rule should not treat franchisees (or their workers) as employees of the franchisor, the current solicitation seems determined to lay the groundwork to do just that. For instance, the solicitation asks about franchise provisions "that determine wages, hours or working conditions of employees of the franchise," "that mandate franchisees to maintain certain hours of operation, and "that restrict or do not restrict the territory or sites where the franchisee may operate its business." The FTC's own compliance guide, however, recognizes that a franchisor's "significant control" over a franchisee properly should extend to "hours of operation," "personnel policies," "site approval," "site design," and "production techniques." Why is the FTC asking about these topics when they have been settled, for decades, as integral parts of the franchise model? Through this solicitation, it appears that the FTC is attempting to lay the groundwork to invalidate the franchise model as we have known it for decades, if not centuries.

Moreover, FTC regulation of the substance of franchise agreements would threaten the success of the franchise model and the economic wellbeing of countless franchisees—as well as millions of Americans who work at franchised businesses. The solicitation foreshadows FTC efforts to restrict franchisors' contractual relationships with franchisees and to impose bureaucratic oversight to regulate business decisions that are best within franchise systems. The FTC also appears poised to attempt to alter franchise systems' use of brand standards, which lie at the heart of the franchise model. For instance, the FTC appears to be considering restricting cost-sharing provisions allocating expenses between franchisors and franchisees, regulating or prohibiting contractual provisions and system practices by which franchisors can dictate the products and services franchisees offer, and limiting franchisors ability to screen and approve the suppliers and vendors from which franchisors purchase the goods and services they sell to the American public. Those changes not only could imperil one of the major economic engines of the past 50 years, but endanger workers and consumers alike.

FTC regulation would also be profoundly unwise. The franchise model succeeds because it delivers consistency. Consumers of a franchise know and expect that each and every location will offer functionally the exact same experience; products, services, quality, atmosphere, and prices will not differ between locations. Absent consistency, individual locations would struggle to attract new consumers. A lack of consistency would also inflict reputational harm on the franchised brand as a whole; if just one location fails to meet franchise standards, consumers will be less likely to patronize other locations in the future, resulting in diminished brand value.

[15] See https://www.ftc.gov/system/files/documents/amicus_briefs/dhananjay-patel-et-al-v-7-eleven-inc/ftc_franchise_rule_brief_final_sl_copy_1_file_stamped.pdf. In the same case, the First Circuit noted that it "appears difficult, if not impossible" for a franchisor to satisfy the Franchise Rule's control requirement and also avoid being deemed an employer for purposes of state law. *Patel v. 7-Eleven, Inc.*, 8 F.4th 26, 28 (1st Cir. 2021).

Consistency is impossible without contractual restraints. Franchisees have incentives to free-ride on the value of the brand and to maximize short-run profits by reducing costs. They can accomplish this by purchasing cheap suppliers or offering inferior products. They can also do so by reducing workplace safety, putting workers and customers at risk. Contractual restraints protect the franchise system's long-run interests in quality and consistency by preventing free-riding. This benefits the brand, franchisees, and workers—especially when contractual restraints promote workplace safety by requiring franchisees to purchase high-quality supplies or to invest in worker training.

Conclusion

The franchise relationship is intentionally not an employer-employee relationship. And both the franchisor and the franchisee want it that way. Franchisees are themselves small business owners, investing their own capital into the business and having personal economic stakes in the success of the enterprise. Those stakes benefit the franchisees, who can realize capital appreciation; the franchisor, which secures returns from its franchisee-operated stores; and consumers, who experience uniformity and consistent high-quality from a recognized brand.

The Chamber urges the FTC to abandon this solicitation and direct its resources to enforcing existing statutes and regulations relating to franchise agreements.

Sincerely,

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