FTC Warns Franchisors Against Unfair Practices and Spotlights Risks in Franchising

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July 19, 2024

> On July 12, 2024, the Federal Trade Commission (FTC) issued a policy statement and staff guidance expressing its "growing concern about unfair and deceptive practices by franchisers."

The FTC administers the federal franchise sales law, which requires all franchisors engaged in franchise sales in the United States to deliver a franchise disclosure document (FDD) to their prospective franchise buyers unless the transaction qualifies for an exemption. The federal pre-sale disclosure rule aims to prevent unfair and deceptive practices by ensuring that potential franchise buyers have information in the form of a legally-compliant FDD so they can make an informed investment decision about a franchise opportunity.

Since the Biden administration took office, the FTC has been scrutinizing franchisor practices. In March 2023, it initiated a comprehensive review of the federal franchise sales law through a Request for Information ("RFI") (discussed here.) The RFI asked the public various questions probing into franchisor business practices, including how franchisors exert control over franchisees and their workers.

The 2023 RFI produced nearly 5,300 comments, a majority from franchisees many of whom refused to identify themselves saying they feared retribution from their franchisor.

The following summarizes the FTC's July 12, 2024 policy statement and staff guidance, in which the FTC recognizes the importance of franchising to the U.S. economy and offers its first public reaction to the RFI comments that were amassed:

- The FTC sternly warns franchisors not to impose fees on franchisees that are not disclosed in their FDD or retaliate against franchisees who speak with government officials. The Biden administration has railed against "junk fees" in various other settings, including credit card late fees and live event ticket agency fees. A number of franchisee commentors to the 2023 RFI complained about "surprise" and "junk" fees not disclosed in the FDD they received before signing the franchise agreement. Some reported that their franchisor claimed a right to collect undisclosed fees by changing the franchise system's Operating Manual. The FTC denounced this practice as an "unfair" trade practice. The FTC also condemned using non-disparagement provisions in a franchise agreement, which forbid a franchisee from speaking negatively about the franchisor or franchise brand, to stifle franchisee communications with franchise regulators. The so-called guidance from the FTC offers no direction on whether franchisors must remove non-disparagement clauses from their franchise agreements or how they should tailor these provisions to avoid inhibiting law enforcement communications.

- In a lengthy "Issue Spotlight" accompanying the policy statement and staff guidance, the FTC identified the top dozen concerns raised by franchisee commentors in their responses to the 2023 RFI. Notably, the Issue Spotlight names the franchise chains most frequently mentioned by franchisee commentors as bad actors:

Top Dozen Concerns for Franchisees	Frequently Referenced Franchises
1. Unilateral changes to franchise operating manuals	Home Instead
2. Franchisor misrepresentations and deception	Premier Martial Arts (owned by Unleashed Brands) Dickey's Barbecue Pit
3. Fees and royalties	Home Instead Dickey's Barbecue Pit
4. Franchise supply restrictions and vendor kickbacks	Dickey's Barbecue Pit Edible Arrangements
5. Actual and feared retaliation	Premier Martial Arts (Unleashed) Subway
6. Non-competes and no-poach clauses	N/A
7. Franchise renewal problems	Home Instead Subway
8. Franchisor refusal to negotiate contract terms	N/A
9. Franchise Disclosure Document issues	Unleashed Brands Dickey's Barbecue Pit
10. Private equity takeovers	Home Instead Unleashed Brands
11. Marketing fund transparency	Subway Dickey's Barbecue Pit Edible Arrangements
12. Liquidated damages clauses and early termination fees	N/A

The Issue Spotlight creates an extensive public record of unfair and deceptive practices by franchisors based on anecdotal comments from franchisees without any sort of regulatory or judicial fact-finding.[1] The FTC has not conducted any public hearings since the RFI's public comment period closed on June 8, 2023. The FTC is not expected to do anything further on the RFI until after the 2024 presidential elections. Curiously, however, it has reopened the public comment period welcoming new comments to the 2023 RFI through October 10, 2024, online at https://www.regulations.gov/document/FTC-2023-0026-2219.

The FTC July 12, 2024 release was not accompanied by any new enforcement actions. In 2022, the FTC brought its first enforcement action against a franchisor in over 10 years against quick-service burger restaurant franchisor, Burgerim Group USA, Inc., and its owner for "using false promises while withholding information required by its Franchise Rule" in selling franchises to more than 1,500 people each of whom paid Burgerim between $50,000 and $70,000 in franchise fees and most of whom were never able to open their restaurants after Burgerim pocketed their money. In January 2024, a federal district court awarded the FTC over $56,000,000 in damages and penalties and upheld a permanent injunction forbidding the franchisor's owner from ever selling any franchises again. See https://www.ftc.gov/legal-library/browse/cases-proceedings/2023057-burgerim-us-v.

If you have questions about this update or would like additional information, please contact us.

[1] The fact that a specific franchise chain is disproportionately referenced in connection with a particular issue may be due to that system having a well-organized franchisee association that supplied its franchisee members with a form comment letter to submit during the RFI public comment period. A casual spot check of the public comments shows numerous identical comments submitted by franchisees of the same system. The International Franchise Association also supplied its members with a form comment letter to register the IFA's position on the RFI. Special-interest groups often use this tactic to tip the scale during public comment periods.