

June 8, 2023

The Honorable Lina Khan
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: FTC-2023-0026-0001, Franchise Agreements and Franchisor Business Practices Request for Information

Dear Chair Khan:

As a leading representative of America's 33 million small businesses, we are pleased to provide these comments to the Federal Trade Commission (FTC) as it develops a fuller understanding of franchise agreements. We spoke with many small business owners in our network who are franchise owners about the challenges they face in operating successful franchises, and we hope this feedback will be insightful as the Commission examines this issue.

Small Business Majority is a national small business organization that empowers America's diverse entrepreneurs to build a thriving and equitable economy. From our nine offices across the country, we engage our network of more than 85,000 small businesses and 1,500 business and community organizations to deliver resources to entrepreneurs and advocate for public policy solutions that promote inclusive small business growth. Our work is bolstered by extensive research and deep connections with the small business community that enable us to educate stakeholders about key issues impacting America's entrepreneurs, with a special focus on the smallest businesses and those facing systemic inequities.

Franchising can be an important pathway to entrepreneurship for many Americans, particularly for BIPOC individuals. According to [Franchising World](#), the minority franchise ownership rate is 26%, compared to 19% for non-franchised small businesses. However, without rules to ensure a level playing field, franchisees will operate on an unequal playing field, making them vulnerable to unfair contract terms.

The common perception is that in a franchise relationship, franchisees simply pay a royalty fee to the franchisor in exchange for a business format and structure, including the right to use the franchisor's trademark for a specific number of years and to receive business assistance. However, in practice too many franchisees discover that owning a franchise can be egregiously one-sided.

We examine six elements that illustrate inequities in the franchisor-franchisee relationship.

1. Upfront disclosures

Many franchise owners tell us that they would have appreciated more transparency in the actual cost of owning and running the franchise. For example, the initial contracts that are signed do not necessarily disclose all fees that may be incurred after the business is in operation. One franchise owner we spoke with said that while they were aware of the base 5% royalty fee required of them, they did not understand that there was an additional marketing fee to be charged after their franchise was operational. Lastly, the financial arrangement of these contracts is subject to change at the time of renewal or at the time a franchisor comes into new ownership, with the franchisee having no negotiating power.

A possible solution to this problem would be to require full transparency in the contract, making the would-be franchise owner aware of all financial obligations.

2. Unilateral contract changes

We've also heard from small business owners in our network that franchise owners are rarely able to negotiate the terms of the contract. In fact, to exert control the franchisor will often update or change the operation manual during the course of the franchise term. However, members of our network report that the operation manual can be modified and amended at any time, putting franchisees at a disadvantage. Another franchise owner explained that they have “no power” to advocate for themselves when their operation manual changes and that the changes made do not increase the bottom line of the business. Failure to comply with new operating regulations could result in termination.

One solution to offset the power imbalance would be to allow franchise owners the ability to negotiate the terms of operation manual changes and/or postpone them until the time of renewal.

3. Requirements to purchase from third-party vendors

Franchise owners in our network often have been contractually obligated to do business with certain vendors for supplies and materials. Furthermore, some of them report that the contracted vendors are either owned by the franchisor or there is an economic benefit to the franchisor for said vendor to be contracted. The vendor contracting agreement may put the franchisee at a further disadvantage in terms of the price of materials, the geographic location of the vendor to the franchisee and the conditions in which the materials arrive. Another franchise owner spoke about how in her agreement there was “a requirement to purchase 80% of materials from a specific vendor.” In this case, the vendor was owned by the franchisor.

More equitable vendor agreements would allow for more competition and enable franchise owners to make economic decisions that benefit their bottom line, rather than that of the franchisors.

4. Non-recoverable capital investments

We have also heard from franchise owners that they have been required to purchase branded merchandise or equipment from their franchisor and make unrecoverable improvements or renovations to their businesses. Thus, if the business owner leaves the franchise at the end of the agreement, they are not able to take any of the equipment or furniture they have purchased to their next venture.

Franchise owners should not be forced to make these types of investments in the business. The required purchase of new equipment or furniture should be the franchisor's fiscal responsibility.

5. Unilateral termination

We also hear frequently from franchise owners that they are afraid to speak about their franchise relationship, no matter how unfair, because of a fear of retaliation. Retaliation—in the form of terminating the contract agreement on spurious grounds—is a real threat and the reason why the comments provided by small business owners in our network are anonymous. Some franchise owners feel that the regulations in their agreements are structured so tightly that it is nearly impossible to fully comply with all of them, giving the franchisor an excuse to capriciously terminate the agreement.

Franchisees have no power to seek due process of law if they feel that the franchisor is targeting them or acting in retaliation. Allowing franchise owners the ability to seek due process is imperative to make these agreements more equitable.

6. Non-compete agreements

Regardless of geography or industry, all of the franchise owners we spoke with shared that they felt particularly powerless and taken advantage of because they had signed non-compete agreements. This was unanimously their number one complaint. Non-compete agreements reduce franchisees' bargaining power by preventing them from taking their skills, acumen, client lists and products elsewhere. Too often this binds them to a one-sided business arrangement.

The FTC should consider the disproportionate impact of non-compete agreements on franchisees in considering their proposed rule to ban these one-sided agreements.

Small Business Majority appreciates the opportunity to comment on the Federal Trade Commission's request for information on franchisor-franchisee agreements. We urge the FTC to consider the above comments and consider measures that will better support franchisees as they strive to operate successful businesses.