



October 14, 2015

Consumer Affairs Committee
PA House of Representatives
Harrisburg, PA

RE: House Consumer Affairs Committee Hearing- HB 1346 (Daley)

Ladies and Gentlemen:

This is in support of the testimony I plan to give on Wednesday, October 21, 2015 at the Hearing on HB 1346 which is scheduled on that date.

Before getting into the substance of my comments on the Bill, I thought it might be helpful to describe my involvement in the franchise community as I previously indicated when I testified on HB 1620 in 2013. I believe my involvement in franchising is unique and different from others who may appear before the Committee because my experience reflects my position(s) as a franchisor; a franchisee; and as a consultant working with potential franchisees who are seeking help in selecting a franchise which fits their business goals and objectives. I help them through the process of doing the research on franchises to determine whether they understand the risks and rewards of owning a business. In the latter case, for more than 25 years, my Associates and I in Pennsylvania have worked with almost 300 individuals and groups who have expressed an interest in owning a business and have requested our help in finding a suitable franchise opportunity. We have assisted them in conducting the research necessary to understand the different opportunities before deciding if their selection was a good fit for them and represented a risk worth taking.

As mentioned above, I am involved in franchising as a franchisor, a franchisee and as an intermediary working with more than 100 quality franchises and attempting to find franchise candidates who are fully informed about the opportunity and prepared to speak with the franchisor about the franchise and ready to conduct due diligence. As a franchisor, I was a founder of FranNet, a franchisor offering franchise consulting for purchasing franchises. FranNet, which is now headquartered in Louisville, Kentucky, has 65 offices throughout North America. The owner(s) of the offices perform the

consulting services described above. Each office represents carefully selected and screened franchises and introduces appropriate franchises to qualified candidates. A FranNet franchisee performs the same service in their respective markets which I and my colleagues perform in Pennsylvania. I served as Chairman and CEO of the franchising company and I am now Chairman Emeritus. My office in Pennsylvania has successfully launched more than 300 individuals into business ownership since 1990, while nationally FranNet places hundreds of people into quality franchises. So I wear the hat of franchisor as well as franchise coach and intermediary.

But I am also a franchisee. A portion of my business has to do with the sale of existing businesses. And I do so as a franchisee of Sunbelt Business Brokers. I have been a franchisee of Sunbelt since 1998 and I am part of a system with franchised offices throughout the world. My franchised office covers parts of Southeastern Pennsylvania.

The reason for giving you all of this information is to explain why my comments to HB 1346 come from someone who understands the viewpoint of all sides in this matter. I can speak dispassionately about the Bill and its impact on the basic franchise relationship between franchisor and franchisee.

The franchise opportunity does not guarantee success. Nor, within a franchise system will each franchisee achieve the same level of success as other franchisees. What a franchise does is improve the potential for success compared to starting a business in which the business owner does not have a system to follow. The success factor has proved true statistically. Moreover, not every franchisee is as successful as every other franchisee. That is why due diligence is so critical before anyone enters into the franchise relationship. The potential franchise owner must know several things before making a decision. He must know the quality of the system; the strength of the franchisor; and whether the franchise matches the strengths of the potential owner. Fortunately, franchises operate in a heavily regulated environment and the information is available and disclosed. However, as with any other important decision, it is incumbent upon the prospective franchise owner to get the information and study it before making a decision. Once that is done, each individual makes his own decision and assumes the risk of being successful or unsuccessful. The franchisor cannot guarantee the level of success which will be achieved. The unknown ingredient is the individual franchise owner and how well he will follow the system. By definition, not all franchisees in a system will be as successful as other franchisees and not all franchise systems will be as successful as other systems. There is an obligation on the part of the franchisee to get the facts and make an informed decision. Starting a business always involves taking a risk, but understanding beforehand the risk as well as the potential reward is key. Just as a franchisor is obligated to develop and maintain a system which will keep franchisees competitive in the marketplace, the franchisee also has obligations in a free market society. There are no guarantees, but things are leveled so long as both sides have access to relevant information.

HB 1346 states, and presumably creates a need for this legislation that (Section 5502(a)(5)) that most franchisees lack bargaining power and generally invest substantial amounts to obtain a franchise business when they are unfamiliar with operating a business, with the business being franchised and with industry practices in franchising; (4) many franchises reflect a profound imbalance of contractual power in favor of the franchisor, and fail to give due regard to the legitimate business interests of the franchisee.....; (5) Franchisees may suffer financial losses when the franchisor does not act in good faith.....(6) Traditional common law doctrines have not evolved sufficiently to protect adequately from fraudulent or unfair practices.....and (7) A franchisee's freedom to contract is greatly limited by the disparity of bargaining power and lack of consistent legal standards. This Act is necessary to restore freedom to contract and to remove restrictive barriers impeding entry into industries and markets dominated by franchise systems. (Underline emphasis added).

Setting aside my basic disagreement with the premise that there is an imbalance of contractual power which I base on practical experience of the way franchise agreements are negotiated, the premise and the remedy make no sense. It makes no sense to state that common law does not protect franchisees from fraudulent or unfair practices, when the proposed legislation makes no attempt to define what constitutes a fraudulent or unfair practice. Instead it proposes a series of remedies which are applicable irrespective of whether there exists a fraudulent or unfair practice. It is made applicable to **ALL** franchise agreements.

Additionally, in stating that it is necessary to restore freedom to contract and remove restrictive barriers impeding entry into industries and markets dominated by franchise systems, what can that possibly mean? Does a prospective franchisee have a right to only enter into a contract deemed acceptable by the franchisee? Is there now a right to enter markets dominated by franchise systems? And is there a right to renegotiate a franchise agreement after the parties have agreed to it to meet whatever is perceived as the above? It makes no business sense, and could destroy the uniformity of a franchise system which would be detrimental to all other franchisees.

The proposed legislation neither addresses nor offers solutions to any of these key issues which form the basis of HB 1346.

Let me now put other specific issues in the context of HB 1346.

1. The Bill provides a broad definition of good faith on the part of the franchisor. Good faith is very difficult to define. Specifically Section 5503 states that "Good faith is Honesty in fact and the observance of commercial standards of fair dealing". Those words are inserted throughout without a definition in any instance of what constitutes good faith. That is very vague and could give rise to new causes of action with the language to be factually interpreted by a Court. It opens up the possibility of an unhappy or underperforming franchisee in a successful franchise system claiming that they were not able to enjoy the benefits of being part of the system

despite many others being happy and successful, by raising the claim of lack of good faith and fair dealing.

2. Section 5504 of HB1346 makes HB 1346 applicable not only to the franchisor but to any person who engages directly or indirectly in contracts in this Commonwealth in connection with the offering or advertising for sale or has business dealings with respect to franchises in this Commonwealth. What does this mean? Can it mean that the Counsel for the franchisor is covered, or the lender who finances the transaction, or the franchise consultant who introduces franchise concepts to a prospective franchisee with instructions as to how to research the opportunity? Can it also mean the internet portal which advertises franchises?
3. Section 5504(f) discusses the issue of termination of the Agreement by the franchisee. It gives the franchisee the right to terminate the franchise agreement for good cause, presumably no longer burdened by any provision of the Agreement. This Section states that good cause shall include changes to the franchise system or competitive circumstances of the franchise agreement. This would cause substantial negative impact or financial hardship to the franchisor in the operation of the franchise. This, again, creates no precise standard(s) which makes the intent difficult to define. This is the very thing which HB 1346 accuses the franchisor of doing and seeks to remedy, but makes no such burden on the franchisee.
4. Conversely, and incorporating my thought in 3 above, when addressing the obligation of the franchisor to renew the term of the franchise agreement (perhaps in perpetuity), HB 1346 contains multiple provisions which extend cure rights; and it severely limits the ability of the franchisor to act promptly to protect the integrity of the system. There are, in fact, instances of default which deserve an opportunity to cure. But to require, if criminal activity is involved, that termination cannot occur until conviction of the crime and exhaustion of all appeals is illogical. In the criminal justice system it could take years until there is a final determination which would give the franchisor the right of termination. In the interim, the system and other franchisees could suffer great and lasting harm.
5. Section 5509 requires the franchisor, upon termination of a franchise, to compensate the terminated franchisee for the fair market value of (i) the franchise; and (iii) goodwill. Section 5509 does not in any way distinguish between rightful and wrongful termination. But of even greater importance, both (i) and (iii) are intangible assets. There is no way, without a formal valuation done by a valuation expert, of fixing this value. It is difficult enough to determine the value of tangible assets. But it is impossible, without the investment of both time and money, to determine the value of intangible assets.

While there are several other issues I could touch on, these are my major points. The key point is that a well-informed franchisee candidate will make a good decision and it may be to pass on the opportunity. But not everyone is successful, and legislation cannot guarantee universal success. If a franchisee has been defrauded or misled, they should be made whole if they suffer a loss. However, giving broad and undefined power to a fact finder makes little business sense. It creates a private cause of action to anyone who feels aggrieved and that makes no sense. Franchising has been very

successful in Pennsylvania and has been a significant driver of job creation. It is counterintuitive to interfere with that by making it hazardous to do business in Pennsylvania.

I also note that I reside in Ambler, Pennsylvania and I am a constituent of Representative Todd Stephens. He and I have spoken and I have explained to him why I think the Bill is so important. And why its passage could be so detrimental to the growth of business in Pennsylvania. Clearly the rights of franchisees must be protected and they are protected by contract. If they are defrauded they must have a remedy. But creating new rights outside of the contract or short of the standard of fraud is wrong.

I look forward to being present on October 21 and presenting my views and answering questions.

Very truly yours,

Steven A. Rosen

Chairman Emeritus, FranNet