

Franchising in an Entrepreneurial Age

By George Ward

Just as reports in the 1920s and '30s of investors being cheated by fraudulent stock sales led to the adoption of the federal Securities Act of 1933 and the 1934 act which created the federal Securities Commission, reports in the 1950s and '60s of retirees being convinced to use their life savings to acquire and operate local franchise businesses only to lose everything as a result of an obscure term in the franchise documents prompted victims to look to Congress for remedial action.

In 1967, Michigan Sen. Phil Hart introduced the Franchise Competition Practices Act, which was intended to regulate franchise relationships and prohibit terminations, cancellations, and failures to renew for other than *good cause*. The bill also required franchisors to give franchisees at least 90 days' advance notice before any termination.

Although Congress never passed Hart's bill, its Small Business Committee published a report entitled *Impact of Franchising on Small Businesses*, which led states to enact general¹ franchising laws to level the playing field between the financially stronger franchisors and the financially weaker franchisees.

California was the first to act. In 1970, it passed the California Franchise Disclosure Law. Later in the '70s, the Federal Trade Commission promulgated the FTC Franchise Rule, which required that prospective franchisees be given a franchise offering circular with 20 categories of information about the franchising company and its owners and officers. Presently, at least another 17 states including Michigan² have general statutes regulating franchise sales and relationships.

For a business contract to constitute a franchise contract, it must contain three elements: (1) the grant of a license by the franchisor to the franchisee to use a trademark

or service mark in the conduct of the franchisee's business, (2) payment by the franchisee of a fee to the franchisor for that right, and (3) a marketing plan prescribed by the franchisor (or as some states express the requirement, "community of interest"). These three elements turn a standard business contract into a franchise contract.

Product franchise

Singer Sewing Machine Co. is often cited as the first example of the product form of franchising in which the franchisor manufactures and sells finished products to dealers (franchisees) who resell the products to consumers or others in the chain of distribution.

Product franchising evolved from exclusive agency relationships involving small firms serving a limited market to sizeable firms selling in regional markets.

Business format franchise

Franchising took off after World War II with the development of the business format franchise. Howard Johnson's restaurants and motels are often cited as the first example of this type of franchise. Unlike product franchising, business format franchising provides not only a license for use of the franchisor's trademark or service mark, but also a complete business plan and marketing strategy with operating manuals, quality

control standards, and a process of continuing assistance and guidance for franchisees and employees.

Some of the names behind the explosion of business format franchises after World War II are Harry Axene, who spread the Dairy Queen franchise throughout the United States; Kemmons Wilson, who developed the Holiday Inn chain of hotels; Harland Sanders, who started Kentucky Fried Chicken at age 62 by licensing restaurants to use his secret recipes; Al Tunick, owner of the Chicken Delight franchise; William Rosenberg, who established the Dunkin' Donuts franchise; and, of course, the subject of the recent movie *Founder*, Ray Kroc, who developed the McDonald's system of franchising.

Franchising continued to prosper in the 1980s and '90s. In 2005, the International Franchise Association retained PricewaterhouseCoopers (PwC) to study the economic effect of franchising. The PwC report concluded that franchise businesses generate an annual economic output of \$2.3 trillion, or 11.4 percent of the total U.S. sector output.³

Resources for practitioners of franchise law

Despite the importance of franchising to the U.S. economy, the American Bar Association stated as of June 2013 that "more than 30 years after franchising became a regulated part of the economy, there are

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only a handful of law schools—maybe ten—which offer Franchise Law as a course of study.”⁴

So how can practitioners develop expertise⁵ in this field of law? Fortunately, there are a number of excellent resources available to anyone interested in this field.

Franchise opportunities handbook

Michigan practitioners are provided an excellent resource by MCL 445.1505a, which says:

The department [of Attorney General], in cooperation with the Michigan consumers council, shall prepare and make available to an interested agency or person a *franchise opportunities handbook* containing information to be used by a potential franchisee in evaluating a franchise offering. (Emphasis added.)

In accordance with this statute, the attorney general published *Guidelines for Prospective Franchisees* with this helpful message:

This booklet has been set up so you can first read an explanation of what you should be looking for and then use the checklist to evaluate the franchise.... When you finish the evaluation, you should have a fairly complete picture of most aspects of the franchise.⁶

American Bar Association's *Franchising: Cases, Materials & Problems*

As its table of contents shows, this book is an attempt to organize for the practitioner all aspects of law applicable to the complex relationship among parties to a franchise. In that sense, it's among the best study resources available.

International Franchise Association

The International Franchise Association has a plethora of papers on various franchise subjects.

Federal Trade Commission

The Federal Trade Commission publishes many guides including:

- *Buying a Franchise: A Consumer Guide*
- *Amended Franchise Rule Compliance Guide*

- *Amended Franchise Rule FAQs*
- *Basic Franchise and Business Opportunity FAQs*

Additional resources

Other resources include:

- Julie Bennett, John Hamburger & Cheryl Babcock, *Franchise Times Guide to Selecting, Buying and Owning a Franchise* (Sterling Publishing Co., Inc. 2008)
- The Federal Trade Commission, *A Consumer's Guide to Buying a Franchise* (June 6, 2015), pp 1–7, available at <<http://www.ftc.gov/tips-advice/business-center/guidance/consumers-guide-buying-franchise>>
- Louis J. Lefkowitz, *Franchising Abuses—One State's Approach*, 75 Case & Com 13, 13–17 (July–August 1970)
- Norman D. Axelrad, *Franchising—Changing Legal Skirmish Lines or Armageddon? Some Observations from the Foxhole*, 26 Bus Lawyer 695, 699–709 (January 1971)
- Mary L. Brown & Lynn R. Price, *The Federal Trade Commission Franchise Disclosure Rule*, 13 J Marshall L Rev 637 (1979–1980)

The *Franchise Law Journal* contains many valuable historical and current articles, including:

- Gerald C. Wells & Dennis E. Wiczorek, *A Road Map to the New FTC Franchise Rule*, 27 Franchise L J 105 (Fall 2007)
- William L. Killion, *The Modern Myth of the Vulnerable Franchisee*, 28 Franchise L J 23 (Summer 2008)
- Victor Vital & Elizabeth Wirmani, *Surviving the Amended FTC Franchise Rule: Merger and Integration Clauses, Franchise Agreements, and Disclosure Documents*, 30 Franchise L J 88 (Fall 2010)
- Peter C. Lagarias & Edward Kushell, *Fair Franchise Agreements from the Franchisee Perspective*, 33 Franchise L J 3 (Summer 2013)
- Brian B. Schnell & Ronald K. Gardner Jr., *Battle over the Franchisor Business*

Judgment Rule and the Path to Peace, 35 Franchise L J 167 (Fall 2015)

- Susan Grueneberg & Ann Hurwitz, eds, *The FTC Franchise Rule* (2d ed, ABA Forum on Franchising, 2012)
- Rupert M. Barkoff, et al, eds, *Fundamentals of Franchising* (4th ed, ABA Forum on Franchising, 2015)
- Will K. Woods, ed, *Fundamentals of International Franchising* (2d ed, ABA Forum on Franchising, 2013)
- W. Michael Garner, *I–III Franchise and Distribution Law and Practice* (2016–2017 ed, Thomson Reuters) ■



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ENDNOTES

1. In addition to general franchise laws, a number of special franchise laws apply to particular businesses; for example, the Dealers' Day in Court Act (15 USC 1221–1225), Petroleum Marketing Practices Act (15 USC 2801), State Motor Vehicle Dealer Acts, and Farm Implement and Heavy Equipment Dealer Acts.
2. See MCL 445.1501 *et seq.*
3. PricewaterhouseCoopers, *The Economic Impact of Franchised Businesses, Volume II: Results for 2005* (January 31, 2008), p 7 <http://www.franchise.org/sites/default/files/ek-pdfs/html_page/EconomicImpactVollpart1_0.pdf> (accessed April 13, 2017).
4. Meiklejohn, *Franchising: Cases, Materials & Problems* (Chicago: American Bar Association, 2013).
5. See *Nebraska v Orr*, 277 Neb 102; 759 NW2d 702 (2009) (finding the defendant violated the canons of ethics for accepting a franchise case without having expertise in the field).
6. Schuette, *Guidelines for Prospective Franchisees* <https://www.michigan.gov/documents/mifran_guide_40368_7.pdf> (accessed April 13, 2017).