

Publications

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FTC Issues Statements Signaling Major Changes to its Oversight of Franchise Relationships and Franchise Disclosure Requirements

On July 12, 2024, the FTC released several statements and a News Release as its first response to comments collected in response to the March 2023 Franchise Request for Information (RFI). These actions are part of the FTC's ongoing rule-making process within the framework of an apparent larger policy shift by the FTC to increase its efforts to regulate franchising. The legal and practical significance of these different statements have differing impacts, but all signal more activity by the FTC on several levels.

First, the FTC released a Policy Statement on a franchisor's inclusion or use of certain contract provisions, including non-disparagement, goodwill, and confidentiality clauses, in franchise and other agreements. Approved by the commissioners in the 3–2 vote, the Policy Statement asserts that it is an unlawful and unfair and deceptive practice in violation of the FTC Act for a franchisor to include clauses that restrict franchisees' communications with state or federal law enforcers or regulators about potential law violations. The Policy Statement makes clear that franchisors cannot prevent or retaliate against franchisees for speaking out or making complaints through such contractual provisions (or otherwise), including by asserting that complaints to the FTC or responding to investigation efforts are breaches of such clauses in a franchise agreement or settlement agreement. For example, the Policy Statement means that a franchisor may not threaten termination of a franchise agreement for the franchisee's violation of the non-disparagement clause if the franchisee alerts the FTC of a law violation by that franchisor.

Second, the FTC released Staff Guidance regarding franchisors' charging franchisees undisclosed fees. The staff guidance takes the position that any new or increased fee not disclosed in the Franchise Disclosure Documents (FDD) is likely a violation of Section 5 of the FTC Act and cites various cases pertaining to the same. The FTC Franchise Rule requires that franchisors disclose fees in their FDD. See 16 C.F.R. § 436.5(e), (f), (i). The FTC staff issued this guidance in response to reports by franchisees of franchisors adding fees, including to address new services and technology franchisors are adding to their systems. The FTC staff made clear that unilaterally changing operating manuals and other documents to impose and collect fees previously not disclosed in the FDD is a violation of the FTC Act in its view. While the Staff Guidance is less clear on whether undisclosed increases to disclosed fees would be considered a violation, the staff guidance certainly

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creates significant questions in that regard.

While neither the Policy Statement nor Staff Guidance are judicial rulings or amendments to the Act, such statements reveal the FTC's interpretation of the Act and emphasize the way the FTC will enforce its rules.

Third, the FTC released an Issue Spotlight listing and describing the top 12 complaints from franchisees in response to the 2023 Request for Information. As part of the required rule-making process and procedure, to issue or amend a federal agency rule, the agency must undergo a notice and comment period and provide written responses and feedback to the relevant comments it receives. As part of the FTC's current rule-making process, it issued an RFI in March 2023 seeking comments on several points. On July 12 it issued some feedback in the form of an "Issue Spotlight." The FTC said it was addressing the topics raised in over 2000 of the comments received. It stated that it received over 5000 comments but that over 3000 were "irrelevant" so it was not providing a response or comment on those. In this regard, focusing on complaints from the franchisee perspective, the FTC ranked the top 12 issues raised. The top 12 issues include the imposition of fees, renewal problems, unilateral changes to franchise operating manuals, actual and feared retaliation, franchise supply restrictions and vendor kickbacks, liquidated damages clauses, and early termination fees, among other issues.

Fourth, the FTC reopened the 2023 Request for Information from franchisees, franchisors, and other stakeholders until October 10, 2024. The original comment period opened on March 20, 2023. The FTC had sought public comment on various franchise business practices, including how franchisors may exert control over franchisees and their workers and how franchisors disclose certain aspects of the franchise relationship and contractual terms. Interested parties may now add comments directly to the FTC throughout its web page.

In addition to the above, the FTC published Inflation-Adjusted Monetary Thresholds for three exemptions in the Franchise Rule. Under 16 C.F.R. § 436.8, there are available exemptions from the FTC disclosure laws for certain relationships that would otherwise be bound by the FTC definition of franchise. Three of those exemptions include minimum payment, large franchise investment, and sales to large franchisees, all of which include threshold amounts that were increased. The amended rule can be summarized by the following chart:

| Exemption | 2007 Base | Adjusted 2024 threshold |
|----------------------------|------------------|--------------------------------|
| Minimum Payment | \$500 | ⁹ \$735 |
| Large Franchise Investment | 1,000,000 | 1,469,600 |
| Large Franchisee | 5,000,000 | 7,348,000 |

The FTC used a consumer price index as published by the Department of Labor to increase for inflation since the last adjustment in 2020.

Polsinelli attorneys are monitoring these developments and stand ready to assist clients about how these actions may change the enforcement of franchise regulations. We are also available to assist with a deeper understanding of how to adjust current business practices in light of such changes.

