

## INSIGHT: It's Time for FTC to Preempt State Franchise Sales Laws

By Rochelle Spandorf

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*The current FTC system of regulating franchise sales at the federal and state levels is inefficient, burdensome, and confusing, writes Davis Wright Tremaine partner Rochelle Spandorf. She offers a proposal for Congress and the FTC to preempt all state franchise sales laws to safeguard franchising as an important engine of capitalism.*

The Federal Trade Commission recently invited the public to comment on whether it should continue to regulate franchise sales as it has since 1979. More than three dozen commenters weighed in and I expressed what I believe is the silent consensus among franchisors and franchisees alike: The current system of regulating franchise sales at both the federal and state levels is inefficient, burdensome, and confusing.

I proposed that Congress and the FTC preempt all state franchise sales laws (leaving state laws regulating relationship subjects like termination alone). Preemption is the proverbial elephant in the room, but it is time to begin discussing preemption openly.

### The Problematic Status Quo

Modeled after federal securities laws, the FTC's Franchise Rule regulates franchise sales in all 50 states by requiring a franchisor to make extensive pre-sale disclosures to prospective franchisees about itself and the franchise opportunity. For the last 40 years, franchisors have also had to comply with disuniform franchise sales laws in 14 states (Regulating States).

Despite decades of co-existence, no evidence shows that Regulating States deliver greater consumer protection to franchisees than the FTC's Franchise Rule or that franchisees in Regulating States perform better or experience less fraud than franchisees in the same franchise system in non-regulating states.

### Dual Regulation Dysfunction

The following illustrates the dysfunction of dual regulation.

**Coverage:** Franchises are strictly creatures of statute, but only one state uses the FTC's definition of "franchise." The others define "franchise" their own way with both marked and subtle differences. All definitions use imprecise terms creating unnecessary uncertainty over when and where a promoter must qualify as a franchise.

Due to differences in definitions, exclusions, and exemptions, the same program may be regulated as a franchise at the federal level, but not qualify as a franchise in any or all Regulating States, or vice versa.

**Regulatory Process:** The FTC has never required franchisors to register with a federal agency before offering franchises in the United States. Instead, the FTC expects franchisors to serve as their own watchdog to ensure that mandatory disclosures are accurate and delivered per federal delivery rules,

and sales practices meet federal standards for fair play. Regulating States, however, impose registration duties and operate as gatekeepers.

The registration process is uncoordinated, redundant, and can turn the lights off for a franchisor's sales team for weeks or longer during busy ling periods.

**Remedies:** Franchisees' ability to enforce the FTC's Franchise Rule or receive restitution or other suitable relief depends on the luck of where they reside or operate their franchise. While laws in Regulating States give franchisees a private cause of action, the FTC's Franchise Rule does not. In most states, where only the FTC's Franchise Rule applies, franchisees depend on the FTC to enforce the Franchise Rule on their behalf. Unfortunately, the FTC has not done this once in the last 10 years. Instead, the FTC depends on states to enact consumer protection laws that protect their citizens from unfair trade practices. While all states have laws that prohibit unfair trade practices, some states limit standing to individual consumers, which franchisees are not. Consequently, in a state where only the FTC Rule applies and franchisees lack standing to sue for unfair trade practices, franchisees have no statutory remedy against unscrupulous franchisors.

**Does Congress Have the Authority to Preempt State Franchise Sales Laws?** Yes. Congress has preempted state laws when it has wanted to, as illustrated by the CAN-SPAM Act. Indeed, many in Congress are currently advocating for preemption of all state privacy laws in favor of a unitary federal privacy standard.

### **A Preemption Proposal**

With 40 years of dual regulation in the rearview mirror and no objective proof that Regulating States have ever delivered more effective protection than the FTC, preemption would improve regulatory efficiency and allow the FTC and state franchise agencies to pool their limited resources to safeguard franchising as an important engine of capitalism.

- A unitary definition of "franchise" will decrease uncertainty over compliance duties.
- Preemption would replace the cumbersome state registration process with a federal franchise registry (equivalent to the EDGAR system for securities) where franchisors would upload their franchise disclosure document allowing for universal informational transparency of franchise offers.
- Preemption would repurpose the states' role by deputizing states to prosecute violations of the federal Franchise Rule within their borders. This will produce a single body of franchise law, cultivate healthy competition among states in public enforcement, and make public enforcement more efficient by allowing multiple states to sue together in one federal court rather than le duplicative actions in separate state courts.
- Any preemption solution should give all franchisees a private cause of action so that access to courts for unfair sales practices does not depend on the fortuity of jurisdictional facts.
- Preemption will not add any regulatory burdens to law-abiding franchisors; it will reduce compliance burdens. The certainty and uniformity ensured by a federal framework are good for both businesses and consumers.

Given the significant problems in regulating franchise sales today in the United States, let's let the elephant out of the room and begin discussing a preemption solution.

*This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.*

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