Chair Holvey and members of the committee:

To answer these questions:

1. HB 2946 requires a franchisor to provide financial information that could potentially not exist. The term "forecasted financial performance" is not defined in the bill. What does forecasted financial performance mean, and what type of documents or information would franchisors need to provide? Does Section 3 conflict with federal law by forcing franchisors to make a financial performance representation – which essentially would impose disclosure obligations that would increase liability on a franchisor?

   Although the term "forecasted financial performance" is not defined in the bill, the section states that "a person, in advertising or offering a franchise, **may not misrepresent or fail to disclose** ... [t]he financial performance **or** forecasted financial performance of **existing franchises**." This phrasing has a couple of implications. First, the requirement is disjunctive, which means that it can be read to apply only to a situation in which circumstances allow for that application. In other words, if a person includes any forecasted financial performance in an advertisement or offer, the duty is to not misrepresent that forecasted financial performance. If the person does not include financial performance information in the offer, the language could be read to require the person to do so, but the language would not require the person to conjure financial performance data that does not exist because under the circumstances that duty could not apply to the person. The disjunctive nature of the duty also means that the section does not require the person to disclose forecasted financial performance for franchises that do not yet exist. All of this is not to say that this section of the bill would not benefit from an amendment to make the policy much clearer, perhaps by inserting "as appropriate" after "may not" in line 17 of the bill, by removing the requirement to compel disclosure under specific circumstances or in other ways that better clarify the intent.

   As for whether a requirement to make such a disclosure conflicts with federal law, with one possible exception noted below, the answer is an unequivocal "no." The relevant federal laws are regulations of the Federal Trade Commission under 16. C.F.R. 436.1 to 436.11. As an initial matter, 16 C.F.R. 436.10 provides:

   > (a) The [Federal Trade] Commission does not approve or express any opinion on the legality of any matter a franchisor may be required to disclose by part 436. Further, franchisors may have additional obligations to impart material information to prospective franchisees outside of the disclosure document under Section 5 of the Federal Trade Commission Act. The Commission intends to enforce all applicable statutes and rules.
   >
   > (b) **The FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with part 436. A law is not inconsistent with part 436 if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures** [emphasis added].

   With this statement, the FTC disclaims a preemption of state laws to the extent that the state laws do not conflict with the FTC's regulations and specifically notes that any state

law provision that provides greater protection to franchisees than is available under FTC regulations is not inconsistent with those regulations.

In addition, 16 C.F.R. 436.5 lists financial performance information among the items franchisors may disclose to prospective franchisees in franchise offers. The list of permissible statements and qualifications to those statements is extensive and appears below with some of the salient provisions in boldface:

> (s) Item 19: Financial Performance Representations.
>
> (1) Begin by stating the following:
>
> The FTC's Franchise Rule **permits a franchisor to provide information about the actual or potential financial performance of its franchised and/or franchisor-owned outlets, if there is a reasonable basis for the information** [emphasis added], and if the information is included in the disclosure document. Financial performance information that differs from that included in Item 19 may be given only if: (1) a franchisor provides the actual records of an existing outlet you are considering buying; or (2) a franchisor supplements the information provided in this Item 19, for example, by providing information about possible performance at a particular location or under particular circumstances.
>
> (2) If a franchisor does not provide any financial performance representation in Item 19, also state:
>
> We do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor's management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.
>
> (3) **If the franchisor makes any financial performance representation to prospective franchisees, the franchisor must have a reasonable basis and written substantiation for the representation at the time the representation is made and must state the representation in the Item 19 disclosure**. The franchisor must also disclose the following:
>
>> (i) Whether the representation is an historic financial performance representation about the franchise system's existing outlets, or a subset of those outlets, or is a forecast of the prospective franchisee's future financial performance.

(ii) If the representation relates to past performance of the franchise system's existing outlets, the material bases for the representation, including:

(A) Whether the representation relates to the performance of all of the franchise system's existing outlets or only to a subset of outlets that share a particular set of characteristics (for example, geographic location, type of location (such as free standing vs. shopping center), degree of competition, length of time the outlets have operated, services or goods sold, services supplied by the franchisor, and whether the outlets are franchised or franchisor-owned or operated).

(B) The dates when the reported level of financial performance was achieved.

(C) The total number of outlets that existed in the relevant period and, if different, the number of outlets that had the described characteristics.

(D) The number of outlets with the described characteristics whose actual financial performance data were used in arriving at the representation.

(E) Of those outlets whose data were used in arriving at the representation, the number and percent that actually attained or surpassed the stated results.

(F) Characteristics of the included outlets, such as those characteristics noted in paragraph (3)(ii)(A) of this section, that may differ materially from those of the outlet that may be offered to a prospective franchisee.

(iii) If the representation is a forecast of future financial performance, state the material bases and assumptions on which the projection is based. The material assumptions underlying a forecast include significant factors upon which a franchisee's future results are expected to depend. These factors include, for example, economic or market conditions that are basic to a franchisee's operation, and encompass matters affecting, among other things, a franchisee's sales, the cost of goods or services sold, and operating expenses.

(iv) A clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.

(v) A statement that written substantiation for the financial performance representation will be made available to the prospective franchisee upon reasonable request.

(4) If a franchisor wishes to disclose only the actual operating results for a specific outlet being offered for sale, it need not comply with this section, provided the information is given only to potential purchasers of that outlet.

(5) If a franchisor furnishes financial performance information according to this section, the franchisor may deliver to a prospective franchisee a supplemental financial performance representation about a particular location or variation, apart from the disclosure document. The supplemental representation must:

(i) Be in writing.

(ii) Explain the departure from the financial performance representation in the disclosure document.

(iii) Be prepared in accordance with the requirements of paragraph (s)(3)(i)-(iv) of this section.

(iv) Be furnished to the prospective franchisee.

The upshot of these disclosure requirements is that under federal law a franchisor may provide forecasted financial performance information but only if the franchisor has a reasonable basis for the financial performance information and can substantiate it in writing. To the extent that HB 2946 could be read to require disclosure of such information, this in itself does not conflict with federal law and could be read as providing more protection to a franchisee, so long as the franchisor meets federal law requirements for the reasonable basis of the forecasts and substantiates the forecasts in writing, along with meeting HB 2946's requirement that the information is not misleading.

There is one respect in which the requirement under section 3 of HB 2946 **might** conflict with federal law. Section 3 requires a "person" to refrain from misleading a prospective franchisee and to disclose certain information, not a "franchisor." Under 16. C.F.R. 436.5, a franchisor that does not routinely disclose financial performance information must state in the franchise offer that it does not do so and that if a prospective franchisee obtains such information from another source, the prospective franchisee should report that fact to the franchisor and to the FTC. Under HB 2946, if the "person" offering the franchise is not the franchisor (perhaps a previous franchisee, for example), the disclosure that section 3 requires could run afoul of the franchisor's policy and the FTC if the franchisor has explicitly refused to provide financial performance information. This potential conflict could likely be dealt with by amendment -- perhaps either changing the party responsible for making the disclosure to "franchisor" or explicitly excluding persons other than the franchisor from having to make the disclosure. Alternatively, an amendment might remove the compulsory nature of the disclosure under certain identified circumstances, such as when the franchisor is not the person making the offer of a franchise.

One further federal regulation has a bearing on this question. 16 C.F.R. 436.9 provides that:

> It is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchise seller covered by part 436 to:
>
> ...
>
> (c) Disseminate any financial performance representations to prospective franchisees **unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in Item 19 (§ 436.5(s)) of the franchisor's disclosure document**. In conjunction with any such financial performance representation, the franchise seller shall also:
>
> > (1) Disclose the information required by §§ 436.5(s)(3)(ii)(B) and (E) of this part if the representation relates to the past performance of the franchisor's outlets.
> >
> > (2) Include a clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.

This regulation, however, has the effect of reinforcing the nature of the disclosure requirements under 16 C.F.R. 436.5. Therefore, a requirement to make such a disclosure under section 3 of HB 2946 does not conflict with federal law, but can be read as a supplementary requirement.

2. Would passage of this bill effect all currently signed franchisor/franchisee agreements or just new agreements that are entered into if the bill is enacted? If it is retroactive, do all the contracts currently in existence need to be renegotiated? Could this lead to franchisees being required to pay new or additional fees?

   Section 12 of HB 2946 states that the bill and the amendments in the bill "apply to franchises that are operating, and to franchise agreements that a franchisor enters into or renews, on or after the effective date of this 2021 Act." The effect of this language is first, to apply the bill's requirements both to new franchises and to franchises that are now in existence, but that application is conditioned on the application to new franchise agreements or existing franchise agreements that get renewed after the effective date. The second effect is that if a provision in an existing franchise contract provides that the contract renews automatically, this bill will likely require some renegotiation of the contract terms. Under contract law jurisprudence, however, the parties to a new contract or a contract that gets renewed are ordinarily assumed to be aware of the changes in the law and expected to conform their contracts to the requirements of the law as it is in effect at the time of the renewal. This requirement does not contravene the Oregon or federal constitutional prohibitions against impairing the obligations of contracts. It is certainly possible that a franchisor might require a franchisee to pay new or additional fees as a condition of renewal or that a franchisee might change the fee structure for a franchise based on what the bill requires, but the bill provisions do not compel such a result. Franchisees might need to seek representation or other assistance if they are concerned about their prospects during renegotiations of franchise terms and conditions.

3. Franchising requires the establishing of uniform products, services, hours, and standards. This uniformity is both necessary for the overall strength of a brand and required by federal law. Would HB 2946 conflict with federal law or weaking protections that franchisors coming to Oregon would have?

   As I noted in the answer to question 2, above, to the extent that the provisions of HB 2946 provide greater protection to franchisees, the bill does not conflict with federal law. The general tenor of the Federal Trade Commission regulations is not for protection of franchisors, but rather, protection of franchisees, who are assumed to be in a weaker bargaining position than franchisors are. Likely for that reason, nearly all of the FTC regulations are aimed at the conduct of franchisors. It is likely that one of the aims of HB 2946 is in fact to weaken some of the protections that franchisors have with respect to their relations with franchisees in order to put both parties on a relatively level "playing field," but I would not characterize the aim of HB 2946 as explicitly reducing protections for a franchisor's products, services, hours, and standards or overall brand identity. It is possible that some franchisors might perceive the requirements of HB 2946 in that manner, but I would guess -- and this is only a guess and is not a legal judgment in any way -- that the aims of franchisors and franchisees alike are to strengthen the perception of a franchisor's brand identity so that both parties can make their respective businesses succeed.

4. Do the restrictions on arbitration in this bill violate the Federal Arbitration Act? If included in the bill that is ultimately passed would these sections be declared invalid?

   No, the provision in section 4 (1)(f)(A) of HB 2946 that forbids a franchise agreement from requiring a franchisee to resolve a dispute by means of binding arbitration (with one exception stated in section 7 (1)(e) of the bill) would not violate the Federal Arbitration Act and would not be preempted by the Act because the purpose of the Act is to enforce arbitration clauses that parties negotiate and memorialize in their contracts (see, e.g., Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University, 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989)). The Act does not purport to require parties to include arbitration clauses in their contracts or prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement; rather the Act simply requires courts to enforce privately negotiated agreements to arbitrate in accordance with their terms. If a state law makes it illegal to have a contract provision that requires arbitration, the Federal Arbitration Act simply does not come into play because there is not and cannot be an agreement between the parties to arbitrate disputes under the contract.

5. Section 4b appears to give franchisees more control over the goods and the price for which they sell those goods. Language states that a franchisor may not require a franchisee to sell goods or services at a price that is not "reasonably acceptable" to the franchisee. It does not define "reasonably acceptable." What does that mean? How would a price be determined not "reasonably acceptable? And what agency or entity would determine that? Or does this give franchisees full authority to set their own prices at their locations?

   Generally the term "reasonable" or "reasonably" is included in a statute or contract provision in order to constrain the interpretation given to a provision of the statute or contract. The constraint is meant to ensure that one party's subjective interpretation of a term is not what

controls the construction of that term, but rather that a more objective interpretation is necessary. This, of course is not an exact science or capable of precise enumeration because the circumstances in which disputes can arise over acceptability could be quite varied. Although the term is not defined in the bill, a dispute between the parties over the meaning of “reasonably acceptable,” or what is in fact reasonably acceptable under the circumstances, would likely be resolved in litigation, as with any other dispute over contract terms and conditions. In that event, a court would likely apply a standard that takes into consideration what a reasonable franchisee in the position of the litigating franchisee and under the factual circumstances of the dispute would understand as an acceptable price. Here, the “reasonable franchisee” would be a stand-in for a kind of average of franchisee opinion on the matter, excluding those franchisees who would interpret the acceptability of a price arbitrarily or otherwise unreasonably (by whatever measure the court would apply to that term). This is not at all the same, however, as granting a franchisee carte blanche to set prices. Under the bill, the franchisee’s ability to set prices may still be constrained by the terms and conditions of the franchise agreement, but the franchisor cannot compel the franchisee to sell at prices that the franchisee would (reasonably) reject.

6. Section 4b states that except for initial inventory purchases, a franchisor cannot require a franchisee to make purchases from the franchisor or approved suppliers. A franchisee would only be required to purchase from the vendors approved by the franchisor one time, but could buy supply and inventory where ever they want after? The language in section 4b further says that a franchisor would be required to certify that using their product line is necessary to further the business purposes of the franchisee and does not substantially affect the competition for goods and services. I’d like to get a better understanding what that means, and who and how would that be decided? How would this be enforced?

   The initial characterization in this question of the bill’s provisions is not quite what the bill requires. A franchise agreement *could* require a franchisee to purchase future inventory from the franchisor or approved suppliers, but in order for the franchise agreement to include that requirement, the franchisor must “certif[y] in writing that the requirement is reasonably necessary to further the business purposes of the franchise and does not substantially affect competition for the goods or services.” If a franchisor can make such a certification, the franchisor can require purchases solely from the franchisor. If the franchisor cannot make such a certification, the franchisee can purchase goods and services, after the initial purchase, from other sources. The bill does not include any standards for certifying either that the purchase requirement is a business necessity or that it will not substantially affect competition; in fact, the bill does not include any standards for certification other than that the certification be in writing. Should a dispute arise over what type or standard for certification would apply in this case, the parties would ultimately resolve that dispute in litigation (or in any negotiations or settlement talks that precede or follow litigation), as would be the case with most other terms and conditions of the franchise agreement. The bill might benefit from an amendment that specifies some standards for evaluating either the truth or accuracy of the certification or a requirement that in making the certification the franchisor may not mislead or defraud the franchisee.

7. Current law and restrictions protect not only the brand quality but the secret recipes or proprietary systems that have led to the franchisor’s success. How is this protected under the bill? How would this be protected if franchisees aren’t required to use the franchisor’s vendors?

> As I understand it, the purpose of the bill is not to protect franchisor's trade secrets or proprietary methods, so the bill does not include any provisions that do so. I am not in this discussion taking any position on the merits of the bill's purpose or what should or should not be in the bill. My expectation is that the proponents of the bill would argue that existing laws that protect intellectual property, such as the laws that protect trade secrets, patents, copyrights, trademarks and related property, would be adequate to protect a franchisor's interests. I expect also that proponents of the bill would argue that the connection between, on one hand, requiring a franchisee to use the franchisor's vendors and, on the other, having adequate protection of the franchisor's intellectual property would need to be demonstrated, rather than asserted.

I hope this discussion is helpful.

Thank you,

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