

FINAL REPORT

FRANCHISE REGULATION STUDY COMMITTEE

January 1992

AUTHORIZATION AND APPOINTMENT

The Franchise Regulation Study Committee was established by the Legislative Council to "[E]xamine whether there is a need to regulate franchises in Iowa and what, if any, rules should be adopted."

Members serving on the Study Committee included:

Senator Patrick Deluhery, Co-chairperson
Representative Steve Hansen, Co-chairperson
Senator Donald Gettings
Senator Michael Gronstal
Senator James Kersten
Senator Maggie Tinsman
Representative Tom Baker
Representative Jack Holveck
Representative Joseph Kremer
Representative Bob Renken

COMMITTEE PROCEEDINGS

The Study Committee was granted two meeting days to conduct its study, and held meetings on September 27 and November 1, 1991. A number of individuals testified before the Study Committee, and several additional statements were received from individuals not appearing before the Study Committee. A list of all materials received by the Study Committee is attached to this report. Copies of these materials are maintained on file with the Legislative Service Bureau.

MEETING – September 27, 1991

The first meeting of the Study Committee was held on September 27, 1991, in Senate Committee Room 22 of the Statehouse. Presentations were made by proponents and opponents of legislation similar to Senate File 522 which was voted out of the Senate Commerce Committee during the 1991 Legislative Session.

Mr. Bob Shlutz, a franchisee with Kentucky Fried Chicken (KFC), discussed the problems he has recognized in his experience including unequal bargaining positions and venue concerns. He stated that recently KFC has offered new franchise agreements on a "take it or leave it" basis with no real opportunity to negotiate. He also noted the importance of the venue issue and commented that the new franchise contract requires all lawsuits initiated against the franchisor to be brought in Kentucky.

Professor Marc Edelman, Professor of Economics and Public Policy at Iowa State University, testified generally concerning the franchise relationship and expressed concerns regarding inadequate disclosure by the franchisor during the sale of a franchise, limited recourse by the franchisee to redress problems with the franchisor, and unfair influence by the franchisor over the franchisee.

Mr. Lowell Shuman, a franchisee with KFC, discussed his concerns relating to encroachment of territory, and stated that his original agreement granted him a one-mile radius and 30,000 population base defining the territory within which another KFC store could not be operated. He indicated that the new agreement being offered is site-specific, which in theory would permit the opening of a KFC store literally next door. He also expressed concern regarding the venue provision.

Mr. Hal Higgs, a franchisee with Casey's General Stores, stated that although he has not experienced any problems with the current Casey's management, he is concerned that if Casey's is sold he may face many potential concerns including transfer of ownership restrictions, nonrenewal of the franchise agreement without cause, venue restrictions, termination of franchise without cause, and encroachment of territory.

Mr. Fred Miller, Mr. Joel Grodberg, Mr. Gene Bicknell, and Mr. Marvin Day, franchisees with Pizza Hut, presented a panel discussion concerning their experiences. Mr. Miller testified that Pepsico forced a new agreement on franchisees seven years earlier and noted that a good faith clause was rejected by Pepsico. Mr. Grodberg expressed concern related to his right to transfer ownership, and asserted that the franchisor's right of refusal has been used to force some franchisees out of the system. Mr. Bicknell indicated that he is the founder of the largest Pizza Hut franchising company and the only public company within the Pepsico structure. Mr. Bicknell testified that he has been "threatened" by Pepsico, and that franchisees need to be protected from the acts of franchisors. Mr. Day stated that the franchisor's right of refusal concerning transfer of ownership of a franchise is a major concern which needs to be addressed.

Mr. Patrick Dandino, Director of Legal and Regulatory Affairs with the International Franchise Association, expressed the belief that Senate File 522, as drafted, places severe restrictions on the contract rights of franchisors and that no basis exists for enactment. He noted that the federal government currently has regulations governing franchisors.

Mr. Cal James, Medicap, Inc., voiced his opposition to the legislation citing federal presale disclosure requirements as sufficient, and asserting that state regulation would hurt the small franchisors.

Mr. Merle Newman, Jamie Lea's, also noted the increased regulatory burden in which passage of Senate File 522 would result.

Mr. Phil Aiken, Duds 'n Suds Corporation, stated that had the provisions of Senate File 522 been enacted when he was attempting to start his business, he might very well have failed. He commented that he currently does not attempt to do business in states requiring registration because of the increased costs involved. He also noted that while some abuses may exist, remedies already exist under contract law and federal regulations.

Mr. Warren Heidbreder, Bandag, Inc., testified that passage of legislation similar to Senate File 522 would impact detrimentally upon a wide variety of international relationships in which Bandag is currently involved. He stated that additional registration requirements are unnecessary and the duty of good faith required under Senate File 522 would undermine a franchisor's opportunity to make independent, market-based business decisions.

Mr. Mark Hamer, an attorney with Meardon, Sueppel, Downer, and Hayes in Iowa City, testified concerning specific problems he believes exist in Senate File 522, and noted that the Model Franchise Act, upon which a portion of Senate File 522 is based, excluded relationship provisions which Senate File 522 contains.

Mr. Frank Reynolds, Vice President of Government Affairs for KFC, noted that KFC has been franchising in Iowa since 1959 and boasts a 100 percent renewal rate of Iowa franchisees. He stated that several of the issues raised by Mr. Shlutz are currently being litigated in federal court.

MEETING -- November 1, 1991

The second and final meeting of the Study Committee was held on November 1, 1991, in Senate Room 22 of the Statehouse. Presentations were again made by proponents and opponents of legislative action, and by the Iowa State Bar Association, and the Division of Insurance.

Mr. Donald Lamberti, Chairman of the Board and Chief Executive Officer of Casey's General Stores, Incorporated, discussed the evolution of Casey's from its beginning to its present structure. While noting that the registration provisions were not cause for concern, he did raise objections to those provisions which attempt to affect the relationship between the franchisor and franchisee, and the impact those provisions would have on existing agreements.

Mr. Cary Claiborne, a franchisee with Country Kitchens, expressed his concern with Senate File 522, noting that a franchisee's investment is valuable as long as consistency throughout the system is maintained. He also noted that passage of the proposed legislation would be harmful to existing franchises and future franchise growth in this state.

Ms. Jackie Samuelson, Trade Regulation Section of the Iowa State Bar Association, after noting that the comments of the Section had not been endorsed by the Bar Association's board of governors at the time of the meeting, discussed several areas which the Section identified as being problematic including vague and undefined terms, overbroad provisions, provisions which conflict with existing law, internal inconsistencies, and unnecessary provisions.

Mr. Craig Goetsch briefly discussed the proposed legislation, and federal disclosure and enforcement provisions. He suggested that uniformity of disclosure and registration requirements among the states is critical.

Mr. Dennis Hogan briefly described the experience of an individual forced to suffer financial hardship as a result of dealings with an unscrupulous franchisor. He commented that legislation is needed to protect franchisees who act in good faith and work hard to develop a business.

Ms. Joan McCoy, President of the Roto-Rooter Franchisee Association, and Ms. Sonja Hunt, a Roto-Rooter franchisee, voiced their support for the proposed legislation. Ms. McCoy asserted that two important issues, which are covered under Arkansas law, are that the franchisor cannot terminate or cancel a franchise without good cause, and a franchisor cannot collect a percentage of the franchisee's fee for advertising and then not use the amount collected for that purpose.

Several other franchisees described their personal experiences and their concerns with the future of their franchises and the security of their operations.

Mr. Brent Appel responded to concerns expressed by the Iowa State Bar Association concerning the drafting of S.F. 522 and generally endorsed the style in which the bill was drafted. He did indicate, however, that a provision in the bill concerning termination should be amended to clarify the intent of that section.

COMMITTEE RECOMMENDATIONS

The Study Committee considered 17 proposed action items and divided those items into the following three categories:

THE STUDY COMMITTEE RECOMMENDS THAT LEGISLATION BE DRAFTED FOR ENACTMENT BASED ON THE FOLLOWING PRINCIPLES:

1. Registration of franchise offerings prior to sale or offer for sale within Iowa. Registration should include disclosure document, filing fee, consent to service of process, and other documents as required by the administrator.
2. Delivery of disclosure document with copy of proposed agreements relating to the sale of a franchise prior to the sale of the franchise.
3. Venue and jurisdiction provision restricting jurisdiction or venue to forum outside Iowa is unenforceable. Civil action arising out of franchise agreement may be brought wherever jurisdiction over parties or subject matter exists.
4. Refusal to permit transfer of ownership of franchise only where good cause is shown.
5. Establish limitations on franchisor's ability to compete with an established franchisee offering the same goods or services.
6. Provide exemptions for real estate, insurance, farm and construction equipment dealers, auto dealers, and alcoholic beverage dealers already covered by statute. This list was amended to include petroleum industry.

THE STUDY COMMITTEE RECOMMENDS THAT LEGISLATION BE DRAFTED BY THE LEGISLATIVE SERVICE BUREAU FOR SUBMISSION TO THE COMMERCE COMMITTEES OF THE HOUSE AND SENATE:

1. Imposition of duty of good faith in performance and enforcement of franchise agreement.
2. Imposition of duty on franchisor to bargain in good faith with certain organizations representing franchisees.
3. Termination of franchise prior to expiration under the franchise agreement only where good cause is shown.
4. Establishment of limitations on franchisor's ability to refuse to renew franchise agreement.

THE STUDY COMMITTEE IDENTIFIES THE FOLLOWING ISSUES WHICH WERE DESCRIBED BY WITNESSES AND THE STUDY COMMITTEE NOTES FURTHER THAT ADDITIONAL LEGISLATIVE DELIBERATION MIGHT BE WARRANTED:

1. Unconscionability provision permitting court to limit application of franchise agreement where court finds a provision of that agreement to be unconscionable.
2. Establishment of criminal and civil penalties, and establishment of civil cause of action for certain violations.
3. Permit franchisee to obtain equipment, fixtures, supplies, and services used in the franchise from a source of franchisee's choosing except where the goods or services are central to the franchised business.

4. Franchisor must have the ability to maintain reasonable standards to ensure the quality of the franchise system.
5. Some ability for the franchisee to rescind the agreement if the franchisor fails to perform according to the agreement.
6. The legislation would only apply to franchise businesses operating in Iowa.
7. Prohibit discrimination by franchisor among franchisees in franchise fees, or charges for goods, services, equipment, or leases.

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ATTACHMENT 1
DESCRIPTION OF MATERIALS RECEIVED AT FIRST MEETING
Friday, September 27, 1991

1. Meeting agenda
2. Proposed rules
3. Membership list
4. Committee charge
5. Background information provided by Service Bureau
6. Statement of Bob Shlutz, KFC franchisee
7. Statement of Professor Mark Edelman (includes summary statement and follow-up written statement)
8. Statement of Fred Miller, Pizza Hut franchisee (includes actual statement provided at meeting and follow-up testimony)
9. Statement of Joel Grodberg, Pizza Hut franchisee (handwritten)
10. Statement of Marvin Day, Pizza Hut franchisee (includes actual statement provided at meeting and follow-up testimony)
11. Statement of Lowell Shuman, KFC franchisee
12. Statement of Hal Higgs, Casey's franchisee
13. Outline of speaker's testimony for persons testifying during morning session of September 27 meeting
14. "Abuse of power" summary
15. Documents provided by Doug Gross on behalf of franchisees
16. Statement of Pat Dandino, Director of Legal and Regulatory Affairs, International Franchise Association (includes summary statement and follow-up written statement)
17. Statement of Warren Heidbreder, Bandag, Incorporated (includes summary statement and follow-up written statement)
18. Statement of Phil Aiken, Duds 'n Suds Corp.
19. Statement of Mark Hamer, Attorney with Meardon, Sueppel, Downer, & Hayes, Iowa City
20. Miscellaneous documents distributed to Study Committee members including the following:
 - Letter from Bob Skow, Independent Insurance Agents of Iowa
 - Two letters from Jim West, representing views of Iowa Life Insurance Association and Iowa Automobile Dealers Association
 - Letter from Stanley White, Diamond Dave's Taco Company
 - Letter from Lee Staak, Iowa Management Systems
 - Letter from Cary Claiborne, franchisee with Country Kitchen
 - Letter from Tom Barbee, Restaurant Profit Systems, Inc., franchisee operator with Wendy's

ATTACHMENT 2

DESCRIPTION OF MATERIALS RECEIVED AT SECOND MEETING Friday, November 1, 1991

1. Meeting agenda
2. Statement of Donald Lamberti, Casey's General Stores
3. Statement of Jacqueline Samuelson, Trade Regulations Section, Iowa State Bar Association
4. Statement of Craig Goettsch, Superintendent of Securities, Insurance Division
5. Statement of Joan McCoy, Roto-Rooter Franchisee Association
6. Written statement from Meredith Corporation
7. Written statement from Deere & Company
8. Additional information provided by Service Bureau requested at first meeting
9. Miscellaneous documents distributed to Study Committee members including the following:
 - Categories for Committee recommendations
 - List of possible action items