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Federal Trade Commission  
Office of the Secretary  
Constitution Center  
400 7<sup>th</sup> Street, SW  
5<sup>th</sup> Floor, Suite 5601 (Annex B)  
Washington, DC 20024

**Re: Franchise Rule Regulatory Review, 16 CFR Part 436 Matter No. R511003**

Dear Acting Secretary Tabor:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”)<sup>1</sup>, I am writing in response to the Federal Trade Commission’s (the “FTC” or “Commission”) February 13, 2019 request for public comment concerning its Trade Regulation Rule, entitled “Disclosure Requirements and Prohibitions Concerning Franchising” (the “Franchise Rule” or “Rule”).<sup>2</sup> NASAA has long advocated for strong disclosure requirements within franchise registration materials to ensure prospective franchisees are fully informed regarding their decision to invest in a particular franchise.<sup>3</sup> NASAA applauds the FTC’s effort in reviewing its franchise rule to ensure the appropriate level of transparency exists to protect franchisees.

Several NASAA members currently administer and enforce state franchise registration and disclosure laws. These franchise registration states require that franchisors file their Franchise Disclosure Documents (“FDDs”) with state franchise agencies prior to offering or selling franchise opportunities in the state. Those states also employ franchise examiners to review and comment on FDDs before the state grants the franchisor an approved registration of its franchise offering.

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<sup>1</sup>NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as a forum for these regulators to work with each other to protect investors at the grassroots level and promote fair and open capital markets.

<sup>2</sup> See <https://www.ftc.gov/news-events/press-releases/2019/02/ftc-seeks-public-comment-part-its-review-franchise-rule>. The proposal was published in the Federal Register at 84 Fed. Reg. 9051 (Mar. 13, 2019).

<sup>3</sup> See November 12, 2004 letter from NASAA President Franklin L. Widmann to FTC Secretary Donald S. Clark (available at: <http://www.nasaa.org/wp-content/uploads/2011/07/52-FTCFranchiseLetter.38304-69682.pdf>).

More than thirty years ago, NASAA established a standing committee, now called the Franchise Project Group,<sup>4</sup> to address franchise issues. The Franchise Project Group studies and makes recommendations to NASAA members regarding model acts, statements of policy, and interpretive commentaries that the group considers to be in the public interest. The expertise of this Project Group is core to NASAA's comments in this letter.

For approximately the last twenty-five years, the franchise registration states and the FTC have followed the same disclosure framework. In the early 1990s, the Franchise Project Group drafted and proposed for adoption at the state level Uniform Franchise Offering Circular ("UFOC") Guidelines on which much of the present Franchise Rule is based.<sup>5</sup> On June 6, 2008, NASAA adopted the disclosures under the Franchise Rule as the replacement for the UFOC Guidelines. The Franchise Project Group works closely with Commission staff and state franchise regulators in order to promote uniformity regarding franchise disclosure requirements.

Below are comments to certain of the thirteen questions raised in the FTC proposal.

**1.) Is there a continuing need for the Rule? Why or why not?**

There is a continuing need for the Franchise Rule for the following reasons: i) it serves as a deterrent against fraudulent and deceptive practices in the offer and sale of franchises; ii) it helps prospective franchisees make informed investment decisions; iii) it gives consumers a starting point to conduct their own due diligence and to verify the accuracy and completeness of information provided to them by franchisors and their agents; iv) it enables prospective franchisees to comparison shop and contrast disclosures provided by franchisors in whom they have an interest; v) it benefits franchisors by increasing investor confidence in the franchise industry; and vii) it encourages uniformity by having a universally accepted format for FDDs throughout the U.S.

**3.) What modifications, if any, should be made to the Rule to increase its benefits to prospective franchisees, including small businesses?**

- a. What evidence supports the proposed modifications?**
- b. How would these modifications affect the costs the Rule imposes on franchisors and franchise sellers, including small businesses?**
- c. How would these modifications affect the benefits to prospective franchisees?**

NASAA believes that meaningful presale disclosure remains an important tool that allows prospective franchisees to make an informed investment choice about buying a franchise. NASAA recognizes, however, that presale disclosure works only when prospective franchisees

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<sup>4</sup> NASAA's Franchise and Business Opportunities Project Group currently consists of seven members, including Project Group Chair Dale Cantone (MD), Henry Tanji (HI), Timothy O'Brien (VA), Joseph Punturo (NY), Theresa Leets (CA), Nathan Quigly (WA), and Michelle Webster (WA).

<sup>5</sup> See Amended Franchise Rule Statement of Basis and Purpose 72 FR 15444, 15449 (Mar. 30, 2007) (hereinafter, "SBP").

receive information that they can understand.

In order to ensure that the Franchise Rule continues to require meaningful presale disclosure, NASAA suggests the Commission explore in its Rule review whether the FDD should be simplified or shortened to improve readability. NASAA also suggests that the Commission incorporate into the Franchise Rule, or compliance guides accompanying the Franchise Rule, the NASAA Commentaries regarding FDDs. Finally, NASAA suggests that the Commission explore whether specific disclosure items in the FDD should be updated and improved.

#### A. *Improve Readability*

NASAA is concerned that too many franchisees do not completely understand the disclosures in FDDs. Although FDDs include language urging prospective franchisees to consult with an advisor, like a lawyer or accountant,<sup>6</sup> many prospective franchisees do not consult a lawyer before purchasing a franchise.<sup>7</sup> And all too often, FDDs are simply too long.

Over the last twenty-five years, FDDs have become longer and more complicated. According to one noted franchisee lawyer, “[i]t is now not unusual for the entire [FDD], including all related attachments, to exceed 300 pages. In fact, it is not unheard of for a[n FDD] to exceed 500 pages, or 7.5 pounds, of material.”<sup>8</sup> Some FDDs even exceed 1,000 pages of material.<sup>9</sup> There are several possible reasons for this development.

First, many FDDs now incorporate disclosures for a single “unit” franchise with disclosure for multi-unit franchise offerings like area development offerings. Other FDDs combine disclosures in a single document for different types of outlets, such as restaurants, kiosks, mall locations, drive-throughs, express units, and cobranding units.

Second, FDDs have numerous attachments and exhibits that add to the overall length and complexity of the document. Item 22 of the FDD requires that franchisors attach a copy of “all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options and purchase agreements.” Many FDDs contain voluminous copies of various forms of agreements, addenda, and other ancillary documents, including financing documents,

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<sup>6</sup> SBP, 72 FR 15545.

<sup>7</sup> See R. Emerson, *Fortune Favors the Franchisor: Survey and Analysis of the Franchisee’s Decision Whether to Hire Counsel*, 51 San Diego L. Rev 709, 717-18 (2014) (“Franchisees Often Fail to Hire an Attorney”); K. A. Morrison, *An Empirical Test of a Model of Franchisee Job Satisfaction*, 34, J. Small Bus. Mgmt. 27, 31 (1996) (finding that 49% of responding franchisees stated that they consulted a lawyer before making their franchise investment).

<sup>8</sup> E. Karp and A. Stern, “A Proposal for a Mandatory Summary Franchise Disclosure Document,” 35 Franchise Law Journal No. 4, 541 (Spring 2016) (hereafter “Karp and Stern”), p. 543.

<sup>9</sup> See Franchise Disclosure Document of Burger King Corporation issued Apr. 27, 2018, amended Sept. 6, 2018, <https://www.wdfr.org/apps/FranchiseSearch/details.aspx?id=619386&hash=1728642841&search=external&type=GENERAL>.

and lease agreements that may not apply to every prospective franchisee.<sup>10</sup>

Additionally, franchisors have an incentive to increase the amount of disclosures in an FDD because the FDD is a tool that franchisors use to defend themselves against allegations that the franchisor made unlawful pre-sale statements, misrepresentations, or omissions of material fact.<sup>11</sup>

Finally, some franchisors have very complicated business structures, which must be disclosed in Item 1. In recent years, more and more franchisors have been acquired by private equity firms,<sup>12</sup> which may result in extensive disclosure regarding the franchisor's business structure and, potentially, numerous affiliates.<sup>13</sup> In addition, franchisors have increasingly turned to "securitizations" in recent years in order to obtain financing.<sup>14</sup> Franchisors that have undergone a securitization must include additional disclosures regarding a new business structure along with new financial statements.<sup>15</sup>

Unfortunately, many FDDs are not written in plain English as required under the Franchise Rule.<sup>16</sup> Although state franchise examiners in those states that regulate franchise offerings can and do make comments to simplify FDD disclosures, the limited number of states conducting FDD review necessarily limits the benefits of this process. And even those states that do review FDDs have limited resources to conduct their reviews.

Even franchisor advocates acknowledge that, all too often, prospective franchisees do not

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<sup>10</sup>*See id.* Neither NASAA nor NASAA's Franchise Project Group is suggesting that there is a problem with the Burger King FDD, only that it is one of many FDDs that are quite lengthy, perhaps for legitimate reasons. In the Burger King FDD, Items 1-22 comprise less than 150 pages of the 1,000+ pages of the document. The remainder of the document consists of various applications, agreements, addenda to agreements, leases, subleases, and loan agreements, etc.

<sup>11</sup> Karp and Stern, p. 542; *see also Siemer v Quiznos's Franchise Company, LLC*, 2008 WL 904874 ("Here, none of the clauses contained within the UFOC or the Franchise agreement can be seen as creating an unfair surprise. Before signing the Franchise Agreement each Plaintiff was provided with the UFOC, which clearly disclosed the vendor rebates.").

<sup>12</sup> "Private Equity Power Boost: Why Private Equity-Owned Franchises Thrive," *Forbes.com* (December 28, 2017) <https://www.forbes.com/sites/forbesfinancecouncil/2017/12/28/private-equity-power-boost-why-private-equity-owned-franchises-thrive/#21aca37c507e>.

<sup>13</sup> For example, Item 1 of the December 2018 FDD for Sonic Franchising, LLC ("Sonic 2018 FDD"), which was acquired by Inspire Brands, Inc., an affiliate of Roark Capital Group, includes more than 6 pages of disclosure of affiliates and affiliated franchise programs. *See* Sonic 2018 FDD at <https://www.wdfr.org/apps/FranchiseSearch/MainSearch.aspx>.

<sup>14</sup> "How Dominos Persuaded Wall Street to Lend to it for Less." *Wall Street Journal*, (March 20, 2019) ("Within this whole business space, it's [whole business securitization] as hot as it's ever been."); "What the Heck is Securitization?" *Franchise Times* (November 14, 2017) <https://www.franchisetimes.com/news/November-2017/What-the-Heck-is-Securitization/>.

<sup>15</sup> *See* Sonic 2018 FDD, p. 1.

<sup>16</sup> 16 CFR §436.6(b), SBP, p. 15560.

read or understand the entire FDD.<sup>17</sup> At least one study has found that, in many cases, “franchisees ... ignore franchise disclosure documents, avoid conducting a comparison between various franchise contracts and disclosure documents, and refrain from consulting with a specialized franchise attorney before signing the franchise agreement.”<sup>18</sup> NASAA members have had numerous interactions with both current and former franchisees that support the findings of this study. This problem is especially acute for single unit franchisees, franchisees without prior business experience, and franchisees who seek out lower cost franchise investments.

It is difficult to determine the cost to franchisors of requiring a more readable FDD. It is clear, however, that the benefits to prospective franchisees would be considerable. NASAA recommends, therefore, that the Commission hold public hearings or workshops to explore whether it is feasible to revise the FDD format to make it simpler and more readable for prospective franchisees and, if so, how that may be accomplished.

#### *B. Incorporate Guidance from NASAA Commentaries.*

When the FTC adopted the Franchise Rule in 2007, it stated that it intended Commission staff to coordinate the issuance of Compliance Guides and future interpretations of the Rule with the NASAA Franchise Project Group in order to minimize differences between FTC and state regulation.<sup>19</sup> And Commission staff have consulted with the Franchise Project Group before publishing the FTC’s Rule Compliance Guide and FAQ’s.

Between 2009 and 2017, NASAA published several commentaries regarding FDD requirements (collectively the “Franchise Commentaries”) to address important issues regarding franchise disclosure: the NASAA Commentary on the FTC Rule (adopted April 27, 2009); the NASAA Franchise Multi-Unit Commentary (adopted September 16, 2014); and the NASAA Financial Performance Representation Commentary (adopted May 8, 2017).<sup>20</sup> The Franchise Project Group consulted with Commission staff before finalizing all of those Franchise Commentaries. The Franchise Commentaries were adopted after public comment periods.<sup>21</sup> Some of the comments submitted were very extensive. State franchise examiners enforce the guidance in the Franchise Commentaries to ensure that FDDs filed in franchise registration states comply with the guidance in those materials. As a result, franchisors routinely follow the Franchise Commentaries when preparing their FDDs in franchise registration and non-registration states.

Incorporating guidance from these Franchise Commentaries into the Rule would codify

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<sup>17</sup> See U. Benoliel and J. Buchan, *Franchisee’s Optimism Bias and the Inefficiency of the FTC Franchise Rule*, 13 DePaul Bus. And Com. Law J. 411, 428-429. (Spring 2015) (quotations omitted).

<sup>18</sup> R. Emerson and U Benoliel, *Are Franchisee’s Well-Informed? Revisiting the Debate Over Franchise Relationship Laws*, 76 Albany Law Review 193, 209 (2013) (citations omitted).

<sup>19</sup> SPB, p. 15449.

<sup>20</sup> See <http://www.nasaa.org/industry-resources/corporation-finance/franchise-resources/>.

<sup>21</sup> Public comments received on NASAA proposals are available to view on the NASAA website: <http://www.nasaa.org/regulatory-activity/nasaa-proposals/public-comment-on-nasaa-proposals/>.

well-established disclosure guidance that is already generally accepted and would promote uniformity in the franchise marketplace. If the Commission determines that incorporating NASAA's Franchise Commentaries into the Franchise Rule is not practical, the Commission should incorporate guidance from the Franchise Commentaries into interpretive guides or into an updated FTC Compliance Guide.<sup>22</sup>

### *C. Consider Modifying and Updating Specific Disclosure Items*

NASAA has identified several areas where specific disclosures required in an FDD could be improved. For purpose of this comment, we will discuss one example, regarding Item 12, which entails disclosing a franchisee's territory.

Item 12 of the FDD requires that franchisors disclose whether a franchisor grants an "exclusive territory." This disclosure is intended to clarify one of the most important issues in a franchise system: the extent to which a franchisee will face competition from the franchisor, other franchisees, and alternative channels of distribution (including the Internet). Yet the disclosure in Item 12 can be confusing. Experienced franchisor attorneys observed that "franchise lawyers who draft FDDs typically have nineteen years of formal education" but even these experts "generally will not fully understand an Item 12 disclosure after a single reading."<sup>23</sup>

Commission staff have issued two FAQs (FAQ 25 and 37) to clarify the meaning of "exclusive territory."<sup>24</sup> In FAQ 25, Commission staff opined that the term "exclusive territory" has a "well-established usage" in franchising. However, prospective franchisees, many of whom are new to franchising, may not be familiar with the well-established usage of the term. Franchisors regularly use different terms to describe the extent of exclusivity they offer, not just exclusive territory, but also "protected territory" and even "limited exclusive territory." Therefore, the Commission should explore whether requirements surrounding Item 12 should be modified to make clearer, in plain English, the type of territorial exclusivity a franchisor offers in its franchise system.

In addition to Item 12, the Commission should explore whether other disclosure requirements related to FDDs should be modified or updated. For example, the Commission should consider whether to require franchisors to make some type of affirmative financial performance representation (currently, Item 19).

## **12.) What modifications, if any, should be made to the Rule to account for changes in relevant technology or economic conditions? What evidence supports the proposed modifications?**

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<sup>22</sup> The FTC also should consider incorporating, where appropriate, the guidance it has issued on the Franchise Rule in the form of FTC FAQs at <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs>.

<sup>23</sup> C. Zwisler and A. Garney, *Clearing the Fog about FDD Readability*, 21 *The Franchise Lawyer*, No. 4 p. 8 (Fall 2018) (Suggesting further "But should we? Why should FDDs be subject to the same readability standards as newspapers and elementary school textbooks?").

<sup>24</sup> See <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs>.

Significant technological innovations have occurred since the FTC last amended the Franchise Rule. Changes to the Rule should account for innovations that have influenced the manner in which franchisors and franchisees do business and structure their relationship.

- A. *The Rule should be modified to account for the increase in cloud computing and to acknowledge cybersecurity concerns within a franchise system.*

The Rule currently requires the franchisor to disclose “whether the franchisor requires the franchisee to buy or use electronic cash registers or computer systems,” and if so, to describe “the systems generally in non-technical language, including the types of data to be generated or stored in these systems.” Further, the Rule currently requires the franchisor to disclose “[w]hether the franchisor will have independent access to the information that will be generated or stored in any electronic cash register or computer system.” If Yes, the franchisor must “describe the information that the franchisor may access and whether there are any contractual limitations on the franchisor’s right to access the information.”

NASAA urges the Commission to explore modifications to the Rule to account for the value of customer data to the franchise system and the potential value of this data to third parties. In addition to disclosing whether the franchisor will have independent access to the information that will be generated or stored, the Rule should require disclosure of what the franchisor plans to do with the data that it accesses. For example, the Rule should require the franchisor to state whether the franchisor reserves the right or intends to sell franchisee-generated data, and if so, the franchisor should disclose whether it will share any revenue from the sale of data with franchisees. Similarly, the Rule should require the franchisor to disclose if it reserves the right to share franchisee-generated data with an affiliate or another party.

Moreover, in light of data breaches at large sophisticated companies that have made national headlines, the Rule should require disclosure of the data protection obligations of the parties and duties of each in the event of a data breach. If the franchisor has independent access to data on the franchisee’s computer system or franchisees share a common network, in theory, it would appear to be possible for hackers or other bad actors to access this information. The Rule should require the franchisor to state whether the franchisor suggests or requires franchisees to comply with data protection policies established by the franchisor. In addition, because a breach of data could occur at both the franchisor level and the franchisee level, the Rule should require the franchisor to disclose whether it has data protection policies and whether the franchisor has adopted a cyber-security incident response plan for the system. Finally, the Rule should require the franchisor to disclose which party bears the costs associated with a data breach at both the franchisor and franchisee level.

The additional disclosures in the Rule discussed above would provide important information to prospective franchisees, illustrate which franchisors have thoughtfully considered data protection, and highlight to prospective franchisees the risks associated with a data breach at any level in any franchise system.

*B. The Rule should be modified to account for financial performance representations on social media platforms and on other forms of communication.*

NASAA urges the Commission to explore modifications to the Rule to account for social media. In particular, NASAA urges the Commission to explore modifying the Rule to (i) address how financial performance representations made on social media and on other forms of communication should be treated, and to (ii) require specific disclosures in the FDD to the extent applicable.

Since the adoption of the Rule, businesses have increasingly relied on social media to reach and engage with a large universe of current and prospective customers. For franchisors, social media platforms may serve as an effective tool not only to attract customers, but to find and solicit prospective franchisees. Although the Commission has published guidance on financial performance representations made in the general media, the Rule and corresponding guidance adopted under the Rule do not indicate whether these principles extend to financial performance representations made on social media platforms (as well as other forms of communication). Given the nature of certain social media platforms, NASAA notes that the general media guidance may not be sufficient to address similar financial performance representations made on social media. For example, platforms with character limitations (*e.g.*, Twitter) may cause franchisors to issue abbreviated statements, or gloss over certain information, which may mislead prospective franchisees in the process.

Accordingly, NASAA recommends the Commission explore whether it is appropriate to extend its prior guidance to financial performance representations made on social media platforms, or whether new guidance is necessary to assist franchisors in complying with the Rule. Further, NASAA suggests that any new guidance adopted be sufficiently flexible to extend to all forms of communication that require short-form content. Although the rise of social media has created the need to address this issue, NASAA acknowledges that social media platforms may continue to evolve. However, NASAA believes that there will continue to be forms of communication that require short-form content, and that it may be appropriate to issue separate guidance to address all forms of communication that limit the amount of content that may be published.

Beyond financial performance representations, NASAA urges the Commission to explore whether modifications to the Rule are necessary to account for franchisors' advertising policies, including franchisors' treatment of social media and other forms of internet advertising. NASAA sees an increasing number of disclosures in Item 11 about restrictions on the franchisee's ability to conduct advertising, including the franchisee's ability to conduct advertising on social media. In light of this trend, NASAA believes it is appropriate to modify the Rule to promote uniform disclosure standards. In particular, given that social media platforms may be a cost-effective means of advertising the franchised outlet, franchisees should be aware of whether the franchisor permits its franchisees to conduct internet and/or social media-based advertising, and any conditions imposed on conducting such advertising.

*C. The Rule should be modified to expressly prohibit the selective use of navigational tools in electronic disclosure documents for the franchisor's benefit.*

NASAA urges the Commission to explore a minor modification to the Rule to protect prospective franchisees who receive electronic disclosure. NASAA commends the Commission for setting forth principles in the Rule to govern delivery of electronic franchise disclosure documents. NASAA believes these principles may be sufficiently flexible to withstand advances in technology and electronic disclosure. However, since the adoption of the current Rule, there have been significant changes in the devices on which business is conducted. Indeed, smartphones and other mobile devices are supplanting separate devices such as personal computers as the primary means for sending and receiving information. As such, electronic disclosure documents may be increasingly delivered, read, and acknowledged from a prospective franchisee's mobile device. Accordingly, NASAA urges the Commission to explore a minor modification in the Rule to protect prospective franchisees and provide clarity to franchisors.

Specifically, NASAA suggests that the Commission provide further guidance relating to the use of permitted scroll bars, internal links, and search features in electronic disclosure documents. Although the Commission noted in a footnote to its Statement of Basis & Purpose that a franchisor's selective use of navigational tools referenced in the Rule for its own benefit (*i.e.*, to draw the prospect's attention to, or away from, certain disclosure items) is prohibited, NASAA urges the Commission to make this an express prohibition in the Rule itself. We believe it is particularly appropriate to move it to the Rule itself in light of advances in technological devices and the frequency of electronic delivery and disclosure.

**Conclusion**

NASAA appreciates the opportunity to comment on the Commission's proposal and stands ready to work with Commission staff to review issues involving the Franchise Rule. If you have any questions about these comments, please contact NASAA's Franchise and Business Opportunities Project Group Chair, Dale Cantone, of the Maryland Securities Division at [dcantone@oag.state.md.us](mailto:dcantone@oag.state.md.us).

Sincerely,



Michael Pieciak  
NASAA President  
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