

## **Proposed Statement of Policy Regarding Uniform Franchise Delivery Requirements**

### **I. Background**

The Franchise and Business Opportunity Project Group (the “Franchise Project Group”) of the North American Securities Administrations Association, Inc. (“NASAA”) proposes that NASAA adopt a statement of policy recommending that states revise their franchise law provisions, if necessary, to achieve a more uniform approach to state franchise delivery requirements. Currently, there is a lack of uniformity among state franchise laws regarding when franchisors must deliver a franchise disclosure document to prospective franchisees. There is also a lack of uniformity between some state franchise delivery requirements and the delivery requirement adopted in 2007 under a Federal Trade Commission (“FTC”) Franchise Rule for franchise disclosure documents throughout the United States.<sup>1</sup>

### **II. Franchise Delivery Requirements Prior to 2008**

Historically, states with specific franchise disclosure laws enacted statutory provisions requiring that franchisors deliver a copy of a franchise disclosure document to prospective franchisees before the sale of a franchise occurs. California was the first state to enact a specific franchise law in 1971.<sup>2</sup> In 1979, the FTC adopted a federal Franchise Rule that required franchisors to deliver a form of franchise disclosure document to prospects at the earlier of: (i) the first personal (face-to-face) meeting; or (ii) 10 business days before the execution of the franchise agreement or payment of any fees in connection with the franchise sale (collectively the “10 Business Day/First Personal Meeting Approach”).<sup>3</sup>

After the FTC adopted the 1979 Franchise Rule, several states enacted or amended their franchise laws to mirror the 10 Business Day/First Personal Meeting Approach. NASAA’s own Model Franchise Investment Act also follows this 10 Business Day/First Personal Meeting Approach.<sup>4</sup> Some states adopted the 10 business-day delivery model as part of their franchise statutes but omitted the first personal meeting trigger. Other state laws require shorter waiting periods. In those states, franchisors still had to follow the 10 Business Day/First Personal Meeting Approach because the 1979 Franchise Rule preempted lesser state delivery requirements. Therefore, prior to 2008, there was a uniform delivery requirement for franchise disclosure in the United States.

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<sup>1</sup>Final Amended Franchise Rule, 16 CFR 436, as amended, 72 FR 15444 (Mar. 30, 2007).

<sup>2</sup>Cal. Corp. Code Ann. §31000 et seq. (West Supp. 1972).

<sup>3</sup>See 16 CFR 436.1 (a), 436.2(g) and 436(o), Federal Trade Commission Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 FR 59614 (December 21, 1978);

<sup>4</sup>See NASAA Model Franchise Investment Act, adopted August 30, 1990, BUS. FRAN. GUIDE (CCH) ¶3700 at page 4775.

### III. The FTC's Amended Franchise Rule

In 1995, the FTC began a regulatory review of its 1979 Franchise Rule. The final Amended Franchise Rule was announced in February 2007. One of the more significant revisions the FTC made to its Franchise Rule was to change the 10 Business Day/First Personal Meeting Approach for delivery of franchise disclosure documents. *First*, the Amended Franchise Rule eliminated the first personal meeting disclosure trigger. The FTC concluded that the face-to-face meeting trigger has become obsolete in the electronic age, where even large investments are made by telephone or the Internet.<sup>5</sup> *Second*, the Amended Franchise Rule replaced the 10 business-day trigger with a 14 calendar-day trigger. The FTC concluded that a 14 calendar-day trigger is clearer than a 10 business-day trigger.<sup>6</sup> The FTC noted that commenters expressed confusion as to what constitutes a “business day,” that holidays are not observed uniformly among the states, and that in most instances 10 business days amounts to 14 calendar days as a practical matter.<sup>7</sup>

*Third*, the FTC adopted a new prohibition making it an unfair or deceptive act or practice in violation of the FTC Rule for any franchise seller to “fail to furnish a copy of the franchisor’s disclosure document to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.”<sup>8</sup> The FTC stated that a requirement to provide a franchise disclosure document earlier than the standard 14 calendar-day trigger upon reasonable request was necessary in light of the FTC’s decision to eliminate the original face-to-face meeting disclosure trigger. The FTC noted that the new prohibition “strikes the right balance between relieving franchisors of the burden to furnish disclosures at the first face-to-face meeting in all instances, and the prospective franchisee’s desire to review disclosures early in the sales process before investing significant time, effort, and money in considering the franchise offering.”<sup>9</sup>

### IV. The Current Inconsistent Approaches to State Franchise Delivery Requirements

The FTC’s adoption of its Amended Franchise Rule has resulted in inconsistencies in franchise delivery requirements at the state level. In states without a specific franchise

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<sup>5</sup>Amended Franchise Rule, Statement of Basis and Purpose (“SBP”), 72 FR 15468-69 (March 30, 2007).

<sup>6</sup>SBP, 72 FR 15469.

<sup>7</sup>See Amended Franchise Rule, Notice of Proposed Rulemaking, 64 FR 57301 (October 22, 1999).

<sup>8</sup>Final Amended Franchise Rule, 16 CFR §436.9 (e), 72 FR 15561 (March 30, 2007). Under the Amended Franchise Rule, a “prospective franchisee” is defined as any person who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship. See 16 CFR §436.1(r), 72 FR 15545 (March 30, 2007). *Accord*, Section VII, Definition (o), 2008 NASAA Franchise Registration and Disclosure Guidelines (defining “prospective franchisee”).

<sup>9</sup>SBP, 72 FR 15532.

disclosure statute, franchisors must follow the FTC's 14 calendar-day approach. In states with delivery requirements that are equal to or shorter than the FTC's 14 calendar-day approach,<sup>10</sup> franchisors still must follow the FTC's 14 calendar-day approach, since the Amended Franchise Rule preempts any lesser disclosure period. In states that retain the First Personal Meeting/10 Business Day Approach,<sup>11</sup> however, franchisors must continue to comply with the First Personal Meeting/10 Business Day Approach because that disclosure period is potentially longer than the FTC's 14 calendar-day approach.

## **V. The Franchise Project Group's Recommendation for a Uniform Franchise Delivery Provision**

The Franchise Project Group recognizes the merits of a uniform approach to state franchise delivery requirements. The Franchise Project Group agrees with the FTC's approach that a 14 calendar-day delivery trigger is clearer than a 10 business-day delivery trigger and amounts to an equivalent delivery period as a practical matter. The Franchise Project Group also agrees that a first personal meeting requirement has less significance to prospective franchisees in an electronic age. We recognize, however, as did the FTC, that prospective franchisees should have the ability to review a franchise disclosure document as early in the sales process as possible. Our law enforcement experience at the state level reflects that many franchisee prospects decide to purchase a franchise early in the sales process, well more than 14 calendar days before the franchisee pays money or sign an agreement.

Therefore, the Franchise Project Group recommends that NASAA adopt the following Statement of Policy urging states to enact or amend their statutes to follow a uniform state franchise delivery requirement. The following model delivery provision is consistent with the FTC's Amended Franchise Rule and, if enacted by states, would further the goal of uniformity in franchise regulation. In addition, the provision protects prospective franchisees by enabling them to receive a franchise disclosure document early in the sales process upon reasonable request. At the same time, the Franchise Project Group recommends that states adopt a regulation to expound on the meaning of "reasonable request" to give franchisors and prospective franchisees a more thorough understanding of when a franchise disclosure document must be delivered.

## **VI. Text of Proposed Statutory Provision Regarding Delivery Requirement.**

### **[Add to definitions]:**

Prospective Franchisee.— "Prospective franchisee" means any person (including any agent, representative, or employee) who approaches or is approached by the franchisor, its employees, representatives, agents, subfranchisors, or any third party brokers involved in

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<sup>10</sup>California, Hawaii, Illinois, Indiana, Minnesota, North Dakota, South Dakota, Virginia, and Wisconsin.

<sup>11</sup>Maryland, Michigan, New York, Rhode Island and Washington.

franchise sales activities, to discuss the possible establishment of a franchise relationship.

**[Statutory delivery provision]:**

A. A franchisor may not sell a franchise subject to registration in this State without delivering to a prospective franchisee a franchise disclosure document [offering circular/prospectus] and a copy of each proposed agreement that relates to the sale of the franchise at the earlier of:

(i) 14 calendar days prior to the execution by the prospective franchisee of any binding agreement with the franchisor; or

(ii) 14 calendar days prior to payment of any consideration that relates to the franchise relationship.

B. A franchisor may not sell a franchise subject to registration in this State without delivering to a prospective franchisee the franchise disclosure document [offering circular/prospectus] earlier in the franchise sales process than required under [Section (II)(A)] of [the Act] upon the prospective franchisee’s reasonable request.

C. A franchisor is not required under this [provision] to provide a franchise disclosure document [offering circular/prospectus] to a prospective franchisee if providing that disclosure document [offering circular/prospectus] would violate another provision of [the Act].

**VII. Text of Proposed Regulation Regarding Reasonable Request**

For purposes of §[A] of the [state] Franchise Law, the 14 calendar day period commences the day after the Franchise Disclosure Document is received by the prospective franchisee.

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For purposes of §[ B] of the [state] Franchise Law, a “reasonable request” to receive a franchise disclosure document means any request by a prospective franchisee already in the sales process to buy a franchise from the franchisor.

(i) An indication that a prospective franchisee is already “in the sales process” includes the situation when that individual has submitted a franchise application to the franchisor and been notified by the franchisor that he or she qualifies for a franchise.

(ii) A franchisor has no obligation under this regulation to furnish a franchise disclosure document to the franchisor’s competitors, the media, academicians, researchers, or any prospective franchisee who is not already in the sales process to buy a franchise from the franchisor.