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Mr. Dale Cantone
Office of the Attorney General
Division of Securities
200 St. Paul Place, 24
Baltimore, MD 21202-2020

Dear Mr. Cantone:

The following comments are offered to the Proposed Model Franchise Exemptions:

General Comment – The effort to pass uniform exemptions is applauded. The project mirrors the aim for uniformity that dates back to the efforts in the 1970's to agree on a uniform disclosure format, and the recent effort to have uniform requirements for the timing of disclosures. The current status of having a variety of exemptions in the various states, some consistent with federal exemptions, and some inconsistent, is very confusing to franchisors and imposes significant additional costs on franchisors. This project is therefore much appreciated, at least among the franchisor community.

Without intending in any way to slow down the process of passing uniform exemptions, I assume everyone would agree that it is important we not create new confusion with these exemptions, or render any of these exemptions to be of no value because of the restrictions placed upon them. I do therefore have a number of comments concerning the exemptions.

1. Fractional Franchise Exemption –

   a. The definition of "same type of business," is very narrow. By using a definition that focuses on competing products, it narrows the exemption far more than practitioners may be interpreting the exemption today. For example, if I currently operate a full service restaurant, and I add a pizza concept to the restaurant, it appears I will not qualify for the exemption unless I was already selling pizzas because someone could argue that pizzas are not competitive with other types of meals (an argument fostered by franchisors with multiple concepts that grant exclusive territories for one concept that do not cover others). Is that really a situation where registration and disclosure is necessary? Another example would be the sale of an ethnic restaurant franchise to a hotel that has always had a food service component, albeit not one in that particular segment. In that situation, the hotel often has more business experience, and food service experience, than the franchisor. Using a completely different example, if I operate a vending concept in a particular market, and someone has a new line of vending machines/products

I can add to my existing route, and which will generate less than 20% of my revenue, the new items to be vended will not likely be competitive with the products sold in my existing machines, but the new products are still compatible with my existing business. In this example, my knowledge of the vending business in general, and the market for vending machines, is far more important than any knowledge of the goods being sold, and the exemption should be available. I would suggest the exemption refer to products that are competitive, or that are compatible with those sold in an existing business. The key in either case is that I am already experienced in the industry, and the new products will generate less than 20% of my revenues.

b. Under the proposed exemption, for the first time, franchisors will be required to file a notice when relying on the exemption. Many manufacturers have relied on the exemption in the past. These companies have never been involved in the sale of franchises, and will not be familiar with this requirement. Unless there are significant issues with the current use of fractional exemptions (and case law would suggest there are not), since availability of the exemption has not required a filing for the last 30 years, it should not be necessary to impose the requirement at this time.

2. Experienced Franchisor Exemption –

a. The requirement for a $10 million net worth is higher than the current requirements in a number of states. If that number is important, it is suggested a phase-in process be included for states that currently have a $5 million net worth exemption so that companies that have been relying on this exemption (and I am aware of at least one that has lending requirements tied to compliance with the exemption) will have some period of time to either have their growth keep them within the exemption, or register.

b. With the requirement that a notice of exemption be filed, along with a copy of the disclosure document, the exemption becomes of no value in states such as South Dakota, Wisconsin, Michigan and Indiana that already permit franchisors to make sales after a simple filing (and without state review). Was it intentional that franchisors who previously qualified for this exemption will now likely register in those states, rather than avail themselves of the exemption?

3. Sophisticated Purchaser Exemption –

a. Existing Franchisees.

(i) The availability of this exemption is dependent on the first sale to the existing franchisee having been lawful at the time of sale. Because the franchisee must have been operating for least two years, that sale would have taken place at least two years earlier. In fact, if the franchisee had

been in the system for a number of years, it could have occurred many years earlier. And unfortunately, what a franchisor and its lawyer may think was a lawful sale (based on a complete disclosure) could always be questioned by a franchisee's attorney who found an alleged omission from the disclosure document (perhaps obscure or irrelevant, and perhaps significant). If the franchisee has been in the system for at least two years, they already know far more than they would have learned at the time they purchased their first franchise. Under the circumstances, this requirement is unnecessary, and only provides a trap for well-intentioned franchisors.

(ii) The availability of this exemption also requires the execution of a franchise agreement "that is substantially similar to the first franchise agreement" between the parties. Any franchisor seeking to rely on this exemption runs the risk that if it makes any changes in its franchise agreement from one year to another (something routine for all franchisors), a court will find the changed terms so significant as to make the new franchise agreement one that is not deemed to be substantially similar to the first one. If a franchisee has been in the system for 24 months, does this requirement really provide any significant protection to them, particularly given the risk to the franchisor? This problem is exacerbated for franchisees with multiple franchises, who purchased the first one many years ago. In that case, the agreements would rarely be "substantially similar." I would submit that because the prospective franchisee will still receive a disclosure document at least 14 days before they sign the agreement, they have plenty of time to review the new franchise agreement, compare it to their existing agreement (or agreements) and decide whether to ask additional questions. Perhaps the appropriate standard should be that the new franchise agreement is for the same type of business as is covered by at least one franchise agreement that has been in effect between the parties for at least the last 24 months.

b. Franchisor Insider. This is another exemption that requires filing of a notice of the sale following its occurrence. These sales are sometimes made before a company ever starts selling franchises. In that case, they may not have previously consulted an attorney about selling franchises. Given that this is a sale to someone who already has two years of experience inside the business, or is a 25% owner of the franchisor, is this additional step providing any protection to that franchisee, such that the failure to report the sale should give rights to that person if they later have a falling out with the franchise system?

c. Sophisticated Franchisee (Accredited Investor).

(i) The threshold for the accredited investor is much higher than the threshold for an accredited investor under securities laws. This will cause confusion. Is the significantly higher threshold really necessary? Given

that these exemptions were updated in the last year by the Securities and Exchange Commission, is it really necessary to create new definitions? It is suggested that the threshold tie to that created by securities law (or to avoiding the need for future amendments, the higher of today's S.E.C. standard and any subsequent one made effective by the S.E.C.).

(ii) The exemption requires that the financial statements of the prospective franchisee be prepared under GAAP, as of a date within 90 days of the date the franchise agreement is signed or any monies are paid to the franchisor. However, there is no requirement that the financial statements actually be provided to the franchisor.

(A) If the intention is that the franchisor be given a copy of the financial statements, then the exemption should so state. I would submit, however, that this is not necessary, and will be problematic for many high net worth individuals who do not want to provide their financial statements to the franchisor. Given that the prospective franchisee must be represented by legal counsel, and they must sign a certification verifying the grounds for the exemption, it should not be necessary that the financial statements be provided; if the franchisee does not have the net worth, and the franchisor has no reason to believe otherwise, the franchisor should be able to rely on the signed verification, particularly when the person must be represented by counsel.

(B) The requirement that the financial statements be prepared in accordance with GAAP makes the exemption worthless for individuals. For one thing, most individuals who prepare their own financial statements probably would not know whether or not they were prepared under GAAP. Franchisors certainly have no way of confirming this fact (and unlike their own financial statements, they were not responsible for preparing them). Also, GAAP requires footnotes to financial statements, and I have never seen an individual who would put footnotes in his or her financial statements. It may therefore be more appropriate to remove this requirement and instead provide (subject to my next comment) that the financial statements accurately reflect the financial position of the prospective franchisee. (I also believe that GAAP requires preparation of a number of financial statements, and you are really talking about only a balance sheet in addressing net worth. Thus, any reference to "financial statements" in this exemption should be "balance sheet.")

(C) It is really more appropriate to remove these requirements (GAAP and 90 days) entirely; if a franchisee is satisfied that he or she has

the required net worth, that should be sufficient. The obligation to verify all these facts (or the risk if they are misrepresented) should not be shifted to or imposed on the franchisor. If that is not acceptable, then the requirement that the balance sheet be prepared in accordance with GAAP, and that it be within 90 days can, if necessary, be included as part of the verification to be signed by the prospective franchisee. If a franchisee states these facts (subject to my comment above regarding GAAP), and is represented by counsel, the franchisor should not be at risk if the verification is not correct.

4. Discretionary Exemption –

a. In order to rely on this exemption, the franchisor must make a specific request to the administrator. If the administrator determines registration (and perhaps disclosure) is not required, then why is it necessary to file another notice after the sale?

b. With the filing for the Notice of Exemption, an applicant must submit a "proposed order of exemption." Will a regulator actually adopt a proposed order, verbatim, submitted by someone who has likely never written such an order, as opposed to creating their own order? Even for the best intentioned applicant, proposed orders are likely to be in such a large variety of formats, and include a large range of verbiage, from formal legalistic to fragments and broken English, that there may not be any benefit to having applicants craft their own proposed orders.

Respectfully submitted,

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