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Dale E. Cantone, Chair, Franchise Project Group, dcantone@oag.state.md.us

Christopher Staley, NASAA Legal Department, cs@nasaa.org

Re: PROPOSED FRANCHISE COMMENTARY ON FINANCIAL PERFORMANCE REPRESENTATIONS

Dear Mr. Cantone and Mr. Staley:

I write to comment on the proposed FPR Commentary. Overall, it is quite useful to practitioners and I applaud the Franchise Project Group for its hard work in tackling the most important issue in franchise sales regulation. However, given the importance of the subject, I strongly object to Section 19.7 of the proposed FPR Commentary because it is unfair to both early stage franchisors and their prospects.

I have been representing early stage franchisors and prospective franchisees since the late 1990's. Throughout that period, state and FTC regulators, and most responsible franchise law practitioners, have encouraged franchisors to make financial performance information available through Item 19 of the Franchise Disclosure Document (f/k/a UFOC) so as to decrease the incidents of franchise salespeople providing financial performance representation ("FPR") disclosures outside of the FDD.

For example, the Item 19 commentary in the Statement of Basis and Purpose for the current FTC Franchise Rule states, "Based upon the record, the Commission has concluded that eliminating the geographic relevance requirement, coupled with permitting broader disclosure of financial performance of subgroups, will remove obstacles that discourage franchisors from making financial performance data available to prospective franchisees." When discussing whether a historical data FPR should have to be presented in accordance with GAAP, the NASAA comment to the FTC stated, "This requirement would discourage franchisors that have a factual basis for making financial performance disclosures from doing so." As a result of that advocacy the percentage of franchisors providing Item 19 FPRs has increased from a very low number in the late 1990's to what may be a majority today.

The demand for financial performance information is often prospect-driven, as the sales and net earnings of existing units are almost always the first question asked by my prospective franchisee clients. ("How much money can I make?")

Unlike established franchisors, start up and early stage franchisors do not have franchisees from whom prospects can obtain cost and net profit data. Accordingly, the only way they can obtain a brand-specific FPR is from the franchisor. So Section 19.7 will unfairly benefit incumbent franchisors, to the detriment of new franchisors and prospective franchisees whose choices of offerings will be artificially limited.

Prospective franchisees will be unable to obtain financing without creating a pro forma, and their pro forma has to be based on factual data. In my experience, early stage franchisors who provide a Gross Sales FPR to prospects (pursuant to Section 19.5 of the Commentary) will find ways to facilitate prospects' creation of Pro Forma net profit projections. They may be able to do so within the law, by providing "cost only" data on labor rates, the costs of certain key products or ingredients sold, and real estate occupancy costs (rent, utilities, etc.). However, rather than putting them at a competitive disadvantage by having to engage in complicated methods of helping prospects, it is a better and more equitable policy to place all the information in Item 19.

Moreover, will Section 19.7 prohibit a company that actually operates the type of units being franchised from offering franchises? During the 2000's one of my clients actually took the unusual step of not establishing a separate new company for franchising purposes, obtaining audits of the financial statements of its existing operating company (which operated the flagship "in-home senior care" business), and then referencing those audited financials in Item 19 as its FPR. That audited statement of course included expense and net profit data. Would that course of proceeding be illegal for start-up franchisors?

The page that follows is an example of an Item 19 FPR that was included in one of my franchisor client's recent initial FDD, as registered this year by more than one state that participates in NASAA, and would be deemed impermissible under Section 19.7. It has been edited to avoid identifying the franchisor, and for brevity the introductory paragraph required by the FTC Rule is deleted. I submit that, if the information about labor and operating expenses were removed, this franchise's prospective franchisees would be much worse off in terms of understanding the real economic effect and challenges of "growing to scale" in this type of business.

ITEM 19. FINANCIAL PERFORMANCE REPRESENTATIONS

[standard introductory paragraph deleted]

The table below documents the financial performance of our affiliate's [painting service business] from 2010 through 2013, including the expansion of staff during the same period:

	Jan - Dec 10	Jan - Dec 11	Jan - Dec 12	Jan - Dec 13
Gross Sales	437,886.52	591,591.83	1,082,258.21	1,507,919.90
Payroll Expenses	115,053.51	259,499.10	551,715.94	561,777.49
Subcontractors	104,740.40	60,840.15	103,579.08	244,209.08
All Other Operating Expenses	125,496.60	185,017.56	328,791.49	531,715.12
Earnings before Depreciation, Interest & Taxes ("EBITD")	92,596.01	86,235.02	98,171.70	170,218.21
EBIDT as percentage of Sales	21%	15%	9%	11%
Number of Estimators*	0.25	1	1	1.5
Number of Painters	3.00	4.5	6.75	6
Number of Painter/carpenters	0.00	1	2	2
Office Manager	0	0	1	1
Office Admin. Assistant	0	0	1	1

In 2010 [our founder] was the primary estimator and supervisor of painters, and the affiliate's minor home renovation services were provided by sub-contractors. Through 2011 [our founder's wife's] only role was as a part-time bookkeeper. Expanded marketing and staffing, as well as improvements in processes, are the primary factors that have led to the growth in [our affiliate's] gross sales and, in 2013, in net earnings before interest, taxes and depreciation. However, it is important to remember that [our founder] has been providing painting services in [our affiliate's home county] since 1989. You should be aware that earnings are directly linked to the effort and expertise of, and hours worked by, the franchisee in operating and marketing the business. It may take you several years of operations to build up your _____________ business to the level that our affiliate has achieved.

Written substantiation for the financial performance representation will be made available to the prospective franchisee upon reasonable request.

These figures only represent the recent results of our affiliate ________________. Your individual results may differ. There is no assurance that you'll earn as much.

In light of the foregoing, I encourage the Franchise Project Group to reconsider Section 19.7 and avoid creating unfair barriers to entry and full disclosure by new franchisors.

Sincerely,

David L. Cahn

Counsel