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VIA E-MAIL to dcantone@oag.state.md.us & cs@nasaa.org

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Re: NASAA's Notice of Request for Comments Regarding FPR Commentary

Gentlemen:

Thank you for the opportunity to comment on NASAA's Franchise Project Group's FPR Commentary. The members of our Faegre Baker Daniels' franchise practice have many years of experience in (i) working with franchisors in preparing Item 19 FPRs and (ii) representing franchisors in disputes with franchisees regarding Item 19 FPR claims.

Generally, we believe the Background and Introduction to the FPR Commentary identify the key pressure points and appropriately frame the FPR Commentary's objectives of providing guidance and clarification to several important questions regarding FPRs. In most instances we do not see any issues with the Questions and Answers. In a few instances, though, we do see problems that NASAA's Franchise Practice Group should consider as they complete their work. Some of those instances simply require clarification. Other instances merit a more substantive review of the Answer, as the current draft does not provide clear guidance or raises more questions than answers. That type of uncertainty can't be the desired outcome for the FPR Commentary, based on the objectives noted in the Background and Introduction and the overall purpose of the Item 19 rules.

We respectfully submit our comments as follows:

19.6 The current language in the proposed 19.6 Answer requiring a franchisor to adjust costs to "reflect potential material financial and operational differences between company-owned outlets and franchised outlets" undoubtedly will result in confusion and inconsistent application among state examiners and will invite increased litigation due to second-guessing of a franchisor's decisions in preparing its Item 19 that will go well beyond the current required standards of having a reasonable basis for the claim and the other Item 19 requirements. For example, other than straightforward expenses like imputed royalties and ad fund contributions, a standard that requires a franchisor to disclose potential material financial

and operational differences will only lead to more disputes of why a franchisor disclosed a particular potential difference and not any other potential differences. The FPR Commentary should provide clear guidance, not create confusion or ambiguity.

State examiners also will be confused with the language in 19.6. What one state examiner feels satisfies this ambiguous standard will be different than a second state examiner and likely different from a third examiner. This already happens under the current Item 19 standards. The language in 19.6 will only exacerbate the problem. That result can't be the desired outcome for the FPR Commentary.

As the Franchise Project Group reviews 19.6, we strongly recommend that it consult with seasoned franchisor and franchisee executives to determine how this standard might play out in the real world. Our sense is that you will get a much different picture than what you have received without that type of input. In addition, prospective franchisees should be encouraged to take advantage of the opportunity to contact existing and former franchisees, as those franchisees can provide any additional input the prospect may require in its decision-making process

In short, the current standard works without the 19.6 Answer. If the Franchise Project Group does believe there are issues, it should not attempt to resolve those issues through some type of compromise that only creates more questions and will result in more costly litigation. That benefits no one.

19.7 The Franchise Project Group assumes that a franchisor with no operational franchises has no reasonable basis to make an FPR disclosing gross profit or net profit based on company-owned outlet information. Why? Is there actual data to support the concern?

In fact, in several instances the expenses of company-owned outlets may be more accurate than information the franchisor receives from its franchisees. The Franchise Project Group should not prohibit a franchisor from making its own decision on what to include in its Item 19 FPR, in which case the franchisor still must comply with the Item 19 rules. This is particularly true when the alternative is that prospective franchisees will get no Item 19 information when, in fact, they want that type of information as they make their decisions.

19.9 The only change requested is to replace "must" with "may" in the final sentence. If a franchisor must state whether interest, taxes, depreciation or amortization are excluded, then the first part of that sentence should not state that the franchisor must include those items.

19.16 The 19.16 Answer is limited to the first year of operation. Does this answer suggest or imply that a franchisor can't exclude outlets that close during the year regardless of how many years the outlet has been open? For example, if a franchisor includes in its Item 19 FPR an annual gross sale average of franchised outlets, can it exclude outlets that have closed during the year (in effect, those outlets are not open the entire year and have less than a full year of sales), rather than just those that opened and closed during the first year of operation? Our concern is that without further clarification, some state examiners will limit to the first year only.

19.20 For a historical Item 19 FPR, Answer 19.20 limits a franchisor to making a clear and conspicuous admonition in Item 19 that: “Some outlets have [sold or earned] this amount. Your individual results may differ. There is no assurance that you’ll [sell or earn] as much.”

The Item 19 rules already require that a “franchisor must disclose... a clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.”) Indeed, the old NASAA Commentary already explained in 19.3 that a franchisor is required to make an admonition.

However, what is troubling with Answer 19.20 is the language that a franchisor “may not vary this language... unless the franchisor makes a type of FPR that does not fit the situation for the language provided.” There are at least four problems with this language.

- First, 19.20 is contradicted by the admission in NASAA Commentary 19.3 that “Item 19 does not require any specific language.”
- Second, it is ambiguous what it means to “make a type of FPR that does not fit the situation for the language provided.”
- Third, does every franchisor that includes something like the language below need to change its Item 19 FPR or else face potential liability? For example, Item 19 for many franchisors includes some type of “admonition” along the following:

Other than as disclosed in this Item 19, ABC Co does not make actual, average, projected or forecasted sales, expenses, profits, or cash flow information available to prospective franchisees. There is no guaranty that any new franchisee will attain the average sales, expenses, profits, cash flow levels attained by any existing franchisees.

ABC Co has compiled these average sales, expenses, profits, and cash flow from information provided by ABC franchisees, and they should not be considered as the actual or potential sales, expenses, profits, or cash flow that will be realized by any other franchisee. A new franchisee's individual financial results are likely to differ from the average figures presented in this Item 19.

- Fourth, what counts as “varying” the language? Is the following statement a separate statement that does not constitute an “admonition” or would it be varying the admonition?

The actual sales, expenses, and cash flow results of any franchised ABC unit may vary from these averages. Sales, expenses and cash flow results depend upon many independently variable factors including the location of the unit, local traffic patterns, demographics like population and other factors, age of the market, the competitive environment, public awareness of and goodwill associated with the ABC brand, the region and market area in which the unit is located, the length of time the unit has been in

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operation, the quality of the management and service at the unit, labor costs, the individual skills of the franchisee and other factors.

We understand that a franchisor is prohibited from disclaiming or requiring a prospective franchisee to waive reliance on any representation made in the FDD. But the language included in many Item 19 FPRs attempts to provide context for the prospective franchisee and to make sure that the prospect has a better understanding as to what the information disclosed in Item 19 means and, as importantly, what the information doesn't mean. We respectfully suggest that the short admonitions do not adequately get the job done and without further explanation the short admonitions can be misleading to a prospect. For example, every prospect should understand the importance of the factors noted in the fourth point above to our Answer 19.20 comments

Again, thank you for the opportunity to submit our comments. We do appreciate the hard work of the Franchise Project Group.

Respectfully submitted,



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