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October 13, 2016

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Re: Comments on the September 14, 2016 NASAA Franchise Project Group FPR Commentary

Dear Mr. Cantone, Mr. Beatty, Ms. Coverman, and Mr. Stewart:

This letter is being submitted on behalf of the law firm Gray, Plant, Mooty, Mooty & Bennett, P.A. (“GPM” or “Gray Plant Mooty”) in response to the request of NASAA’s Franchise and Business Opportunity Project Group (the “Franchise Project Group”) for comments on its September 14, 2016 release of a “Proposed Franchise Commentary on Financial Performance Representations” (the “FPR Commentary”). Our comments below include (A) background and general comments, and (B) specific comments on individual questions and answers in the FPR Commentary. We recognize that the FPR Commentary issued on September 14, 2016 is a second version of the NASAA Commentary, originally issued October 1, 2015, and reflects the Franchise Project Group’s deliberations after receiving comments from interested parties in late 2015. Our comments below relate only to this current, September 2016 version, of the FPR Commentary. To the extent we refer back to the 2015 commentary, we will note that specifically.

A. **Background and General Comments**

1. Thank you to the NASAA Franchise Project Group

GPM recognizes that NASAA and the Franchise Project Group have worked hard over the past several years to develop an FPR Commentary that seeks to serve the needs of prospective franchisees and their counsel, franchisors and their counsel (both in house and outside), and state regulators. We also appreciate the time and effort of the Franchise Project Group in reviewing and deliberating over the comments from 2015. It appears that some changes in the current revised FPR Commentary were based on those public comments. We commend you and thank you for your time and effort. We understand that it is challenging to develop recommendations, suggestions, or answers to frequently asked questions

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that will be applicable to all or even many franchisors and franchisees. While we may not agree with all of the recommended FPR Commentary, we thank you for your willingness to take on this task.

2. GPM Franchise Group

Gray Plant Mooty is a full-service law firm that has been celebrating its 150th anniversary in 2016. Gray Plant Mooty has been involved in franchising matters for over 40 years. Currently, the GPM Franchise Group includes 30+ lawyers who devote all or a majority of their practice to franchise, licensing and distribution matters. We currently represent more than 350 clients or brands in franchising, licensing and distribution, in more than 60 industries, from start-up franchisors, to some of the largest, most recognized brands in the world. More relevant to the Franchise Project Group, is that in the last two calendar years, the GPM Franchise Group has represented over 250 different franchisors or franchise brands in preparing or updating FDDs, and/or filing franchise registrations or renewals, and/or counseling on U.S. franchise regulatory and transactional matters. Many of our current clients, and many companies and brands that our lawyers have represented in the past, have prepared and included FPRs (and earnings claims) in their FDDs (and their UFOCs, prior to 2008). GPM's franchise group has also litigated over the years numerous FDD-related issues, including and specifically Item 19 of the FDD. The issues raised in this letter (and in our November 2, 2015 letter with comments on the original 2015 FPR Commentary) – both the general comments and concerns, immediately below, and the specific comments addressed to individual FPR Commentary Items – are based upon and reflect this substantial experience.

3. General Comments on the FPR Commentary

Because franchising covers 75 to 100 different industries, and there are many different types and sizes of franchise systems even within the same industry, a “one-size-fits-all” approach to FPRs is not practical, useful or warranted, and in some cases it may be disadvantageous, even to prospective franchisees. We remain concerned that the FPR Commentary will be viewed by regulators, lawyers, courts and arbitrators as the “final word” on FPRs, or even “the law,” without room for reasonable variations based on the facts related to specific franchise systems. If a rigid approach to interpretation is followed, then valid, legitimate, reasonable, and helpful FPRs may not be permitted. Further, information which courts and the vast majority of people, including prospective franchises, would now consider to have a reasonable basis, could become the subject of litigation. As noted in some of our comments below, we recommend a more decisive and specific statement regarding the intent and future use of this FPR Commentary. Our reasons for these concerns follow.

a. The FPR Commentary Should Be “Guidelines” and Not an Inflexible Set of Rules. According to the “Background” section of the FPR Commentary, NASAA created the FPR Commentary in recognition of the fact that there was “very little guidance” as to what constitutes a reasonable basis for making and substantiating an FPR under federal and state franchise law. In keeping with this purpose, the FPR Commentary seeks to provide “guidance” and “clarification” as to what is a reasonable basis for an FPR and, in some cases, what is not a reasonable basis. The FPR Commentary paints with a broad brush, applying its definitions and interpretations of reasonable basis to all FPRs, all industries and all franchisors, without allowing for an analysis or review of the specific facts or circumstances applicable to an FPR. At the same time, however, NASAA acknowledges in the “Introduction” to the FPR Commentary that “[w]hat constitutes a reasonable basis, and what information is needed to substantiate an FPR, is fact-specific and varies from case to case, depending on the representation made”(emphasis added). Accordingly, while we are in favor of greater consistency and greater certainty with respect to FPRs, we believe that the FPR Commentary should be viewed as “guidelines” and not an inflexible set of rules.

As such, state examiners should have the discretion to allow for a variance from the guidelines in the FPR Commentary if a franchisor presents a valid reason for doing so (i.e., the state examiner determines the franchisor's FPR has a reasonable basis even if it is not consistent with all aspects of the FPR Commentary). We note that the discussion in Item 19.11, and specifically footnote 9, may have arisen out of one or more discussions between franchise administrators and counsel for franchisors regarding how a narrow and inflexible interpretation of certain rules, FAQs, or guidelines could either do harm to a franchisee (by identifying the franchisee in the FPR) or force a franchisor to eliminate a useful FPR. The franchise examiner's discretion was valuable to permitting a well-written and narrowly tailored FPR to be included in an FDD. A variation on such an exception or situation is now part of the FPR Commentary.

Another example is current Item 19.8. Please see our discussion below regarding this Item.

We therefore recommend that the FPR Commentary include the following statement:

“The FPR Commentary is guidance for franchisors, counsel and franchise administrators. However, this FPR Commentary is not intended to remove all discretion from franchise examiners, and franchise registration states may permit the use of FPRs that may not be in strict adherence with these guidelines.”

b. The FPR Commentary Should Not Apply Retroactively to Existing FPRs. While we recognize that the “Introduction” to the FPR Commentary establishes an applicable effective date, we are still concerned with the impact the FPR Commentary may have on existing FPRs. Specifically, there is a perception that following the adoption of the FPR Commentary, NASAA, state franchise examiners, franchise practitioners, and possibly courts and arbitrators, will view the FPR Commentary as more than just “guidelines” as to what is a reasonable basis, but as the “requirement” for FPRs and the industry standard. This begs the question: if the new FPR Commentary sets a standard for what is a “reasonable basis” for an FPR, does an FPR that is not prepared in accordance with the FPR Commentary lack a reasonable basis, or is it somehow illegal or insufficient? Further, if the new FPR Commentary establishes a reasonable basis “standard,” does that mean that FPRs prepared in 2016, in 2015, and earlier – including FPRs that presumably complied with the FTC Franchise Rule and NASAA guidelines, and were part of FDDs that were reviewed by state examiners and registered – are somehow deficient or illegal? We believe that the answer is and should be “no.” However, we strongly believe that NASAA and the Franchise Project Group should clearly and definitively state that. If such a statement is not made, this new FPR Commentary is likely to engender more disputes and litigation, and not less of it. Therefore, we recommend the inclusion of the following note:

“The FPR Commentary is intended as guidance for the preparation of FPRs following the effective date of the Commentary. It is neither the purpose nor the intent of NASAA nor the Franchise Project Group to state or imply, nor should any reader, franchisee, state administrator, court, arbitrator or other person, entity or agency infer or conclude, that any FPR written before the effective date of this FPR Commentary that does not adhere to the guidelines in this FPR Commentary is deficient, illegal or contrary to law or regulation.”

Of all the Items in the FDD, Item 19 permits – and in fact encourages – flexibility, and discourages rigidity. Our general comments above, and our specific comments and suggestions below, are designed to limit the potential chilling effect of the FPR Commentary, and allow franchisors to provide the type of information – with a reasonable basis – that prospective franchisees are seeking.

B. Comments on Specific Commentary Items

1. Introduction – Effective Date:

The “Introduction” states: “The effective date of this FPR Commentary is the later of 180 days after the date of adoption by NASAA or 120 days after a franchisor’s next fiscal year end, if the franchisor has an effective Franchise Disclosure Document as of the date of adoption by NASAA.” Given that NASAA may adopt the final version of the FPR Commentary fairly soon after the current comment period ends on October 13, 2016, and many franchisors are beginning the process of updating their FDDs and submitting renewal filings in the franchise registration states, we suggest that NASAA clarify how the above language will apply to existing franchisors. For example, if NASAA adopts the FPR Commentary in October, November or December 2016, when does an existing franchisor with a December 31, 2016 fiscal year end which completes its FDD prior to the date of effectiveness of the FPR Commentary, need to comply with the requirements of the FPR Commentary? Assume that the FPR Commentary is “adopted” on November 15, 2016, and a franchisor issues its 2017 FDD on April 15, 2017 (which will be prior to the effective date of the FPR Commentary), and the FDD and FPR does not comply with the requirements of the FPR Commentary, does the franchisor need to amend its 2017 FDD to comply with the FPR Commentary 180 days after its adoption, that is by May 15, 2017, or can the franchisor wait to comply with it during its next, required annual update (i.e., by April 30, 2018)? Does this change if the franchisor is required to update/amend its FDD before the next, required annual update? Also, what happens if state franchise filings are pending 180 days after the FPR Commentary adoption? Further, how does this analysis change if NASAA adopts the FPR Commentary in January, February or March 2017? As you can, see franchisors, their counsel, and state examiners need clear guidance on this issue.

2. Part B – Use of Data from Company-Owned Outlets, Item 19.8

The answer to Item 19.8 states that “No. A franchisor with operational franchise outlets has no reasonable basis for making a gross sales FPR based on company-owned outlet data alone.” This comment presumes that a franchisor has franchise outlet data that is as good as, or better than, company-owned data, and that there is not a reasonable basis to provide company-owned data only.

We can envision many scenarios where a franchisor may have operational franchise outlet data but it would be misleading to use that data, or only that data (i.e., the franchisor would not have a reasonable basis for including the data in an FPR). For example, assume a franchisor has five, ten, or more company-owned outlets substantially similar to the franchises being offered that have all been open for at least three years, and the franchisor opens its first franchise outlet in June 2016. By the end of the franchisor’s 2017 fiscal year (assume December 31, 2017), the franchisor has not granted any other franchises and the first franchise outlet is its only operational franchise outlet. The franchisor could reasonably conclude that even with 18 months of operation, the fact that there is only one franchise outlet may not be sufficient information upon which to base an FPR. Under a strict reading of Item 19.8, the franchisor could not prepare an FPR with its company-owned outlets only, even if it did not think it had a reasonable basis to include gross sales data from the one operational franchise outlet.

As a variation, assume the same franchisor described above does not have just one operational franchise outlet as of the end of its 2017 fiscal year (i.e., December 31, 2017), but instead has three operational franchise outlets that operate in airports. The franchisor may reasonably believe that these airport locations are not representative of the system or of the franchises that are being offered. Again, a strict reading of Item 19.8 would prevent the franchisor from preparing an FPR with only company-owned data.

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Finally, assume the same franchisor as in the previous example, but that while the three operational franchise outlets are not located in airports, they are not representative of the franchises being offered. For example, the three operational franchise outlets may be part of a discontinued offering, like mall outlets versus stand-alone outlets. Where a franchisor has a reasonable basis to include gross sales of its company-owned outlets in an FPR but not its operational franchise outlets, we believe that the franchisor should be allowed to include only company-owned data in the FPR.

Accordingly, we recommend that Item 19.8 be revised to state the following:

“ANSWER: Generally, no. A franchisor with operational franchise outlets has no reasonable basis for making a gross sales FPR based on company-owned outlet data alone, unless the franchisor does not have a reasonable basis for making a gross sales FPR based on any of the operational franchise outlets, in which case the franchisor may make a gross sales FPR based on company-owned outlet data alone.”

* * *

Once again, thank you for the opportunity to submit these comments. Based on our experience we have many examples that can illustrate the points discussed in the general and specific comments above. If the Franchise Project Group would like us to submit any examples and illustrations, or discuss them with the members of the working group, we would be pleased to do so. We sincerely hope that this information will be useful in your consideration of the final adoption of the FPR Commentary.

Respectfully submitted,

Gray, Plant, Mooty, Mooty & Bennett, P.A.

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