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Re: Comments on the June 12, 2018 NASAA Franchise Project Group State Cover Sheet Commentary

Gentlemen:

This letter is being submitted on behalf of the law firm, Larkin, Hoffman, Daly & Lindgren, Ltd. in response to the request of NASAA's Franchise and Business Opportunity Project Group (the "Franchise Project Group") for comments on its June 12, 2018 release of a proposal to revise the instructions in the NASAA Franchise Registration and Disclosure Guidelines for filing the state cover page to Franchise Disclosure Documents. At the outset, we want to say that we applaud the efforts of the Franchise Project Group with respect to this proposal. The proposed disclosure should help prospective franchisees focus on several sections of the Franchise Disclosure Document ("FDD") that answer questions prospective franchisees ask, or should be asking, about the franchise. We believe it will also help prospective franchisees understand some of the important differences between a franchised business and an independent business. If a prospective franchisee is dissuaded from purchasing a franchise as a result of these disclosures, then the disclosures will have helped not only those prospective franchisees, but also franchisors who might otherwise find themselves contractually bound to a long-term relationship with someone who was likely not prepared to operate the business in accordance with a franchise system. Because the required disclosures are uniform for all franchisors, the proposed language imposes only a minimal burden upon franchisors. For these reasons, we support the changes, but wish to comment on a few provisions that we think may be misleading or can be made more beneficial to a prospective franchisee.

Page Entitled How to Use This Franchise Disclosure Document

In the first section, entitled "How much will I earn?," we agree that prospective franchisees should try to obtain financial information from others, "like current and former franchisees." However, there seems to be a glaring omission; we would think that an accountant would be the first person to whom a business person would turn in analyzing financial information, or in constructing a proforma financial statement for their business. Thus, we would suggest including a reference to the possibility of engaging an accountant. To keep it simple, the following sentence could be added at the end of the proposed disclosure: "An accountant may also be helpful."

In the question on how much a person needs to invest, the answer assumes the prospect will find information in Items 5 and 6 of the FDD that is not, in fact, disclosed in those sections. The answer states that those Items list fees that are paid to the franchisor "and at the franchisor's discretion." That is not correct. Those disclosures address fees paid for services or goods "received from the franchisor or any affiliate" (Item 5), or that "the franchisor or its affiliates impose or collect" (Item 6). If a franchisor requires a particular supplier to be used, thus resulting in a fee being paid "at the franchisor's discretion" but paid to the supplier, that fee would not be listed in Items 5 or 6. The fact that such a payment is required would be disclosed in Item 8, which is properly referenced in the answer, but it would not be found in Items 5 and 6. To keep this answer from being misleading, we suggest the answer be changed to state that: "Items 5 and 6 list fees you will be paying to the franchisor or the franchisor's affiliates... ."

(As a final comment on this section, we noted there is a period at the end of each of the answers, except for the one addressed in Items 3 and 4. A period should be added at the end of that answer.)

Page Entitled What You Need to Know About Franchising *Generally*

The fourth point in this section begins by stating that the franchise agreement may not permit the franchise to be renewed. The second sentence provides that even if the agreement allows renewal, most franchise agreements do not allow renewal on the same terms and conditions. The admonition then goes on to state that a franchisee may have to sign a new agreement with different terms and conditions in order to continue to operate the franchised business. This third sentence suggests to us that even if the franchise agreement does not permit renewal, a franchisee may have to sign a new agreement in order to then have the opportunity to continue the franchised business. That is not true. Since the third admonition only applies to the second sentence, we would suggest shortening and combining the second and third sentences to read: "Even if it does, you may have to sign a new agreement with different terms and conditions in order to continue to operate your franchised business."

Page Entitled Special Risks to Consider About *This* Franchise

The required statement concerning out-of-state dispute resolution refers to "mediation and arbitration," and suggests that these proceedings may force a franchisee to accept a less favorable settlement for disputes because it costs more to mediate or arbitrate with the franchisor in another state than in its own state. Litigation is typically a more costly method of dispute resolution than either mediation or arbitration, but it is not covered in this admonition. If it is important to point out that mediation and arbitration can be more costly, then certainly litigation should be included in this disclosure.

We understand that some states prohibit out-of-state litigation, and therefore, an admonition as to the cost of out-of-state litigation would not be necessary in those states. Likewise, many franchise agreements do not include a mediation clause, and the admonition on mediation would not be necessary for those franchise systems. Moreover, in almost all of the franchise agreements we have prepared for clients that require mediation, the agreement provides that the mediator selects the site of mediation, and thus, the mediation may not be required to be held out of state.

These points raise a question as to whether there can be a single, uniform risk factor on this issue. We would also submit that while a risk factor dealing with litigation and arbitration has been required for many years, the venue for dispute resolution is typically far less important to a prospective franchisee than many other provisions of the agreement. For that reason, our first recommendation would be to eliminate the requirement to include this provision on the cover page. Assuming, however, the Franchise Project Group feels this is an important risk to highlight, we would suggest changing it, as follows, so that it would be accurate in every case:

> **Out-of-State Dispute Resolution.** The franchise agreement may require you to resolve disputes with the franchisor by mediation, arbitration and/or litigation only in [State]. Out-of-State mediation, arbitration, or litigation may force you to accept a less favorable settlement for disputes. It may also cost more to mediate, arbitrate or litigate with the franchisor in [State] than in your own state.

This page continues with an admonition that certain states may require other risks to be highlighted and tells a prospect to check the "State Specific Addenda" for these risks. In the case of an initial franchise registration application, a franchisor would not have had their FDD reviewed by any state when it initially prepares this page. Thus, the applicant would not know whether or not this provision is applicable. Therefore, we suggest that all franchisors be required to include this statement, but that it be revised to read as follows: "Certain states may require other risks to be highlighted. Check the "State Specific Addenda" (if any) to determine whether your state requires other risks to be highlighted."

We hope these comments are helpful.

Sincerely,

Larkin, Hoffman, Daly & Lindgren, Ltd.

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