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Ms. Andrea Seidt, Chair, Corporate Finance Section
Mr. Dale Cantone, Chair, Franchise and Business Opportunities Project Group
North American Securities Administration Association, Inc.
750 First St. NE, Ste. 1140
Washington, D.C. 20002

Re: Comment on Proposed NASAA Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements

Dear Ms. Seidt and Mr. Cantone:

Faegre Drinker Biddle & Reath LLP is a full-service law firm handling complex transactions, litigation and regulatory work for franchisors that range from multinational companies to emerging brands. Our franchise practice helps market-leading franchisors launch, grow, protect, and evolve successful franchise systems across multiple industries. Thank you for seeking comments on the Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements, as described in the Request for Public Comment dated December 6, 2021.

The franchise practice at Faegre Drinker Biddle & Reath LLP submits this comment to the North American Securities Administrators Association, Inc. ("NASAA") as experienced practitioners in franchise law, including on issues related to the use of questionnaires and acknowledgements, for consideration in response to NASAA's proposed policy statement ("Policy Statement").

NASAA Should Not Prohibit or Impose Further Restrictions on the Use of Franchise Questionnaires and Acknowledgements

Background and recent history

The issue of the proper scope and use of acknowledgments and questionnaires is not novel and has for years been the subject of debate and discussion among franchise regulators, attorneys, franchisors, and franchisees. At the state level, stakeholders have evaluated and adopted policies regarding this topic, most commonly through regulations regarding disclaimers and waivers of liability. As a result, multiple states have adopted anti-waiver provisions and placed certain limitations on the use of disclaimers as a matter of law, depending on the specific regulatory needs of stakeholders in each state.

At the federal level, the use of disclaimers was the subject of the FTC's 2007 revised Franchise Rule, which prohibits a franchisor from disclaiming or requiring a franchisee "to waive reliance on any representation made in the disclosure document or in its exhibits or amendments." 16 C.F.R. § 436.9(h). At the time, the FTC was careful in revising the Franchise Rule, however, to

make clear that Subsection (h) does not prohibit "a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations." *Id*. Indeed, the FTC has historically recognized that the use of disclaimers, integration clauses, and appropriate waivers of reliance serve valid purposes, including to eliminate any uncertainty as to the terms of the agreement and to ensure the franchisee did not rely on any unauthorized representations. Thus, the revised FTC Rule was intended to "preserve the integrity of the disclosure document and franchise agreement," and was not designed to undermine a franchisor's and franchisee's ability to negotiate mutually agreeable contractual terms or to preclude the use of integration clauses or contractual waivers. *See* Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,530 (Mar. 30, 2007) (codified at 16 C.F.R. Part. 436).

More recently, in 2020, the FTC considered the issue again and requested comments on Matter No. R511003, as it relates to FTC disclosure requirements under 16 CFR 436. Numerous parties, including Faegre Drinker, submitted comments in response to Matter No. R511003, including regarding acknowledgements and questionnaires. Faegre Drinker and others raised concerns that can be summarized as follows. First, questionnaires and acknowledgments serve legitimate business and information-collection purposes that can and do serve the interests of both franchisors and franchisees, including by providing assurances to both parties that the final franchise agreement is the complete agreement and the manifestation of the parties' intent. Second, any effort to wholly prohibit the use of questionnaires and acknowledgments—or certain statements therein—will undermine these mutually beneficial and legitimate purposes without bringing about the intended reduction in fraud and misrepresentation. Third, any limitations or restrictions on the use of questionnaires and acknowledgments should be very narrowly tailored to target specific conduct while upholding their legitimate business use.

These three considerations apply in equal measure across the regulatory and policy spectrum and should also guide evaluation of the proposed Policy Statement by NASAA. As currently drafted, however, the Policy Statement contradicts these considerations and is poised instead to threaten the legitimate and mutually beneficial exchange of information that acknowledgements and questionnaires facilitate. Accordingly, Faegre Drinker encourages NASAA to reconsider and decline to adopt its Policy Statement as currently drafted, including for the additional reasons detailed below.

Acknowledgements and Questionnaires serve a legitimate and mutually beneficial purpose

Acknowledgements and questionnaires used in the context of a franchise agreement are all tools to provide franchisors and franchisees with assurances that the final franchise agreement is the complete agreement and the manifestation of the parties' intent. Integration clauses, for example, are a bedrock of contract law; they ensure that the parties understand that the terms of the franchise agreement are the entire agreement and that any representations or terms outside of the written agreement are ineffective. *See e.g.* 72 Fed. Reg. 15,534 (Mar. 30, 2007). Acknowledgements and questionnaires, which are much more explicit and focused than most integration clauses, are aimed at doing the same thing. Nor are acknowledgments and questionnaires unique to the franchise sector or unusual in other commercial settings—in fact, they are commonly used in commercial contracts, especially between two business parties.

By the time a potential franchisee is prepared to sign a franchise agreement, she has likely consulted with friends, family, accountants, and current or former franchisees. She may have

conducted research and had various discussions with the franchisor. Although not all potential franchisees utilize the services of a lawyer in reviewing the FDD and franchise agreement, many do, and all prospects are encouraged to do so, as specifically stated on the cover page of the FDD (as further noted below). Any one (or all) of these tools is critical for ensuring that in agreeing to the franchise agreement, the parties are not relying on any representations or terms, whether from prior discussions among the parties or third-party sources, that are not expressly included in the franchise agreement or FDD. And the franchisee gains the comfort of knowing that the deal terms are "locked in," so to speak, and not subject to change until renewal.

The questionnaire is also intended to ensure a franchisee is not relying on representations or terms outside of the FDD and franchise agreement. Questionnaires are used at the end of the sales process before the execution of a franchise agreement. A typical questionnaire will ask questions designed to identify any misunderstandings between the parties. For example, if a franchisor includes an FPR in Item 19 of its FDD, a questionnaire will typically ask whether the potential franchisee received any financial performance information from a third-party or from a representative of the franchisor that is different from the information in Item 19. If the answer is "yes," then the franchisor and franchisee have an opportunity prior to a sale to clarify the terms of their agreement and to identify and correct any material misunderstandings or misplaced reliance a potential franchisee may have about the terms of the franchise agreement or statements in the FDD. Of course, the best time to address any issue or misunderstanding is immediately prior to or at the time of signing the franchise agreement and not one or more years down the road, after the franchisee has invested heavily in the franchised business. The questionnaire facilitates this process.

Neither the questionnaire nor the acknowledgements permits a franchisor to disclaim the contents of the FDD; they simply manage the parties' expectations and make clear the universe of terms that bind the franchisee and the franchisor. And to the extent there is concern that any of these tools may provide a franchisor unequal bargaining power, that concern should be allayed by the FTC's mandatory FDD warning that a potential franchisee consult an attorney. To the extent a franchisee has concerns about what may or may not be included in the terms of a franchise agreement, those concerns can and should be addressed by competent franchisee counsel. The franchisee has a responsibility—like any other party to a contract in a business transaction—to do her due diligence and ensure that she understands the terms to which she is agreeing. NASAA should not endorse any policies that would insulate franchisees from that responsibility.

NASAA's Proposed Policy Statement undermines legitimate business purposes

With these considerations in mind, we offer the following additional comments about specific parts of NASAA's proposed Policy Statement.

Revisions to Item 22

In Section B, the Policy Statement proposes new disclosure requirements for inclusion in Item 22. While it is not clear what objective a revision to Item 22 would advance that is not already satisfied by the way questionnaires and acknowledgements are currently used, we are not opposed to this proposal and think it merits a separate discussion, removed from any discussion about prohibiting the litany of statements identified in Section C.

NASAA should not endorse the prohibition of the use of any statements or statement types as currently proposed in Section C

In Section C of the Policy Statement, NASAA proposes to adopt the position that a sweeping array of statements and statement types should be *prohibited* from use altogether. We disagree with this proposed approach for multiple reasons. First, it cuts against the overarching regulatory framework, adopted at the state and federal level, that franchisors and franchisees should be regulated primarily through disclosure and transparency, especially at the pre-closing and formation stages. This framework is designed to increase the information that contracting parties are armed with before entering into business and thereby increases the likelihood that there is a "meeting of the minds" about the franchise's objectives and potential. A prohibition on the use of certain statements, by contrast, results in a *decrease* in the amount and quality of information exchanged and elevates the risk that a potential franchisee and franchisor are not well-matched.

Second, as noted above, questionnaires and acknowledgements serve legitimate business purposes that benefit both the franchisor and franchisee. Prohibiting what the franchise parties may agree to and what information and communications they may exchange undermines that legitimate purpose to the detriment of both parties. A questionnaire or acknowledgement can be a valuable way to learn, for example, that a franchisee has—or has not, in fact—read or understood the FDD. An acknowledgment or questionnaire might allow the correction of that fact and serve as valuable notice that entering into a franchise business is a serious undertaking and that a franchisee should, at minimum, read the applicable disclosures. The Policy Statement, however, proposes to ban questions related to whether a franchisee has read or understood the FDD or franchise agreement. *See* Section C(2)(a). Indeed, the series of statements contained in Sections C(2)(a)-(k) each suffer from this flaw, as they propose to prohibit a franchisee from communicating, and a franchisor from learning, whether: the franchisee understands the risks associated with the purchase of the franchise, Section C(2)(b); the franchisee is qualified or suited to own and operate the franchise, Section C(2)(c); and that a franchisor may rely on the representations of the franchisee, Section C(2)(j)—to cite just a few of the statements in the proposal.

Section C(1) invites the same concerns, as it seeks to prohibit all questionnaire and acknowledgement statements that, among other things, are "subjective or unreasonable." *See* Section C(1). What constitutes a "subjective or unreasonable" statement is vague, ambiguous, and potentially very broad—no examples are even provided. Nor is it clear what statements would necessarily cause a franchisee to surrender *or believe that they have surrendered* rights or have the effect of shifting disclosure duties. *See* Section C(1)(a)-(b). These proposed prohibitions, in short, are bound to result in implementation challenges and regulatory confusion. Additionally, prohibiting statements that might lead a franchisee to believe that she has surrendered rights or that might shift disclosure duties ultimately undermines the same legitimate information-collecting purposes discussed above. The far better approach is to *promote* disclosure and the exchange of valuable information, and to assure that franchisees are provided with the knowledge and advice necessary to make an informed decision. The proposed Policy Statement does the opposite.

The proposed disclaimer is unnecessary and, in the alternative, should be permissive and not binding

Next, Section C(3) proposes adding a disclaimer regarding the effect of acknowledgements and questionnaires. This statement is unnecessary in light of the anti-waiver and disclaimer provisions that are already in effect under state and federal law. It also undermines the freedom to contract and to allocate risk and liability as the parties see fit—subject to the extensive array of existing franchise disclosure and relationship statutes and regulations. To avoid these pitfalls, NASAA might consider, in the alternative, revising Section C(3) to establish that statements, questionnaires, and acknowledgements "*may* have [an] effect" on a franchisee's rights and liabilities. A permissive disclaimer would have the benefit of informing franchisees of their risks without undermining the freedom to contract by *requiring* parties to allocate risk and liability in a prescribed manner. NASAA also might consider adding to this Section C(3) that if a franchisee has any questions about any questionnaire or acknowledgement, she should consult with a lawyer.

Finally, whether a franchisor can rely on a franchisee's questionnaire or acknowledgement to defend against a franchisee's claims of, for example, fraud or promissory estoppel, is an issue that is specific to the facts of the case and governing state law. NASAA should not inject itself into contracts and claims that fall under the province of the laws of individual states.

Thank you for considering these comments from the franchise practice at Faegre Drinker Biddle & Reath LLP. We appreciate NASAA's leadership in the franchise legal community and for allowing us and others to contribute to evaluating the proposed Policy Statement.

Very truly yours,

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