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VIA EMAIL

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North American Securities Administration Association, Inc.

Re: Request for public comment: Proposed statement of policy regarding the use of Franchise Questionnaires and Acknowledgments - December 6, 2021

To The North American Securities Administration Association, Inc.

We appreciate the opportunity to comment on this proposal and hope that, in considering this comment, NASAA will continue its longstanding practice of exercising good judgment and balance in addressing diverse interests in its regulatory oversight. Our comments reflect the position of our firm as a policy matter, but should not be considered to be the comments or position of any of our clients.

By way of background, the franchise practice group at DLA Piper has been preeminent in this field for decades. Our practice goes back to the 1960's with the advent of business format franchising, the formation of the International Franchise Association and the regulatory response both at a state level and the FTC to perceived inappropriate practices by some participants in this dynamic and important segment of the US economy.

I. Introduction

The primary reason Questionnaires and Acknowledgements are used by franchisors is to help "unearth" either bad practices in the franchise sales process or to correct an innocent misunderstanding between the franchisor and franchisee before the franchisee makes a decision to purchase a franchise. In both cases, Questionnaires and Acknowledgements serve goals that are consistent with the purposes of the disclosure laws. On the one hand, they give franchisors the opportunity to correct the practice or misunderstanding before the franchisee decides to proceed. On the other, they give franchisees the chance to refrain from proceeding with the franchise offering in the event their decision to proceed was motivated by statements that they assumed, correctly or not, were inconsistent with the disclosure document. While the Proposed Statement of Policy ("SOP") states that Questionnaires and Acknowledgments could potentially allow unscrupulous franchisors to avoid the consequences of franchise fraud, prohibiting them entirely – as opposing to limiting their scope – will deprive conscientious franchisors of a valuable tool that, properly framed, can help correct misunderstandings or misconceptions or confusion *before* they enter into a long-term relationship with a franchisee. And just as there are certain franchisors who engage in bad practices, there are certainly also franchisees who, unhappy with their investment through no fault of the franchisor, are willing to fabricate claims that oral representations were made by a franchisor representative contrary to those contained in the franchise disclosure document ("FDD"), especially with respect to the disclosures in Items 7 and 19. Including certain permitted questions and statements in a pre-sale questionnaire, acknowledgement, or similar document can assist franchisors and franchisees in engaging in important



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conversations before executing the franchise sale. That opportunity should not be lost, particularly since, as discussed more fully below, NASAA can ensure that these documents do not disclaim any provisions in the FDD or franchise agreement or waive any rights provided to franchisees under applicable franchise laws.

Moreover, allowing the use of limited questionnaires is consistent with the FTC's decision to allow the continued use of those documents. Reading the SOP leaves one with the impression that the practice of using questionnaires had not come to a "flash point" for the FTC when it amended its rule in 2007¹. Not so. In fact, while the SOP cites the views of two commentators advocating for these new regulations, those very same commentators expressed these same views to the FTC prior to the enactment of the amended FTC Rule in 2007². In short, while it is likely more franchisors use disclaimers today than in 2007, this "problem", to the extent there is one, is not new, and the FTC in 2007 struck a balance between the views of franchisee rights advocates and industry supporters:"

After carefully reviewing the record, the Commission is persuaded that a limited disclaimer prohibition, rather than a total ban, is warranted. As an initial matter, the Commission is convinced that integration clauses and waivers serve valid purposes, including ensuring that a prospective franchisee relies solely on information authorized by the franchisor or within the franchisor's control in making an investment decision.

A few commenters urged the Commission to adopt a broader prohibition that would prevent franchisors from disclaiming *any* authorized statement – whether in a disclosure document or promotional materials.[921] However, the Commission is persuaded that a broader prohibition would go beyond what is necessary to address the underlying issue identified in the record – the need to prevent deceptive disclosure documents. Further, franchise advertisements, like other industry advertisements, are already subject to Commission substantiation and anti-deception requirements under Section 5 of the FTC Act. Moreover, any franchisor who makes statements in promotional literature that are inconsistent with the disclosure document and franchise agreement would violate the section 436.9(a) ban

¹ Since the advent of business format franchising in the 1960's our firm has routinely included contractual acknowledgements of a nature now being questioned, and we are aware of other practitioners for whom this also has been a longstanding practice.

² The FTC Statement of Basis and Purpose state as follows: "A few commenters urged the Commission to expand on the prohibition that was proposed in the Franchise NPR. Howard Bundy, for example, urged prohibiting franchisors from disclaiming liability for any authorized statements, including those made in their written marketing material." Footnote 902 states as follows: For example, Peter Lagarias, a franchisee advocate, asserted: In virtually every lawsuit I have filed for franchisees alleging fraud, franchise disclosure, or unfair or deceptive practices (under California law since the FTC rule does not provide a private right of action), counsel for the franchisor defendants have defended the action on lack of justified reliance. Franchisors and their counsel have systemically written the agreements to strip franchisees of all fraud claims and rights the minute the agreement is signed by sophisticated integration, no representation, and no reliance clauses The Commission should provide that reliance on the disclosure document and other representations made in the sale of a franchise is *per se* justified. Footnote 913 states the following: The Staff Report stated that integration clauses may be warranted to enable franchisors to disclaim liability for statements made by a "rogue salesman." Staff Report, at 258. This statement generated significant comment by franchisee representatives asserting that franchisors should always be liable for statements made by their sales force. *E.g.*, AFA, at 4 ("The franchisor must accept responsibility for the person who it authorized and directed to sell franchises to prospective franchisees."); Bundy, at 12 ("No one can reasonably argue that the franchisor should be able to disclaim statements made by its employees or agents within the scope of their agency.").



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on the making of contradictory statements.[922] Accordingly, a broader disclaimer prohibition is unwarranted to achieve the goal of preserving the integrity of franchisors' disclosures.

The FTC wisely decided to leave to the courts the issue of whether statements outside the FDD were actionable or could be barred, and noted that courts were likely to void integration and waiver clauses in the context of fraud in the inducement claims, particularly where a franchise statute is involved³. The results have supported the wisdom of this approach. (See p.4, *infra*.)

All this begs the question: is there anything that now compels NASAA to revisit the balanced approach the FTC struck in 2007. We submit that the answer to that question is clearly "no." As we explain below, properly used, Questionnaires and Acknowledgements promote the goal of the disclosure laws. Prohibiting them would only enhance the likelihood that franchisees will anchor their investment decisions on what they thought or later recall they heard because, as the SOP notes, prospective franchisees "... are emotionally ... invested in completing the transaction." The Questionnaires and Acknowledgements are an instrument to prevent such impulsive decision making.

That said, because of the importance of these documents, they should be listed as an Exhibit in the FDD (and referenced in Item 22) and the scope of permissible questions should be delineated in advance. In particular, it should be made clear that nothing in a Questionnaire or Acknowledgement will waive as a matter of law any claims under any applicable state franchise registration and disclosure law containing an anti-waiver provision.

II. Specific Comments and Suggestions

While we disagree with much of the rationale behind the SOP and believe that Questionnaires and Acknowledgments which pose factual and unbiased questions have a valuable role in the franchise sales process, we support a requirement that all Questionnaires or Acknowledgments be attached to all Franchise Disclosure Documents ("FDDs") as franchise-related documents. Franchisees need to understand the importance of what they are being asked to sign and should be afforded sufficient time to review these documents and discuss their contents with an attorney or advisor. In the past, it has been argued by some that, because these documents are not signed by the franchisor, they need not be referenced in Item 22 and therefore need not be included as an exhibit to the FDD. It is our position that these Questionnaires and Acknowledgments should be included in the FDD, as franchisors rely on the answers to decide whether to proceed with granting the franchise opportunity. Prospective franchisees therefore should have an opportunity to review the contents of these Questionnaires and Acknowledgments at the same time they are considering and reviewing the FDD and other attachments. The Questionnaire or Acknowledgment should also (i) be listed as an Exhibit following the FDD Table of Contents, and (ii) referenced in Item 22 of the FDD.

We also support a requirement that, if instead of using a Questionnaire or Acknowledgement the franchisor poses questions to the prospect during a video or other electronic recording before entering into a franchise agreement, the questions to be posed must be included in written form in the FDD and delivered to the

³ The FTC even goes further to endorse specific disclaimers and states that it would be an appropriate practice to disclaim a financial performance representation when the franchisor doesn't believe it is relevant for a particular franchisee.



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prospective franchisee at least seven calendar days before signing the franchise agreement or paying any consideration to the franchisor, along with the execution copy of the franchise agreement. Again, this practice would ensure that prospective franchisees are not surprised by the questions posed by the franchisor and have the opportunity to consider and reflect upon the questions prior to providing any responses.

In addition to the language proposed in Section II.C.3 of the SOP (which we have revised in Section III below), we also would advocate for adding a statement on the State Risk Factor page that the Questionnaire or Acknowledgement must be signed before the franchisee will be permitted to sign a franchise agreement and should be carefully reviewed.

III. Necessary Qualifications on Use if an SOP is Adopted

The SOP – which would render void certain statements in Questionnaires and Acknowledgements -- should be clarified to state that it applies only in the context of claims filed under those state franchise registration and disclosure statutes which contain Anti-Waiver Provisions. This clarification is required by the language of the SOP itself, the cases discussed in the SOP, and the justification provided for the proposed Policy. For this reason, the proposed provision listed at Section II C.3. of the SOP should be modified, as set forth below.

The proposed SOP refers repeatedly to the Anti-Waiver Provisions contained in the franchise registration and disclosure statutes of the various states as the justification for the proposed new Policy. For example, the SOP refers to the Anti-Waiver Provisions “that prohibit or render void any provision or condition requiring a prospective franchisee to agree to a release, waiver or estoppel that would relieve a person from liability under that law.” (SOP at 4 (emphasis added)). Moreover, the SOP states: “In the opinion of the Section and Project Group, Questionnaires and Acknowledgements violate state Anti-Waiver Provisions when they are used as contractual disclaimers that release or waive a franchisee’s rights under a state franchise law.” (*Id.* at 5 (emphasis added)). Further, in the introduction to the Application section of the SOP, it states that it “applies . . . where an Anti-Waiver Provision or Anti-Fraud Provision applies to the offer or sale.” (*Id.* at 6). Thus, the proposed Policy should apply only with respect to claims for violation of the state franchise registration and disclosure laws which contain an Anti-Waiver Provision.⁴ According to the SOP’s own terms, that proposed Policy should not apply to: (i) any claims under any state franchise laws which do not contain an Anti-Waiver Provision; (ii) any other claims under any state laws; or (iii) any common law claims.

In fact, the SOP expressly acknowledged that the Anti-Waiver Provisions in state franchise laws should not entirely preclude consideration of the Questionnaires and Acknowledgements when it recognized that the prospective franchisee should be allowed to explain to the factfinder his/her responses in the Questionnaires and Acknowledgements. According to the SOP:

The prospective franchisee who signs a Questionnaire or Acknowledgement and later denies the accuracy of what was signed would have to explain such a discrepancy, but

⁴ An Anti-Fraud Provision in the absence of an Anti-Waiver Provision in the statute should not trigger the proposed Policy, as the rationale for the Policy is that the Anti-Waiver Provision renders the disclaimer void. Without the Anti-Waiver Provision, there is no basis to render a disclaimer ineffective even if there is an Anti-Fraud Provision in the statute. However, as the SOP notes, most of the state franchise laws with Anti-Fraud Provisions also contain Anti-Waiver Provisions. (SOP at 4).



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they should have that opportunity before a factfinder, rather than have their claims dismissed based solely on having signed a Questionnaire or series of Acknowledgements.

(SOP at 5 (emphasis added)). In this regard, the SOP by its own terms recognizes that although the Anti-Waiver Provisions of state franchise laws might not allow a franchisor to obtain dismissal of the state franchise law claims as a matter of law, the Questionnaires and Acknowledgements may still be – and should be – considered by the “factfinder.”

This is consistent with the approach taken by the court in Hanley v. Doctors Express Franchising, LLC, 2013 WL 690521 (D. Md. 2013), which is discussed in the SOP as support for the proposed Policy. (SOP at 5). Although the court in that case did hold that the disclaimers involved are “legally inoperative to bar plaintiffs’ Maryland Franchise Law claims,” the court pointed out that the disclaimers “are not necessarily wholly irrelevant.” (Id. at *23). According to the court, “the disclaimers remain factually relevant, and might be persuasive to a fact finder with respect to the materiality of the alleged misrepresentations and omissions and the reasonableness of plaintiffs’ reliance on them.” (Id.). That was the court’s conclusion as to both the Maryland Franchise Law claims and the common law fraud claims. (Id. at *24).⁵

Moreover, the Anti-Waiver Provisions of the state franchise statutes on which the proposed Policy is based apply only to waivers of provisions under those statutes (or rules or orders promulgated under those statutes).⁶ The proposed Policy, based as it is on these Anti-Waiver Provisions, should similarly be limited to waivers of claims under these state franchise statutes (or rules or orders under them). The Policy should not apply to any other statutory or common law claims.

⁵ The other case discussed in the text of the SOP, Randall v. Lady of America Franchise Corporation, 532 F. Supp. 2d 1071 (D. Minn. 2007), is to the same effect. There the court recognized that if reliance is an element of a common law fraud claim under Minnesota law, the disclaimers nevertheless “create an issue of fact for the jury.” (Id. at 1100.)

⁶ See California, Cal. Corp. §31512 (limited to “waiv[ing] compliance with any provision of this law or any rule or order hereunder”); Hawaii, HI Rev. Stat. §482E-6(2)(F) (limited to “waiv[ing] any compliance with any provision of this chapter or a rule promulgated hereunder”); Illinois, 815 ILCS 705/41 (limited to “waiv[ing] compliance with any provision of this Act or any other law of this State”); Indiana, IC 23-2-2.7-1, Sec. 1(5) (limited to “reliev[ing] any person from liability to be imposed by this chapter”); Maryland, Md. Code Bus. Reg. §14-226 (limited to “reliev[ing] a person from liability under this subtitle”); Michigan, 445.1527(b) (limited to “depriv[ing] a franchisee of rights and protections provided in this act”); Minnesota, Minn. Stat. §80C.21 (limited to “waiving compliance with any provision of sections 80C.01 to 80C.22 or any rule or order thereunder”); New York, New York Consolidated Laws, General Business Chapter 20, Article 33, Sec. 687(4) (limited to “waiv[ing] compliance with any provision of this law, or rule promulgated hereunder”); North Dakota, N.D.C.C. 51-19-16(7) (limited to “waiv[ing] compliance with any provision of this chapter or any rule or order hereunder”); Rhode Island, R.I. Gen. Laws §19-28.1-15 (limited to “waiv[ing] compliance with, or relieving a person of, a duty of liability imposed by or right provided by this act or a rule or order under this act”); South Dakota, SDCL §37-5B-21 (limited to “waiv[ing] compliance with or relieving a person of a duty or liability imposed by or a right provided by this chapter or a rule or order under this chapter”); Virginia, VA Code Ann. §13.1-571(c) (limited to “waiv[ing] compliance with any provision of this chapter or of any rule or order thereunder”); Washington, RCW 19.100.180(2)(g) (limited to “waiver which would relieve any person from liability imposed by this chapter”) and RCW 19.100.220(2) (limited to “waiv[ing] compliance with any provision of this chapter or any rule or order hereunder”); and Wisconsin, Wis. Stats. §553.76 (limited to “waiv[ing] compliance with any provision of this chapter or any rule or order under this chapter”).



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Given that the proposed SOP should apply only to claims under state franchise registration and disclosure statutes with Anti-Waiver Provisions, we submit that the language proposed in Section II.C.3 of the SOP be revised to read as follows:

No statement in a questionnaire or acknowledgement signed or agreed to by a prospective franchisee in connection with the commencement of the franchise relationship shall have the effect of waiving as a matter of law any claims under any applicable state franchise registration and disclosure law containing an anti-waiver provision, including, but not limited to, the anti-fraud provisions of those state franchise laws. This provision shall apply to claims filed under the following state franchise laws: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin.⁷

We have deleted part (ii) of Section II.C.3 of the proposed SOP language because it is not necessary as the other language already included renders the statements in questionnaires and acknowledgements ineffective to waive claims under these state franchise laws. Moreover, the proposed part (ii) of Section II.C.3 (referring to disclaiming reliance in general) would improperly apply to all claims -- not just those under the state franchise registration and disclosure statutes with anti-waiver provisions. Therefore, it should be deleted.

IV. Permitted Questions and Statements

Section II(C) of the SOP contemplates prohibiting certain provisions a franchisor may use in a questionnaire, acknowledgement, or similar document, and requiring franchisors to use a specific statement at the end of the questionnaire, acknowledgement, or similar document. The SOP includes a list of prohibited provisions, and also states that the universe of prohibited provisions is not limited to that list. While we can appreciate the desire to identify prohibited or offending statements, the open-ended nature of what is a prohibited provision in questionnaires is likely to create confusion and uncertainty among franchisors, franchisees, and franchise examiners alike. By allowing a “subjective and unreasonableness” standard to govern what is and is not prohibited as indicated under Section II(C)(1) of the SOP, it is easy to imagine a scenario where each franchise registration state prohibits different provisions in a franchisor’s questionnaire, thus creating both a patchwork of permitted questionnaires in each franchise system and confusion for franchisors and franchisees about which questionnaire to use in which states (or, if multiple state laws apply, which questionnaire applies to the franchise being offered).

Instead of attempting to create a list of prohibited provisions, we believe it would be more helpful to the franchising community for NASAA to publish a list of *permitted* provisions that franchisors are expressly permitted to include in their questionnaires, acknowledgements, or similar documents. There are benefits to franchisors, franchisees, and franchise examiners in doing so. First, the franchising community will have certainty as to what provisions are expressly permitted in the questionnaires. Second, providing this guidance and examples of what is permitted will also likely reduce the length of submitted Questionnaires and Acknowledgements (which, according to some state examiners, in the most egregious examples, are 7 or 8 pages long). While a franchisor is free to include additional questions or questions which may be

⁷ This list should be amended over time: (i) to include any other state franchise registration and disclosure laws which in the future contain an anti-waiver provision; and (ii) to exclude any of the listed state franchise laws which are subsequently amended to omit the anti-waiver provision.



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specific to the particular franchise offering, the franchise examiners would have the opportunity to review these additional statements in light of whether they run afoul of applicable Anti-Waiver Provisions.

Therefore, in Section II(C)(2), we recommend deleting the entire section and replacing the prohibited provisions with our proposed language. (Please see Appendix A for all proposed changes to Section II(C)(2) of the SOP.) The questions posed in Appendix A are factual in nature, objective rather than subjective, and when provided to the franchisee in advance of required completion, provide appropriate safeguards in the franchise sales process to ensure that the franchisee is making a decision based on verifiable facts.

Respectfully submitted,

DLA Piper Franchise and Distribution Group



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Appendix A

Proposed Section II(C) of the Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments

1. Permitted Questions or Statements in Questionnaires, Acknowledgments, and similar documents include, but are not limited to, the following:

(A) Please list the name(s) of each person the Prospective Franchisee had discussions regarding the franchise being offered under Franchisor's franchise disclosure document: _____

_____.

(B) Please list the name(s) of the existing franchisees that the Prospective Franchisee had discussions regarding the franchise being offered under Franchisor's franchise disclosure document: _____

_____.

(C) Has the Prospective Franchisee received and personally reviewed the Franchise Agreement and each exhibit attached to it? ___Yes ___ No

(D) Has the Prospective Franchisee received and reviewed the Franchisor's franchise disclosure document and each exhibit attached to it? ___Yes ___ No

(E) Does the Prospective Franchisee have any questions about the information contained in the Franchisor's franchise disclosure document, franchise agreement, and all exhibits attached to the documents? ___Yes ___ No

If Prospective Franchisee answered "yes", please describe which parts of the Franchisor's franchise disclosure document and/or franchise agreement the Prospective Franchisee does not understand? (Attach additional pages, if necessary)

_____.

(F) Did the Prospective Franchisee review the Franchisor's franchise disclosure document with an attorney, accountant, or other professional advisor? ___Yes ___ No

(G) Has the Prospective Franchisee discussed the benefits and risks of developing and operating a franchise offered under the Franchisor's franchise disclosure document with its professional advisor(s)? ___Yes ___ No



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(H) Has any employee or other person speaking on behalf of the Franchisor made any statement or promise regarding the costs involved in operating a franchise that is not contained in the Franchisor's franchise disclosure document or that is contrary to or different from the information contained in the Franchisor's franchise disclosure document? ___Yes ___ No

If the Prospective Franchisee answered "yes", please describe the nature of the information you received and who provided the information: _____

_____.

(I) Has any employee or other person speaking on behalf of the Franchisor made any statement or promise regarding the actual, average, or projected profits or earnings, the likelihood of success, the amount of money you may earn, or the total amount of revenue a franchise will generate that is different from the information contained in the Franchisor's franchise disclosure document? ___Yes ___ No

If the Prospective Franchisee answered "yes", please describe the nature of the information you received and who provided the information: _____

_____.

(J) Has any employee or other person speaking on behalf of the Franchisor made any statement or promise or agreement concerning advertising, marketing, media support, marketing penetration, training, support service or assistance that is contrary to or different from the information contained in the Franchisor's franchise disclosure document or in the Franchisor's franchise agreement? ___Yes ___ No

If the Prospective Franchisee answered "yes", please describe the nature of the information you received and who provided the information: _____

_____.