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Corporation Finance Section (“Section”)  
of the North American Securities  
Administrators Association, Inc. (“NASAA”)

*Via Email:*  
[NASAAComments@nasaa.org](mailto:NASAAComments@nasaa.org)

Franchise and Business Opportunities  
Project Group (“Project Group”) of NASAA

Re: Larkin Hoffman Comments to NASAA’s December 6, 2021 Proposed Statement of  
Policy Regarding the Use of Franchise Questionnaires and Acknowledgments

Dear Members of NASAA’s Section and Project Group:

This letter is being submitted on behalf of the Larkin Hoffman law firm in response to the December 6, 2021 request of NASAA’s Section and Project Group (“Request”) for public comment on the proposed NASAA Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments (“Statement of Policy”).

**I. Portions of Proposed Statement of Policy We Agree With**

**A. Section C.3 – Required Anti-waiver Provision**

The proposed Statement of Policy addresses the use of “Acknowledgements” and “Questionnaires” (as defined in the Request) in franchise sales transactions. The Introduction makes the observation that some franchisors have convinced courts to treat these documents as waivers of franchisee rights under state law. We recognize most state franchise laws prohibit waivers of the obligations of franchisors thereunder, as well as the rights of franchisees. The proposed Statement of Policy addresses and solves this concern in Section C.3, which would require franchisors include in their FDD and franchise agreement, or applicable state-specific addenda, the specific provision set forth in the proposed Statement of Policy stating that no statement, questionnaire or acknowledgement signed or agreed to by a franchisee in connection with the commencement of the franchise relationship shall have the effect of waiving any claims under these laws. This requirement should fully address this issue to both inform prospective franchisees that they are not waiving these rights and assure the anti-waiver provisions of state franchise laws are upheld. We support this requirement as it is consistent with applicable state franchise laws.

**B. Section B – Requirement that Questionnaires be Included in FDDs**

Under the heading of “The Practical Effect of Acknowledgements and Questionnaires,” the proposed Statement of Policy provides anecdotal evidence suggesting that by the time prospective franchisees are presented with a Questionnaire “many are emotionally and financially invested in completing the transaction,” and cannot objectively understand what they are signing or its effect. We do not believe that franchisors ever intended this to be the case. To address this concern, Section B.1 of the proposed Statement of Policy would require the proposed form be attached to the FDD under Item 22. Item 22 of the FTC Franchise Rule (the “Rule”) requires that a copy of all proposed agreements regarding the franchise offering be included in the FDD. Since Questionnaires and Acknowledgments have been treated by courts as agreements by a franchisee that certain events did or did not happen, they are an agreement related to the franchise offering and therefore should have always been included in the FDD. Most franchisors are doing this today and we support this requirement. For similar reasons, we also support the requirement in Section B.2 that the written script of any Questionnaire that must be verbally responded to on video or other electronic media recording must be included in the FDD under Item 22.

**C. Section C.2(k) – Prohibition Against Requiring False Answers**

While we comment on the first half of Section C.2(k) below, we believe the last half of Section C.2(k) is an important restriction. However, we contend this restriction is out of place in Section C.2(k). It prohibits franchisors from suggesting to prospective franchisees that they provide false answers as a condition to the purchase of the franchise. We not only agree with this prohibition, but suggest it be expanded to prohibit franchisors from requiring a prospect to change an answer as a condition to the purchase of a franchise, as well as prohibiting requiring a prospective franchisee to provide a false answer. A prospective franchisee would still be allowed to change an answer if they misunderstood or misread the question, but only on a voluntary basis. This is certainly consistent with state and federal franchise laws. However, it currently falls under “Prohibited Statements” and this is not a prohibited statement, but rather a prohibited practice. The law should not condone fraudulent conduct on the part of either franchisees or franchisors and this unfair practice should be set forth separately in the Statement of Policy and not as a “prohibited statement.”

**II. General Comments Relating to Sections C.1 and C.2**

The foregoing would address all the issues raised in the Introduction section, except those under the heading of “Inappropriate ... Provisions.” Section C.1 would prohibit “subjective, or unreasonable” questions and Section C.2 identifies particular questions that would be prohibited – in addition to any other “subjective or unreasonable” questions. There is no state or federal law that prohibits franchisors from asking such questions of prospective franchisees outside the FDD. It is our understanding that NASAA interprets existing law, but does not have the right to legislate. The restrictions in these sections do not interpret current law but would “make law,” and we urge NASAA to refrain from exceeding its authority by adopting these prohibitions. Moreover, for the reasons set forth below, we believe many of the proposed prohibitions would not be beneficial for prospective franchisees, would impose unreasonable and unnecessary restrictions on franchisors, and could even be damaging to prospective franchisees who did not carefully read the FDD. Thus, we urge the Section and Project Group to reject these sections in full.

The general prohibition on “unreasonable” questions will likely lead to the elimination of these Questionnaires because there is no way a franchisor can know with any degree of certainty what might be considered “unreasonable.” Who would make that determination? Perhaps initially a state examiner, but with more than two dozen examiners spread over ten states that review franchise filings, the determinations of such a subjective standard will be inconsistent. Of greater concern is that a franchisee can ask a court, years after the fact, to make that determination. This would force franchisors who want to ask legitimate questions of prospective franchisees to face the possibility that years from now some court will decide a question was “unreasonable,” thus tainting hundreds of sales which may have closed based on the answer to that question.

The prohibition of a number of these questions is also inconsistent with the Rule and the disclosure obligations enacted under state franchise registration and disclosure laws. The FTC’s goal in adopting the Rule was to protect prospective franchisees before they purchase a franchise.<sup>1</sup> The Rule requires franchisors to disclose material information to prospective purchasers “on the theory that informed investors can determine for themselves whether a particular deal is in their best interests.”<sup>2</sup> The focus of the Rule is to provide to prospective franchisees information that allows them to do their due diligence and make their own decision as to whether the purchase of the franchise is an appropriate investment for them. Many of the proposed prohibitions would prevent franchisors from drawing a prospective franchisee’s attention to important risks they should understand. Prohibitions on including cautions of risks inherent in the purchase of a franchise would thus lead to unsuspecting franchisees purchasing a franchise they may never have purchased if they had been better informed.<sup>3</sup> This results in hurting those who the Rule was most intended to protect.

Franchisors have almost uniformly supported the Rule and the activities of the franchise registration and disclosure states and their enforcement arms in assuring there is proper disclosure under the Rule. No franchisor wants to be subjected to lawsuits from franchisees who are deceived in the sales process, or worse, from franchisees who were not deceived, but claim otherwise when it is in their best interest to do so. Thus, as the proposed Statement of Policy points out, franchisors began adopting these Questionnaires to “allow franchisors to determine before the franchisee is contractually committed to the franchise agreement whether there were improprieties in the franchise sales process or inaccurate or inconsistent information provided to the prospective franchisee.” These Questionnaires provide a means by which franchisors can police their franchise

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<sup>1</sup> The same is true of state disclosure requirements that are designed to keep franchisees from making investments in franchises that are not suitable for them.

<sup>2</sup> Statement of Basis and Purpose to the Rule, page 4.

<sup>3</sup> Any prohibition on warnings of risks inherent in the purchase of the franchise is inconsistent with the philosophy behind the recent NASAA franchise project that created a new cover page to highlight uniform risks to franchisees; if it is good to put these risks at the front of the FDD to increase the chances that franchisees see them, why prohibit the highlighting of these and/or other risks just before the franchisee signs the franchise agreement or hands over any money? So long as the language does not disclaim the obligations the franchisor has to the franchisee, whether imposed by law or by contract, disclosure of these risks immediately before a franchisee commits to the franchise should be encouraged!

sellers, and also address possible wrongdoing before selling a franchise in violation of the Rule. Indeed, we have had franchisor clients walk away from transactions when they learned through the use of a Questionnaire that violations occurred in the sales process. The adoption of Sections C.1 and C.2 would take away a franchisor's ability to correct these mistakes.

Proponents of the prohibitions in Sections C.1 and C.2 argue they would help franchisees who have been deceived and sue for damages. Assuming that is true, this is going to be a limited group of people. It would consist of those franchisees that have suffered significant losses, seek and obtain legal counsel who knows something about franchising, and are able to withstand years of litigation. As a result, we submit that far more franchisees will suffer losses if franchisors cannot use Questionnaires to root out a problem before it occurs, than the number of franchisees who will benefit from litigation.

Compare the relatively small number of franchisees who might be helped by these prohibitions to those who would be hurt by adoption of the prohibitions:

1. Franchisees who are being deceived but would now have no warning that there might be something remiss in the sales process without having these issues brought to their attention in a pre-sale Questionnaire. These are the very people the Rule was intended to protect in the first place!
2. Franchisors who want to stop an improper sale before it occurs.
3. Franchisors who comply with the law but are faced with fraudulent claims from franchisees who failed. These franchisors will lose the one tool they have to prove a negative, i.e., that certain complained of actions did not occur.

We believe the points in the proposed Statement of Policy that we support provide significant protection to those who might have been deceived. We submit that any additional benefit those people might receive by not having signed Questionnaires containing the prohibited provisions is far less than the harm that will be done to people in the three groups described above, which consist of far more people.

### **III. Specific Comments Relating to Individual Prohibitions in Sections C.1 and C.2**

If NASAA is intent on prohibiting certain questions in these Questionnaires, fewer restrictions are needed than what is suggested in Sections C.1 and C.2. For example, there is a difference between questions asking whether a franchisee understands everything presented to them, which they may not know for years, and factual questions, such as whether anyone has given them financial information outside of the FDD. NASAA can prohibit the former without restricting the use of questions that ask factual information about what was or was not given or said to the prospect – something prospects certainly know. Likewise, there is a difference between subjective questions and questions that are designed to assure franchisees understand the nature of the investment they are making and the risks involved, which the law should encourage. And if we agree that “subjective” *questions* are inappropriate, then certainly a subjective *standard* that prohibits anything someone might deem “unreasonable” should likewise be eliminated.

Turning to some of the specific provisions of Sections C.1 and C.2:

**Section C.1(a)** – This prohibition, which would prevent a franchisor from including any statement in its Questionnaire that would cause a reasonable prospective franchisee to surrender or believe they have surrendered rights to which they are entitled, is fully addressed by the proposed new requirement in Section C.3 and can be eliminated. Moreover, the prohibition is too general and would subject franchisors to having courts make the determination as to what is reasonable years after the Questionnaire was used.

**Section C.1(b)** – This prohibition is meant to cover anything that would shift a franchisor’s disclosure duties under federal or state franchise law to the prospective franchisee. A Questionnaire, however, simply asks the franchisee to confirm what did or did not occur. It does not shift the burden of compliance and new Section C.3 informs courts that the burden is not shifted and no rights are waived. This prohibition is thus unnecessary.

**Section C.2(a)** – This prohibition would not allow a franchisor to ask whether a prospective franchisee has read the FDD. The Rule and state disclosure laws require disclosure of information that regulators and legislators feel is important, and the cover page required by the FTC actually encourages prospective franchisees to read this information. A franchisor who wants to know that the prospective franchisee has read everything should be commended. This is an objective question that every prospective franchisee should be able to answer. As to whether the prospective franchisee “understands” everything, we acknowledge that subjective questions are different, and would not object to a prohibition on questions asking if the prospective franchisee understood everything they read.

**Section C.2(b)** – For the same reason described above, we would not object to this prohibition. It asks a prospective franchisee whether they understand and comprehend all the possible risks associated with the purchase of a franchise, which is a subjective question and perhaps one that no prospect can truly answer given the uncertainty of what may happen in the future.

**Section C.2(d)** – Since the Rule allows franchisors to provide additional information to prospective franchisees outside the FDD, and franchisors routinely do so, we would not object to a prohibition on asking a prospective franchisee whether they have relied solely on the FDD and not on any other provided information.

**Section C.2(e)** – This prohibition would prevent a franchisor from asking a prospective franchisee whether the franchisor or a franchise seller has made any representation concerning financial performance outside of or different from the FDD. This is a factual question, and prospective franchisees should know whether they were provided such information. If they were not, and they confirm they were not provided such information, franchisors should be able to rely on this statement in closing the sale, and they should be able to use this statement as evidence in any case subsequently brought by a franchisee claiming the contrary. With the inclusion of the proposed admonition in Section C.3 and the proposed prohibition against requiring false answers in Section C.2(k), franchisees who affirm this statement will not be waiving their rights, but they may (and should) have to

explain to a court the discrepancy in their answers. The inclusion of such a prohibition would actually facilitate franchisee fraud by keeping franchisees from answering such a question before the sale, thus allowing them to make up stories after the sale with little or no ability of the franchisor to prove otherwise. It certainly seems in the best interest of both the prospective franchisee and the franchisor that before entering into a franchise agreement, the parties know what financial performance information the prospective franchisee received from the franchisor and its franchise sellers. As mentioned above, a franchisor may not be aware of all of the financial performance information provided to a prospective franchisee (for example, one of its franchise sellers may have mistakenly provided such information to a prospective franchisee), and by asking this question, the franchisor will have the opportunity to halt the sale, thereby preventing the prospective franchisee from being harmed from this information.

**Section C.2(f)** – This prohibition would not allow a franchisor to ask a prospective franchisee if the franchisee understands that success or failure of the franchise is dependent primarily on the franchisee. A comparison between franchises and securities is instructive here. While a person purchasing a non-controlling security interest in an issuer is typically relying on the efforts of the issuer, a person purchasing a franchise is primarily relying on their own efforts. This is a true statement and the reason franchise laws were enacted. Such a question alerts prospective franchisees of the fact that they are purchasing a franchise and that their success or failure is primarily based on their own efforts. If the prohibition applied only to a question that suggested the franchisee was dependent “solely” on their own efforts, we would not object to the question, but a prohibition on what is essentially a warning to prospective franchisees that success or failure is dependent primarily on their own efforts does a disservice to prospective franchisees who might think that a franchisor can somehow guaranty their success.

**Section C.2(h)** – This prohibition would not allow the use of representations or statements already made elsewhere in the FDD and attachments thereto. The Rule prohibits adding additional information to the FDD so as not to water down disclosures made to prospective franchisees in that document. However, there is no law that prohibits franchisors from highlighting important information in other documents (apart from financial performance representations). As discussed above, we believe implementation of this prohibition runs afoul of the goals of federal and state franchise law, and NASAA policy of assuring prospective franchisees are aware of important information.

**Section C.2(i)** – This prohibition would prevent a franchisor from inquiring whether a prospective franchisee has had an opportunity to or has actually consulted with professional advisors or other franchisees. It is contrary to the objective of the FTC of encouraging prospective franchisees to (i) seek an advisor and requiring inclusion of a statement to that effect on the cover page, and (ii) consulting with other franchisees as they are advised to do in Item 20. Such a prohibition should not be included in the Statement of Policy.

**Section C.2(j)** – The prohibition would not allow prospective franchisees to acknowledge that the franchisor is relying on the Questionnaire in entering into a franchise agreement with them. Prospective franchisees should understand the significance of a Questionnaire

and any other agreements they sign, and no regulation should be adopted that downplays the importance of any agreement or document a prospective franchisee will sign.

**Section C.2(k)** – The first part of this prohibition would not allow a franchisor to require or suggest that a prospective franchisee must agree to any Questionnaire as a condition to the purchase of a franchise. A prospective franchisee must agree to sign a number of agreements as a condition to purchasing a franchise. If a prospective franchisee is not willing to confirm facts within its possession, and is permitted to essentially hide things from a franchisor, the franchisor should not be obligated to do business with that prospect. This is not the way to start any relationship. Therefore, the first part of this prohibition should be eliminated. However, as explained above in Section I.C of this letter, we suggest that the last half of Section C.2(k) be expanded and placed in its own section.

#### **IV. Conclusion**

We recognize the importance of preventing fraud and the unlawful waiver of claims under state franchise laws. Accordingly, as indicated, we support the sections in the proposed Statement of Policy that address these concerns, and have even suggested expansions that should be acceptable to all franchisors. But other proposed sections will encourage franchisee fraud, harm honest franchisors, and reduce the cautions provided to prospective franchisees that the law should be encouraging. Thank you for the opportunity to comment in response to the Request. Please feel free to contact us should you have any follow-up questions.

Sincerely,

By Larkin Hoffman

cc Andrea Seidt, Section Chair ([Andrea.Seidt@com.state.oh.us](mailto:Andrea.Seidt@com.state.oh.us))  
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