

DADY & GARDNER, P.A.

LAWYERS FOR FRANCHISEES

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“Putting franchisees and dealers first for over 25 years”

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January 5, 2022

VIA EMAIL

North American Securities Administrators Association, Inc.

NASAAComments@nasaa.org

Re: Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments

Dear Sir or Madam:

I am writing in support NASAA’s “Statement of Policy Regarding the use of Franchise Questionnaires and Acknowledgments,” as set forth in NASAA’s December 6, 2021, Request for Public Comment (hereinafter the “Statement of Policy”).

I have been a franchise attorney since 2015, when I began my career in law. I am a (relatively) younger member of the franchise bar. I am in the trenches, day-to-day, interviewing franchisees, and learning and observing that fraudulent and misleading franchise sales occur far more than one would imagine that they do, especially in light of the Amended FTC Franchise Rule, 16 C.F.R. 436, which governs a franchisor’s sale of a franchise to be located anywhere in the United States, and the various state franchise and business opportunity laws.

My most recent arbitration, occurring in August of 2021, is the best (though far from the only) example of the misuse and unfairness of the boilerplate “acknowledgments and questionnaires” I have seen in my career.

In this case, a husband and wife nearing the end of their careers¹ were oversold a franchise opportunity with as many as ten separate unlawful financial performance representations. The franchisor also advised the franchisees to pull hundreds of thousands from their retirement account to fund their investment. Fortunately for the husband and wife, they were diligent note takers. They offered into evidence their contemporaneous notes of nearly all of the franchisor’s salespersons’ unlawful financial performance representations, as well as the franchisor salespersons’ statements to the husband and wife that they did not need to speak to a lawyer to review the franchise documents,

¹ The wife was a former service member and current non-franchise lawyer.

that the franchisor would help them understand the franchise documents, and that these franchise documents were non-negotiable anyway.² This was the most well-documented case of franchise fraud and unlawful financial performance representations I have seen in my career. The unlawful financial performance representations were indisputable, or at best, not credibly disputable.

But the franchisor (and/or its lawyers) were completely unfazed, failing to recognize risk at any juncture leading up to or at the final hearing of the arbitration. The focal point of the franchisor's case was the countless acknowledgments of risk, disclaimers of unlawful financial performance representations, as well as a separate questionnaire that the franchisee husband and wife completed at approximately the same time they signed their development agreement and franchise agreement. The franchisor went so far as to make counterclaims against the defrauded franchisees for fraudulently misrepresenting answers to complex questions in the "checklist" questionnaire. When asked under oath why she did not state that a fraudulent sale had occurred in the space provided after the questionnaire, the wife (a non-franchise lawyer) simply stated that she did not know at that time that anything unlawful or untoward had occurred.

I share this anecdote because I believe this case tracked "The Practical Effect of Acknowledgments and Questionnaires" scenario set forth in the Statement of Policy. From my perspective, the franchisor and its salespersons believed (despite overwhelming evidence) they had a "get out of jail" card for violating what is known as the "**cardinal rule**" in franchise sales:

The **cardinal rule** governing the dissemination of [FPRs] ... may be stated simply: under both federal and state law, absolutely no information may be given to prospective franchisees regarding financial performance representations [...] nothing said and nothing written concerning past or projected sales, income or profits of company-owned and/or franchised units - - unless that financial performance representation appears in Item 19 of the franchisor's disclosure document.

The New Item 19 Commentary and other Advanced Performance Financial Representation Issues: The Devil is in the Details, INT'L FRANCHISE ASSOC., May 7, 2019, p. 2 (emphasis added).

In 2018, I published an article in the ABA's Franchise Law Journal defending the extraterritorial application of state franchise laws. Rather than rely on mere anecdotes from my practice (which over time I have learned are representative), my co-authors and I conducted a survey of existing franchisees. Of 253 responding franchisees, more than half (52%) did not have an

² The persons selling the franchise to this husband and wife, who made the blatantly unlawful financial performance representations, appeared at the arbitration as witnesses, and confirmed they were still selling franchises. I only hope that these salespersons do not share the same belief of their former employer, that if they make unlawful financial performance representations to close a sale, there will be no repercussions.

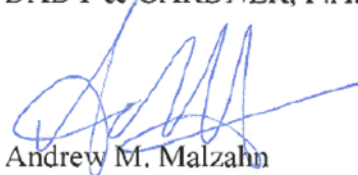
attorney review their FDD/UFOC or franchise agreement;³ 77% of the franchisees were not told an attorney could review their franchise agreement; and 17% (nearly one in every five franchise sales!) of the franchisees indicated the franchisor's salesperson had made statements to them related to sales, costs, and profits that were not included in the FDD/UFOC!

Despite practicing franchise law since 2015, to this day, I remain amazed (and disappointed) that the federal government and several state governments have enacted laws intended to prevent the fraudulent sales of franchises, yet franchisors brazenly violate these laws and insulate themselves from liability because of these boilerplate acknowledgments and questionnaires.

I fully support the Statement of Policy because it will help franchisees with meritorious claims that they have indeed been lied to, and fraudulently induced into the franchise relationship, recover what they lost. In addition, the Statement of Policy will, hopefully, have a cooling effect on the prevalence of fraudulent franchise sales, as franchisors will place more emphasis on proper franchise sales procedures if there are repercussions and no "get of out jail" card for fraudulent sales. The problem of permitting franchisors to contract around fraud, putting the onus on layperson franchisees to identify a fraudulent sale at the time of sale, or face the franchisor's claim of fraudulent misrepresentation against the franchisee, should not have reached this point, but the Statement of Policy is a step in the right direction.

Sincerely,

DADY & GARDNER, P.A.



Andrew M. Malzahn

AMM/pg

cc: Andrea Seidt, Section Chair (Andrea.Seidt@com.state.oh.us)
Dale Cantone, Project Group Chair (dcantone@oag.state.md.us)

³ I have also observed that even those prospective franchisees who do speak to an attorney, often speak to non-franchise lawyers who provide inadequate advice regarding the FDD/franchise agreement.