

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

North American Securities Administrators Association, Inc.
NASAAComments@nasaa.org

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

To Whom It May Concern:

I am writing in support of the newly-proposed NASAA Rule that addresses and limits questionnaires and checklists that disclaim fraud and seek to limit claims under state franchise laws. I believe this it is a Rule that should have been enacted long ago. I fully support the proposed Rule.

Franchising is a business system that is based upon the theory that the franchisor has a successful business system that it believes can be replicated and used by inexperienced individuals to turn these individuals into successful businesspersons. The common refrain heard in franchise sales is, "Be in business for yourself, but not by yourself," which is intended to convey the message that your franchisor will be of a great deal of help to you and, while you might otherwise not be capable of running a successful business, we (as your franchisor) are so capable that we will help you succeed.

I have been a franchise attorney for almost 27 years. During that time, my experience has been that prospective franchisees generally sign up for franchises without ever consulting a franchise attorney. In fact, almost all prospective franchisees never consult an attorney at all before signing their 10-year or 20-year franchise agreements and others consult a distant relative who practices divorce law and offers little insight.

It is generally the case that the prospective franchisee's two greatest sources of "assistance" in buying a franchise are (1) the franchisor and (2) a franchise broker whose compensation is dependent upon the prospect signing up. The most common statement from these two sources regarding franchisee attorneys is that the franchisee should not hire an attorney since (A) the franchisee can trust the franchisor, and (B) the franchisor will not negotiate the franchise agreement's terms anyway (this statement is sometimes combined with the statement that to

negotiate better terms with this prospect would be illegal and the franchisor would be committing a crime by negotiating better terms with the prospect).

As a result, the typical franchise transaction involves a prospect who has no legal representation, and who has no experience at all in the business of the franchisor's system. The prospect is discouraged from seeking legal representation and is told that the franchisor will take care of everything – the franchisor has a proven business system which is successful, and the franchisor will train the franchisee to be successful as well.

The prospect then must take a “leap of faith” and put all his or her trust in the franchisor. The prospect may have saved a five-figure or six-figure savings account. All of that money will go into the franchise (with somewhere between \$10,000 and \$100,000 going directly to the franchisor as a franchise fee, which is shared with the broker). In addition, today's prospects are encouraged to take their assets that are exempt from their creditors (their home equity, their retirement accounts) and put them all at risk on the new venture. The \$400,000 accumulated in the 401(k) account through 30 years of labor from ages 20-50 was put there so that the prospect would have a chance to have a decent retirement at age 65, no matter what other financial problems might befall them. That money has, instead, now been pushed into the pot as a proverbial “all in” play. This result, again, is because the prospect fully trusts the franchisor, and, of course, everything that the franchisor has represented or predicted. Most prospective franchisees accept what they are told as true.

Against this background, when the prospect is (at last) given a franchise agreement that has been presented as “non-negotiable,” franchisor attorneys across the country now argue that the prospect (who in his or her mind has already committed to placing all of his or her net worth into this deal) should be required to go through a 10-20 question checklist and make sure that the franchisor has not violated the law in presenting the opportunity to the prospect. This is absurd. As is stated in the description of the proposed Rule, it is not the prospective franchisee's obligation to ensure that the franchisor has not violated the law. That is the franchisor's obligation.

The prospective franchisee at that very moment has (in his or her mind) agreed to dedicate everything they own and everything they can borrow to acquiring this franchise. It is their gold mine, their chance to be a success in business. They have usually been told not to hire an attorney, and they almost always have never hired a qualified attorney before this point in time. Against this background, it is impossible to believe that the prospect will wade through the paperwork presented to them and suddenly say, “Wait a minute. It appears that you have violated state franchise laws!” Yet this is what courts generally believe – that the prospect has done its own legal work and understands what it is signing. Even worse, some franchisor attorneys have begun to suggest that the prospect is committing affirmative fraud by signing a checklist or questionnaire with responses that are not true! Franchise agreements are beginning to contain contract

provisions stating that the prospect understands that the prospect is liable to the franchisor for incorrect information contained in checklist responses.

Of particular concern is the use of checklists and questionnaires to void state franchise act protections. Many state legislatures have decided that certain false, misleading, and/or deceptive acts should be actionable. There are often even criminal penalties available under these state franchise laws; that is how important they are. Yet, by the use of questionnaires and checklists, the franchisor is now asking the prospective franchisee to insulate (and maybe even indemnify) the franchisor for the franchisor's violations of these state laws. This is not only a prohibited waiver of state law (and violates the state law's anti-waiver provision), but it flips the basis for the franchisee-protection statute on its head. State legislatures have determined that franchisors have an advantage on franchisees and that franchisees need legal protection from franchisors. This should be the end of the inquiry. Instead, what is the franchisor's response to these statutes? The franchisor gets the franchisee to agree that the protections do not apply, then argues in court that the franchisee is a sophisticated person who does not need any state statutory protection. Many courts, remarkably, have decided that the law does not protect someone whom the state legislature has specifically deemed in increased need of protection!

As Judge Schiltz stated in the *Lady of America* case, this sort of analysis of state franchise acts cannot be abided, given the clear purpose of the acts (to protect franchisees):

The Court recognizes that, under its broad interpretation of § 80C.21, franchisors cannot use contractual provisions to protect themselves from being sued for misrepresentation under the Minnesota Franchise Act. Consequently, even scrupulously honest franchisors will have to defend against some misrepresentation claims that would not be brought — or that would be quickly dismissed — if contractual disclaimers were enforceable. But under the interpretation of § 80C.21 advocated by Lady of America — that is, under a rule in which courts give effect to contractual disclaimers regardless of whether franchisors have actually made false statements of material facts — a certain number of franchisees who have been lied to will have no redress against dishonest franchisors. The Minnesota legislature has decided to burden franchisors, and protect franchisees, and this Court is bound to enforce that decision.

Rather than adopt the commonsense rule of *Lady of America*, many courts have chosen, instead, to protect dishonest franchisors and to burden franchisees. This newly-proposed Rule will help swing the law back to a commonsense position and not one that provides a “get out of jail” card to “dishonest franchisors.”

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I fully support this Rule.

Sincerely,

DADY & GARDNER, P.A.

A handwritten signature in blue ink that reads "Jeffrey S. Haff". The signature is written in a cursive style and is positioned above the printed name.

Jeffery S. Haff

JSH/ses

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