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VIA E-MAIL [NASAAComments@nasaa.org]

North American Securities Administrators Association, Inc. (NASAA)
750 First Street, N.E., Suite 1140
Washington, D.C. 20002

Re: Request for public comment: Proposed statement of policy regarding the use of franchise questionnaires and acknowledgements

Ladies and Gentlemen:

In response to your request for comment in the above-referenced matter, I am attaching an article to be published in the forthcoming edition of the ABA's *The Franchise Lawyer*. The article was written by myself and my colleague Jill Klein, and has been submitted to NASAA with the permission of the publication.

We appreciate your consideration.

Sincerely,

A handwritten signature in black ink that reads "W. Sentell".

William Sentell
Partner

cc: Andrea Seidt [Andrea.Seidt@com.state.oh.us]
Dale Cantone [dcantone@oag.state.md.us]

Regulators Take a Hard Look at Franchisee Questionnaires

By William Sentell and Jill Klein, Akerman LLP

State and federal regulators are taking a hard look at franchisee questionnaires. While such questionnaires are not new, state examiners are asking franchisors to justify their use in light of state anti-waiver provisions and statutory duties of good faith and fair dealing. In some instances, regulators are asking franchisors to revise questionnaires or remove them entirely.

The Federal Trade Commission has also solicited comments about questionnaires as part of their periodic review of the Franchise Rule. 84 Fed. Reg. 9051 (Mar. 13, 2019). This issue arises amid a broader discussion about the use of disclaimers in disclosure documents and in franchise agreements generally. This article will highlight diverging viewpoints on franchisee questionnaires and offer concrete suggestions for improving their use.

What is a Franchisee Questionnaire?

A franchisee questionnaire is a document presented to a prospective franchisee during the franchise sales process. It typically contains a series of questions about a range of compliance issues and other aspects of the parties' relationship. Most questionnaires include a variation of this question: "Did you receive a financial performance representation ("FPR") outside of Item 19?" Other questions ask whether the prospect received an FDD at least 14 calendar days before paying any amount to the franchisor or signing any binding agreement, and whether the prospect understands the inherent business risks in operating a franchise. Questionnaires typically require the prospect to check boxes indicating "yes" or "no," and they may also contain blank spaces for comments or explanations.

The Franchisee's Viewpoint

Franchisees and their counsel often take a dim view of franchisee questionnaires, arguing that they are little more than cleverly-disguised disclaimers or contractual waivers. An unscrupulous franchisor might pressure the prospective franchisee to answer the questionnaire in a particular way, even if the answers may be wrong or misleading. Franchisees who believe that a franchisor defrauded them in a subsequent dispute based on pre-signing facts or circumstances may be in the untenable position of having to disavow their earlier responses to the questionnaire. Depending on the jurisdiction, this can make prosecuting an otherwise valid claim difficult or impossible.

The Franchisor's Viewpoint

Franchisors and their counsel often take a more favorable view of questionnaires, arguing that they serve a legitimate purpose. In an age when some franchisors use multiple brokers and salespeople—and sales discussions can stretch on for weeks or even months—the questionnaires can provide a critical opportunity to identify and correct potential violations that may have

occurred during the sales process. Moreover, if done right, franchisors argue that questionnaires are not difficult to comprehend—they are simply an attempt to solicit truthful responses about pre-signing facts and circumstances.

Judicial Authorities

Judicial authorities on franchisee questionnaires generally fall on a continuum. Some courts have held that the franchisees' answers to the questionnaires bar their fraud claims as a matter of law. So, for example, a franchisee who denied receiving an FPR outside of Item 19 in a signed questionnaire would be unlikely to survive a motion to dismiss or motion for summary judgment. *See, e.g., Trident Atlanta, LLC v. Charlie Graingers Franchising, LLC*, No. 7:18-CV-10-BO, 2020 WL 6889208 (E.D.N.C. Nov. 22, 2020); *Yogo Factory Franchising, Inc., v. Ying*, No. 13-630 (JAP)(TJB), 2014 WL 1783146 (D.N.J. May 5, 2014).

Other courts have refused to dismiss a fraud claim prior to trial. These cases are very fact-intensive, and the outcome largely depends on state law (including the existence of a franchise anti-waiver provision). *See, e.g., Emfore Corp. v. Blimpie Associates, Ltd.*, 51 A.D.3d 434 (N.Y. App. Div. 2008); *Martrano v. Quizno's Franchise Co., L.L.C.*, No. 08-0932, 2009 WL 1704469 (W. D. Pa. June 15, 2009) (cleaned up).

In *Martrano*, for example, the court focused on the allegation that Quiznos required all franchisees to write the word "none" in the blanks given for explanations. In the court's view, the inclusion of the blanks was a "sham" designed to "mislead a subsequent reviewer, such as [the] Court, into believing that Quiznos' unilaterally-prescribed disclaimer language was actually authored without constraint by the franchisees." *Id.* at 15. "The same public policy that in general sanctions the avoidance of a promise obtained by deceit strikes down all attempts to circumvent that policy by means of contractual devices." *Id.* at 14 (cleaned up).

Even if a court declines to dismiss a franchisee's claim as a matter of law, the statements contained in the questionnaire nevertheless may become evidence at trial. A fact finder could still find that the franchisee's reliance was unreasonable or not credible in light of the franchisee's response to the questionnaire. *See, e.g., Emfore*, 51 A.D.3d at 435 (noting that issues of fact existed "as to the extent and reasonableness of plaintiff's reliance on defendants' alleged oral misrepresentations").

One largely unresolved issue is whether a questionnaire is itself a disclaimer or waiver, or whether it simply has the potential to persuade a fact finder about issues of credibility. Most state franchise anti-waiver statutes are couched in terms of contractual provisions and not affirmative statements made by a franchisee. *See, e.g., Minn. Stat. § 80C.21.* (describing any "condition, stipulation or provision, including any choice of law provision."). These anti-waiver statutes do not purport to regulate what a prospective franchisee can and cannot tell a franchisor in the course of negotiating a franchise agreement.

Perhaps recognizing this fact, some state regulators have allowed questionnaires to remain intact, but have simply insisted that the franchisor explicitly affirm that the questionnaire is subject to the state's anti-waiver provision. This suggests that the way in which a franchisor uses the questionnaire will determine how a court or arbitrator will apply the law. In other words, the franchisor's *practice* with respect to the questionnaire matters a great deal. Is it an honest effort to solicit truthful information, or is it merely a clever device meant to thwart an otherwise valid claim?

For an excellent discussion of this and other related issues, see Erin E. Conway, *No Fair! Finding an Equitable Balance in Enforcement of Disclaimer Provisions in Franchise Agreements and Franchise Disclosure Documents*, 33 Franchise L.J. 323 (2014).

Best Practices for Franchisors

As discussed previously, case law on franchisee questionnaires is highly fact specific, especially when state anti-waiver laws come into play. The issue often boils down to how the franchisor uses the questionnaire, including its internal policies for reviewing sales documents.

We suggest five affirmative steps that franchisors should take when considering the use of franchisee questionnaires:

1. Provide comprehensive sales compliance training. Franchisors should provide regular, comprehensive training to all employees and contractors who may be involved in the sales process. Such compliance training should include a review of the questionnaire and a discussion of its purpose and benefits as a compliance tool.
2. Review the questionnaire. Franchisors should take time to review and “audit” their questionnaires. Questions should be as short as possible, should only elicit factual information, and should be easy for a layperson to understand.
3. Point out the questionnaire early in the sales process. Often prospective franchisees who are unrepresented by counsel read the questionnaire for the first time at the proverbial “closing table.” They may have specific questions that are difficult to answer on the spot. Often the overriding desire to conclude the deal creates a rushed “check the box” mentality. By pointing out the questionnaire early in the sales process, franchisors can avoid this scenario.
4. Avoid even the appearance of coercion. Franchisors should avoid anything that a franchisee or court may view as coercion, including instructing or leading a franchisee to answer in a specific way or stating or implying that a franchisee will lose the franchise opportunity if he or she “answers incorrectly.” *See, e.g., In Braatz, LLC. v. Red Mango FC, LLC*, No. 3:14-CV-4516-G, 2015 WL 1893194 (N.D. Tex. April 27, 2015).

5. Develop a policy for processing the questionnaire. A franchisor should develop a policy for reviewing all closing documents, including the questionnaire. Ideally, in-house counsel should review and process questionnaires. If an in-house lawyer is unavailable, then an employee with no financial interest in the transaction, such as a controller or risk manager, should manage the review. In the event that a franchisee answered any question in a way that indicates improper action by the franchisor or any of its agents or sales representatives, then the franchisor should promptly investigate and take appropriate action, determining whether the issue is the result of a misunderstanding or misreading of the questions or a legitimate violation or misdeed.

The proper response by a franchisor finding a pre-sale violation or misdeed will necessarily depend on the specific facts and applicable state law. In some circumstances, it may be impossible to “un-ring” the bell through subsequent writings or other corrective action. In these situations, the only solution may be to decline to complete the sale process. While no franchisor wants to lose a sale, foregoing the transaction can demonstrate that the franchisor will not tolerate sales compliance violations.

In less severe circumstances, a franchisor may consider preparing a detailed letter to the prospective franchisee outlining the inappropriate pre-sale action and the specific legal basis for moving ahead with the sale. This letter should also advise the prospective franchisees to retain their own legal counsel and caution them that they should not enter into the franchise agreement if they are relying on any representations made in violation of state or federal law. In any case, franchisors should take corrective action with respect to any individual who participated in the violation.

Conclusion

Franchisee questionnaires will continue to generate ongoing scrutiny by regulators and courts. Franchisors that use them should deploy them in a way that demonstrates utmost good faith and avoid any actions that may lead one to view the questionnaires as strategic devices meant to gain a future litigation advantage.