Transmitted via e-mail to
NASAAComments@nasaa.org

January 5, 2022

North American Securities Administrators Association, Inc.
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 Acknowledgments

Dear Sir or Madam:

We respectfully submit this letter in response to the request for comments that NASAA published on December 6, 2021 regarding the proposed statement of policy referred to above.

Fundamentally, we do not take issue with the notion that a franchisor should not be able to use an acknowledgement or a questionnaire as a shield to evade, contradict, or disclaim the representations or statements made in the FDD. However, that does not extend to asking factual questions.

The SOP proposes to go substantially beyond barring disclaimers. In fact, the SOP proposes to ban questions asking for factual answers. In that respect, we strongly disagree with the proposal and recommend a change, as noted below, to implement a sensible solution.

In sum, we note the following:

- The FTC Franchise Rule prohibits disclaimers.16 CFR § 436.9(h). As discussed below, courts have applied that provision of the FTC Rule as one would expect, that is, to bar franchisors from enforcing disclaimers. As such, the SOP is not necessary to the extent that it goes beyond making clear that a questionnaire can neither disclaim representations in the FDD nor waive provisions in state or federal law.

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- Merely asking factual questions is not meant to – and does not – disclaim representations made in a franchisor's FDD. Nor does doing so waive provisions of state law. (In fact, the idea for using a questionnaire was benign and came many years ago from the then-serving Assistant Attorney General in Maryland, Mark Forseth. He suggested that the questionnaire be added as an exhibit to then-UFOC Item 20, even though it is not a contract and such inclusion is arguably not required.)

- There is no factual record, no substantial evidence, nor any legitimate corroboration for the conclusion that asking factual questions is tantamount to a prohibited disclaimer.

  Nor is there any basis – let alone a substantial basis – to conclude that asking fact questions is inherently deceptive or misleading. As such, a government agency applying its awesome power to ban a franchisor from asking factual and non-deceptive questions certainly implicates, and may run afoul of, the First Amendment to the U.S. Constitution.

- We also submit that questionnaires serve a valuable role in helping franchisors determine whether there might have been a problem, and perhaps even a violation of law, in the franchise sales process. By reviewing the answers to a questionnaire, a franchisor can ascertain whether a problem may have occurred, and decide whether a relatively simple solution can be implemented (e.g., redisclosure if there is a concern over the 14-day rule) or whether to not enter into a transaction where doing so might potentially be illegal.

  Either way, the ability to confirm that the disclosure process worked properly, or to decide not to proceed with a potentially improper transaction, is consistent with the intent and conceptual underpinning of disclosure law. Asking the franchisee to answer factual questions in no way "shift[s] the compliance burden from franchisors to prospective franchisees," as suggested in the SOP (at pg. 3).

  To the extent that some practitioners draft questionnaires that ask the franchisee to draw a bare conclusion of law (e.g., "I did not receive an illegal FPR."), we believe that those questions are ill-suited to the purpose at hand. That said, we also don't believe that the regulatory process is intended to remedy poor drafting.

- Franchisees choose whether or not to hire a lawyer to provide counsel in reviewing and assessing whether to sign a franchise agreement. Franchisees are supposed to read the disclosure documents given to them and are capable of honestly answering factual questions asked about the sales process. Any suggestion to the contrary runs counter to the underlying regulatory basis for requiring disclosure in the first place – after all, why would states and the FTC mandate giving key facts to a prospective franchisee if it is presumed that the recipient will neither read nor comprehend that document?

Parties are presumed to read documents, not lie, and truthfully answer questions. *See*, *e.g.*, *Skagit State Bank v. Rasmussen*, 745 P.2d 37, 39 (Wash. 1987) (en banc), in which the Washington Supreme Court wrote that "[i]t is a general rule that a party to a contract which he has voluntarily signed will not be heard to declare that he did not read it, or was ignorant of its contents."

- There is no appropriate government interest in barring private parties from conducting due diligence about any transaction. In a franchise sale, the questionnaire is one way for a franchisor to seek information from a franchisee about the sales process to confirm whether the parties' transaction may proceed ahead lawfully. A multitude of business-to-business (and consumer) transactions involve substantial due diligence before the deal closes in order to confirm, among other things, that legal requirements were met and that all of the i's are dotted and t's crossed.

  In fact, the point of asking questions is to get truthful answers – in real time – about facts that establish the foundation of the parties' relationship. Obviously, questions that ask for factual answers may impede a party from later asserting facts that are inconsistent with their original confirmation. However, the law does not protect parties from duplicity and does not shield parties – even franchisees – from reinventing facts to suit their purposes. Nor should or does the law favor steps to preclude parties from recording their understandings of certain key facts – in real time – when recollections are fresh and before they have dimmed.

  Questionnaires are routinely used in a multitude of settings and as part of a standard compliance regime. These are consistent with the underlying theme of encouraging parties to adopt procedures to confirm that they have complied with the law. All of these uses are consistent with the goal of encouraging parties to take proactive measures to be cognizant of and comply with their legal requirements. Just a few examples include:

  - Children's Online Privacy Protection Act (COPPA) compliance questionnaires;
  - PCI and GDPR data protection compliance questionnaires;
  - PATRIOT Act questionnaires regarding transactions with prohibited parties;
  - Anti-corruption questionnaires to confirm that vendors are meeting requirements;
  - Corporate transaction questionnaires such as corporate resolutions, insurance schedules, confirmations regarding stock plans and pension programs, corporate structure, and the like;
  - Bank disclosure questionnaires;

- Charter school compliance questionnaires;
- Civil rights, non-discrimination, and EEOC compliance questionnaires;
- Real estate closing questionnaires; and
- Questionnaires to confirm compliance with the requirements of the FTC Red Flags Rule.

The FTC itself uses questionnaires to confirm compliance with procedures and divestiture requirements (through its Office of Inspector General and its Bureau of Competition), as do many other state and federal agencies.[1]

In fact, one of the cases cited in the SOP directly supports the proposition that questionnaires legitimately serve to "root out dishonest sales personnel." In *Emfore*, the N.Y. Appellate Division found that "by requesting franchisees to disclose whether a franchisor's representatives made statements concerning the financial prospects for the franchise during the sales process, **franchisors can effectively root out dishonest sales personnel and avoid sales secured by fraud.**" *Emfore Corp. v. Blimpie Assocs., Ltd.*, 51 A.D.3d 434, 435 (App. Div. 1st Dep't 2008) (emphasis added).

We see no reason for franchise transactions to be an exception to the widespread practice of private parties and government agencies using questionnaires to confirm key facts. Any such step would have to be based on a substantial factual record; even then, doing so would be extraordinary and unprecedented. As noted below, taking such action is unnecessary (in view of how courts treat disclaimers and other solutions) and also implicates the First Amendment.

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Disclaimers in the Courts.

Of course, the FTC banned certain disclaimers when it issued the amended Franchise Rule in 2007. 16 CFR § 436.9(h). Our review of cases in state and federal court found a total of two reported decisions involving the question of whether the FTC Rule ban on disclaimers can be

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[1] *See* https://www.ftc.gov/about-ftc/office-inspector-general/what-you-need-know-about-office-inspector-general-0, https://www.ftc.gov/about-ftc/office-inspector-general/oig-audits-and-evaluations, and https://www.ftc.gov/news-events/press-releases/2015/01/ftc-proposes-study-merger-remedies. *See also* OSHA (Compliance Guidance for Funeral Homes at https://funeralcourse.com/wp-content/uploads/coursebooks/FuneralBook-OSHA-Compliance-for-Funeral-Homes.pdf) and the California Tax Credit Allocation Committee (https://www.treasurer.ca.gov/ctcac/compliance/covenant/questionnaire.pdf).

overridden by a franchisor. In both cases, the courts rejected a franchisor's attempt to evade Section 436.9(h). *See* *Trident Atlanta LLC v. Charlie Graingers Franchising LLC*, 2019 WL 441187, at *3 (E.D.N.C. Feb. 4, 2019) ("The FTC Franchise Rule itself bans disclaimers … Accordingly, the General Release was in violation of 16 C.F.R. 436.9(h) and should not be enforced to bar plaintiffs' claims."); and *Final Cut LLC v. Sharkey*, 2012 WL 310752, at *21 (Conn. Super. Ct. Jan. 3, 2012) ("The defendants also improperly attempted to disclaim, and attempted to require the plaintiff to waive, reliance upon representations made by the defendant Sharkey's Franchising in the UFOC and its exhibits, in violation of 16 CFR 436.9(h).")[2] *See also Emfore Corp.*, *supra* (same result applying New York franchise law anti-waiver provision).

First Amendment Considerations

Courts have upheld the FTC in imposing limits on speech in the face of First Amendment challenges, but only where the Commission: (1) has **met the "substantial evidence" standard** (*see* *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 454, (1986));[3] **and** (2) has determined that without imposing those limits on otherwise protected speech, **deceptive and/or unfair** information would be disseminated. For example, see:

- *POM Wonderful LLC v. F.T.C.*, 777 F.3d 478, 500 (D.C. Cir. 2015) ("We conclude that the Commission's findings of deception are supported by substantial evidence in the record.").

- *FTC v. Vylah Tec LLC*, 2019 WL 722085, at *5 (M.D. Fla. Jan. 9, 2019), *vacated in part*, 2019 WL 13095315 (M.D. Fla. Mar. 5, 2019) ("The FTC Act proscribes—and the First Amendment does not protect—deceptive and misleading advertisements.").

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[2] When it issued the amended Franchise Rule in 2007, the Commission noted that "courts have limited the circumstances where integration clauses have the most potential for harm. Where there is fraud in the inducement, ***courts are likely to void the contract, regardless of any integration clause or waiver.***" (emphasis added) The FTC cited numerous court decisions in the footnote accompanying the text. 72 Fed. Reg. 15544, 15534 n. 917 (2007).

[3] At note 4, the SOP cites an anonymous comment submitted to the FTC and the *Braatz v. Red Mango* decision. However, the court in *Braatz* did not reach a decision on the question of whether the franchisee was asked or even required to revise the answers in its questionnaire. Rather, the court in *Braatz* ruled on whether there was a violation of the 14-day pre-sale disclosure rule under the Wisconsin franchise law. *Braatz LLC v. Red Mango FC LLC*, 642 F. App'x 406, 411 (5th Cir. 2016) ("On the plain text of the 14–day rule, the Braatzes have not alleged facts showing that the rule was violated."). Neither the unverified and incomprehensible anonymous comment submitted to the FTC nor the *Braatz* case can be said to be "substantial evidence."

- *Bellion Spirits LLC v. United States*, 335 F. Supp. 3d 32, 42 (D.D.C. 2018), aff'd, 7 F.4th 1201 (D.C. Cir. 2021) ("this Court will thus review *de novo* any question of constitutional law but must apply the substantial-evidence test and accord some deference to the agency's scientific and fact-bound determinations.").

- *United States Dep't of Justice v. Daniel Chapter One*, 89 F. Supp. 3d 132, 151 (D.D.C. 2015), *aff'd*, 650 F. App'x 20 (D.C. Cir. 2016) ("defendants caused harm by publicizing deceptive information about their products and by failing to send the corrective notice to prior purchasers").

- *Cf*. *Bose Corp. v. Consumers Union of U.S., Inc.*, 466 U.S. 485, 486 (1984) ("In cases raising First Amendment issues, an appellate court has an obligation to make an independent examination of the whole record to ensure that the judgment does not constitute a forbidden intrusion on the field of free expression.")

Moreover, courts have concluded that "the government must show that the regulation is necessary to serve a **compelling state interest** and that it is **narrowly drawn** to achieve that end." *See National Federation of [the] Blind v. FTC*, 303 F. Supp. 2d 707, 716 (D. Md. 2004), *aff'd*, 420 F.3d 331 (4th Cir. 2005 (emphasis added).

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We respectfully submit that here: (1) there has been no substantial fact-finding; (2) there is no rulemaking record; and (3) there can be no finding that the use of questionnaires asking for factual information is either unfair or deceptive. In view of the above cases, we believe that there is no basis on which to adopt a requirement[4] that would ban questionnaires as broadly as proposed in the SOP.

However, we respectfully submit that there is a relatively straightforward approach that can: (1) achieve the goal of preventing impermissible disclaimers via a questionnaire or acknowledgement; and (2) still allow parties to ask factual questions.

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[4] We do not address the significant issue of whether the SOP is the equivalent of a regulation, which of course depends on how state regulators informally apply any such guidance. Every state has its own version of the federal Administrative Procedure Act, which sets out a mandatory process that must be followed to adopt a regulation (here, a policy that, as a practical matter, becomes a requirement that must be met by parties applying for registration under the applicable franchise law).

This approach would involve limited government action and be sufficiently narrowly-drawn so that it would likely pass muster under the *National Federation of [the] Blind* test.

That suggestion would be to require a boilerplate statement (similar to the one that some of the state regulators have requested be included in those questionnaires and acknowledgements), such as:

> *We have asked you a series of questions above. Please provide full, honest, and truthful answers. Neither our questions nor your answers are meant to disclaim any of the statements made in our FDD (and we will not use them to do so). In addition, our questions and your answers are not meant to waive any of your rights under applicable federal or state franchise laws (and we will not assert that they do so).*

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We hope that this analysis and our suggestions are useful to your consideration of the proposed SOP and the related issues.

Respectfully submitted.

Sincerely,

/s/ Plave Koch PLC

Plave Koch PLC

cc: Ms. Andrea Seidt (Andrea.Seidt@com.state.oh.us)
Mr. Dale Cantone (DCantone@oag.state.md.us)