Section Chair Seidt;

Thank you for the opportunity to comment on the proposed SOP. I believe this is a topic overdue for attention, and endorse the Section’s description and analysis of the problem and the proposed SOP.

I have been an attorney since 1984, and have been practicing franchise law since 1998. I am a California State Bar Certified Specialist in Franchise and Distribution Law, and represent franchisees and franchisee associations.

Over the years I have represented numerous franchisees who received information from their franchisors in violation of the California Franchise Investment Law, other state franchise investment laws, and FTC Rule. This has included financial performance representations made outside the FDD (often outside FDDs which included no Item 19 representations). These FPRs have often been false, misleading, incomplete or unsupported by the actual results obtained by the franchisors’ or its franchisees’ existing outlets. In addition to illegal FPRs franchisors have also made misrepresentations to my clients concerning territorial protections, operational support, marketing support, the demand for the franchises’ products or services, and numerous other important components of the franchise relationship. Franchisors provide all this information as part of their sales process, which is often practiced and polished, and most often aimed at potential franchisees who, however sophisticated or experienced, know little about either the franchised business or buying a business. None of these are new problems, and as the members of the Section are aware, are the types of issues which lead to the adoption of state franchise laws and the FTC Franchise Rule.

Unlike franchisors, the vast majority of prospective franchisees are unaware that the sale of franchises is regulated. Even when they read the FDD, few understand either why they received it or why it contains the specific but limited information it does. They have no reason to distinguish between the information in the FDD and any other information the franchisor or its sales people provide. And, of course most of the other information is provided in a more user friendly, eye-catching and exciting form than the FDD. Think the difference between an advertisement for a big-screen TV and a user’s manual.

Buying a franchise is a big decision, representing a commitment of money, time and work. So is deciding to buy a franchise. The franchise sales process is designed to paint the franchise as exciting, fun and profitable. When it works the prospect also feels that they have an investment in the process leading to the decision to buy. Only at that point, at the peak of their excitement, when they are already signing the paperwork and psyched up to write a check, is the buyer’s attention drawn to the questionnaire (though not the disclaimers). They are told that they must answer a certain way or they cannot buy the franchise. This is presented as the way to overcome an unexpected obstacle, rather than as a way for the franchisor to violate the law and get away with it.

Over the course of my franchise law practice I have read hundreds of FDDs and franchise agreements. The use of questionnaires and disclaimers has increased over time. Questionnaires are practically ubiquitous at this point, and the disclaimers have multiplied and evolved. I entirely agree with the conclusion expressed in the second paragraph on Page 2 of the SOP concerning the intent behind the states’ franchise investment laws and some courts’ failures to give them the intended effect. Indeed, I co-authored a paper which included an examination of decisions from courts in several registration states involving franchisors’ defensive use of disclaimers and

Courts are predisposed to enforce contracts as written. Unscrupulous (or abundantly cautious) franchisors are fully aware of this and their questionnaires and disclaimers are designed to take advantage of it. It is likely that courts which enforce disclaimers and accept questionnaires at face value, and regulators who accept them as standard components of the FDDs they examine, are fueling a race to the bottom among franchisors. Franchisors who play by the rules have no need for prophylactic questionnaires or disclaimers, but include them out of an abundance of caution or because their less scrupulous competitors successfully use them to lower their costs of doing business. More of each generation of FDDs, based on these examples, include them. The results are that some franchisees who were harmed by sales in violation of the law are deprived of a legal remedy, and some franchisors are empowered to violate the franchise laws because they feel insulated from the consequences.

I will not be surprised if this SOP is opposed by franchisors and their representatives. They may claim that they need disclaimers to protect themselves from false claims by unscrupulous franchisees and questionnaires to enable them to police their salespeople. Neither claim should persuade you. First, no franchisor has the right to sell a franchise in violation of the law. The way a franchisor to protect itself from false claims is to have and enforce solid, documented sales practices and procedures which comply with the franchise sales statutes and regulations. A franchisor could create a questionnaire for evaluation of salespeople, e.g., one given to each newly signed franchisee to be mailed back anonymously. Indeed, that technique would likely result in more accurate responses than having the buyer fill out the questionnaire with the salesperson sitting next to them. Second, no franchisor is obligated to sell a franchise to everybody who wants one. Franchisors are entitled to choose franchisees who they determine to be honest and diligent, and are far better positioned to do so than prospective franchisees are to determine the same of franchisors. And Third, your charge under your states’ franchise laws is to protect the prospective franchisees in your states. If you have to balance the interests of franchise sellers against those of prospective franchise buyers, you must favor the interests of the buyers.

As regulators your duty is to implement the legislature’s intent. I believe it is entirely appropriate for you to use your position to restrict franchisors’ use of questionnaires, acknowledgments and disclaimers designed to circumvent the disclosure, anti-fraud and anti-waiver provisions of your states’ franchise investment laws. And I urge you to do so, including by adopting the proposed SOP.

Regards,

Bruce

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