

NASAA REQUEST FOR PUBLIC COMMENT

PROPOSED NASAA MODEL FRANCHISE BROKER REGISTRATION ACT

May 13, 2024

Deadline for Comments: June 13, 2024

The Franchise and Business Opportunities Project Group (“Project Group”) of the Corporation Finance Section (“Section”) of the North American Securities Administrators Association, Inc. (“NASAA”) is seeking public comment on a proposed *NASAA Model Franchise Broker Registration Act* (“Franchise Broker Act”). The Franchise Broker Act, if adopted by NASAA, would be a model for states to use to regulate franchise brokers and their representatives. The Franchise Broker Act is drafted so that it could be used by any state, not just those states that currently register franchise offerings. The proposed text of the Franchise Broker Act is enclosed with this request for public comment.

Comments on this proposal are due on or before the deadline stated above. We are only accepting comments by email. Please email your comments to the NASAA Comments inbox (nasaacomment@nasaa.org), cc: Theresa Leets (theresa.leets@dfpi.ca.gov), Chair of the Project Group, and Bill Beatty (bill.beatty@dfi.wa.gov) and Erin Houston (ehouston@sos.nv.gov), Co-chairs of the Section. All comments received in response to this request will be posted to NASAA’s website (www.nasaa.org) without edit or redaction after the close of the comment period, though inappropriate comments will not be posted. Accordingly, please do not include any information in your comment that you do not wish to become publicly available. After the close of the comment period, the Project Group and the Section will review all comments and consider whether to present the proposal, in its current or revised form, to the NASAA Board of Directors for potential adoption by the NASAA membership.

Background

Franchises are offered and sold to prospective franchise investors (called “franchisees”) by franchisors and through independent third-party franchise brokers. Although franchisors are required to register with state franchise administrators in 15 states, currently, only two states require franchise brokers to register with a state franchise administrator.¹ Franchisors also are subject to certain disclosure obligations to prospective franchisees under the Federal Trade Commission Franchise Rule, but franchise brokers have no obligations under the Franchise Rule.

¹ New York, under the New York Franchise Sales Act (N.Y. Comp. Code R. & Regs. tit. 13, §200.11), and Washington, under the Washinton Franchise Investment Protection Act (RCW 19.100.140).

Generally, a franchise broker is an independent sales agent not employed by the franchisor who solicits prospective franchisees to purchase a franchise. Many franchise brokers are compensated by a franchisor in the form of a fee or commission earned solely on the sale of a franchise. Like any broker, the franchise broker has a financial interest in making a sale.

Complaints About Franchise Brokers

Franchise brokers often represent only a limited number of franchise opportunities, and they may push prospective franchisees to purchase a franchise the broker represents, whether or not that franchise is a good fit for the franchisee. In the law enforcement experience of state franchise administrators, some franchise brokers will make misrepresentations to prospective buyers about a franchise offering to conclude a sale, most commonly by making unauthorized or misleading claims of revenue or profits the franchise broker suggests a franchisee can earn from purchasing a franchise.²

Over the years, state franchise regulators have received complaints from franchisees and franchisee advocates about franchise brokers. The complaints include hard sell tactics and alleged misrepresentations by the franchise broker, as well as confusion about who the franchise broker represents. More recently, state franchise regulators have received complaints from franchisors about the role of franchise brokers in franchising and how unscrupulous franchise brokers are harming the franchise business model.

Several years ago, the Federal Trade Commission published a consumer guide that warns about potential problems the public may face when dealing with franchise brokers, including the making of false or misleading earnings claims and confusion over who the franchise broker represents.³

In 2020, United States Senator Catherine Cortez Masto published a report dealing with harmful practices in the franchise sector.⁴ Among her concerns was the role that franchise brokers play in the sale of franchises. Senator Cortez Masto's report recommended, among other things, that franchise brokers could be subject to licensing requirements with annual educational requirements similar to the real estate industry, and she even recommended that franchise

² See, e.g., *In the Matter of Determining Whether There Has Been a Violation of the Franchise Investment Protection Act of Washington* by: David Lopez, *Dental Fix Rx, LLC*, available at: [S-19-2776-20-CO01.pdf](https://www.wa.gov/S-19-2776-20-CO01.pdf) (wa.gov).

³ A Consumer's Guide to Buying a Franchise, at p. 4, available at: https://www.ftc.gov/system/files/documents/plain-language/591a_buying_a_franchise_sept_2020.pdf.

⁴ Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices, available at: <https://www.cortezmasto.senate.gov/wp-content/uploads/media/doc/Franchise%20Report%20from%20the%20Office%20of%20Senator%20Cortez%20Masto.pdf>.

brokers could be subject to a fiduciary responsibility to the prospective franchisees with whom they work.⁵

In 2021, the Project Group proposed the Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments (“Franchise SOP”). The Franchise SOP addressed franchisors’ use of questionnaires and contractual acknowledgements as disclaimers of liability when a franchisor’s representatives or franchise brokers have made misrepresentations or committed fraud in the offer and sale of a franchise. Several public commenters on the proposed Franchise SOP discussed that prospective franchisees have received unauthorized financial data, often from franchise brokers.⁶

Finally, most recently, the International Franchise Association, the largest trade association representing franchisors, franchisees, and franchise suppliers, signaled that it endorses the idea that franchise brokers should be subject to specific disclosure requirements and registration.⁷

The Project Group’s Proposed Franchise Broker Act

The Project Group began exploring a potential model franchise broker act in 2020. At that time, Industry Advisors to the Project Group, both franchisee and franchisor advocates, strongly supported the idea of pursuing a model act. Our Industry Advisors questioned whether the limited regulation of franchise brokers by two states is sufficient to meaningfully police franchise brokers. They noted that franchise brokers currently have no educational or ethical standards. They also suggested that there is no clear path to recovery by defrauded franchisees against a franchise broker who is alleged to have engaged in deceptive practices.

The attached Franchise Broker Act, if adopted by NASAA, would be a model for states to use to regulate franchise brokers and their representatives. The Franchise Broker Act is drafted so that it can be used by any state, not just states that register franchise offerings. The Franchise Broker Act is loosely patterned on Washington State’s current franchise broker registration requirements and has incorporated elements of broker-dealer and securities salesperson requirements.⁸ The Franchise Broker Act includes prohibited practices, disclosure obligations of

⁵ *Id.* at p. 35.

⁶ *See, e.g.*, Public Comment of Keith R. Miller, available at: <https://www.nasaa.org/wp-content/uploads/2021/12/NASAA-Request-for-Comment-on-Franchise-Questionnaires-and-Acknowledgments-Keith-Miller.pdf> ; Public Comment of Jeffrey S. Haff, available at: <https://www.nasaa.org/wp-content/uploads/2021/12/NASAA-JSH-Proposed-Statement-of-Policy-Comments.pdf>

⁷ Pending California Senate Bill 919 (Franchise Broker Registration) is supported by the International Franchise Association. *See* <https://www.franchise.org/media-center/press-releases/ifa-calls-for-additional-regulations-on-third-party-franchise-sellers>.

⁸ RCW 19.100.140 (Washington franchise broker registration requirements).

franchise brokers, and recordkeeping obligations. The Franchise Broker Act also includes optional provisions that would allow states to require franchise brokers subject to registration in the state to make specific additional disclosures, pass examinations, complete continuing education, and meet certain financial requirements.

The Franchise Broker Act references a “disclosure statement” in Section 5 that franchise brokers and their representatives would be required to provide to prospective franchisees. In drafting the Franchise Broker Act, the Project Group envisioned that adopting jurisdictions would require the use of a uniform disclosure statement. The majority of this one- to two-page document would be general information drafted by the Project Group about working with franchise brokers.⁹ It would also include a space for franchise brokers and franchise broker representatives to disclose any material litigation to prospective franchisees. The Project Group plans to begin working on a draft uniform disclosure statement in Summer 2024. Once finalized, the proposed uniform disclosure statement would be posted for public comment before adoption. The Project Group will also consider whether additional uniform forms or model administrative rules are necessary to assist states with implementation of the Act.

Attachment

- ***NASAA Model Franchise Broker Registration Act (Draft)***

⁹ The Project Group envisions that the format of the disclosure statement would be similar to the page of the NASAA State Cover Sheets titled “What You Need To Know About Franchising Generally,” available at: <https://www.nasaa.org/wp-content/uploads/2019/06/New-Franchise-State-Cover-Sheets-Instructions.pdf>, and include similar information about franchise brokers as is included in the FTC’s Consumer Guide on Buying a Franchise.

NASAA Model Franchise Broker Registration Act

(Adopted _____)

Note for Adopting Jurisdictions: This NASAA model act contains bracketed text. The bracketed text should be filled in as appropriate (and the brackets removed) prior to adoption.

Prefatory Notes: The NASAA Model Franchise Broker Registration Act requires registration of franchise brokers and franchise broker representatives. Persons that receive compensation for engaging in one or more of the following activities may need to register under this Act: (1) locating prospective franchisees, (2) acting as an intermediary between prospective franchisees and franchisors, (3) evaluating the qualifications of prospective franchisees, (4) assessing the suitability of prospective franchisees for particular franchise opportunities, (5) managing franchise prospects for franchisors, and/or (6) providing prospective franchisees information about franchise offerings. Jurisdictions considering this model legislation that have a franchise registration and disclosure law may be able to incorporate this model into their existing franchise law with minimal modifications. For example, franchise registration and disclosure laws may already contain certain definitions in Section 2 and may have provisions for revoking registrations and establishing filing fees that can be modified to incorporate broker registration, eliminating the need for Sections 4(5) and 8. Jurisdictions that do not have a franchise registration and disclosure law can use the NASAA Model Franchise Act (available at <https://www.nasaa.org/wp-content/uploads/2023/05/MODEL-FRANCHISE-INVESTMENT-ACT.pdf>) for definitions and provisions necessary for implementation of this Act. For example, the NASAA Model Franchise Act provides a definition for “franchise” and provisions regarding fraudulent, deceptive and prohibited practices, rulemaking, enforcement powers, private civil actions, and waivers.

Section 1: Short Title

Sections 2 to 8 may be cited as the “Franchise Broker Registration Act.”

Section 2: Definitions

In this act, unless the context otherwise requires:

- (1) “Affiliate” means a person controlling, controlled by, or under common control with another person, every officer or director of such person, and every person occupying a similar status or performing similar functions.
- (2) “Director” means the [official administering the act].
- (3) “Franchise broker” means any person that directly or indirectly engages in the offer or sale of a franchise and receives, or is promised, a fee, commission, or other form of consideration from a franchisor, subfranchisor, or franchisee, or an affiliate of a

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franchisor, subfranchisor, or franchisee. “Franchise broker” does not include: (i) a franchise broker representative; (ii) a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor; (iii) the officers, directors, or employees of a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor; or (iv) a current franchisee of a franchisor or subfranchisor so long as the franchisee does not receive fees, commissions, or other forms of consideration valued at more than \$1,000 (an amount that will be adjusted annually for inflation) in a calendar year.

- (4) “Franchise broker representative” means any natural person other than a franchise broker who represents a franchise broker in effecting or attempting to effect offers or sales of franchises. A franchise broker representative can be an owner, officer, director, employee, or independent contractor of a franchise broker.
- (5) “Offer” or “offer to sell” includes every attempt or offer to dispose of or solicitation of an offer to buy a franchise or an interest in a franchise.
- (6) “Other form of consideration” as used in Section 2(3) includes, but is not limited to: (i) the granting of equity in a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor; (ii) a buy-out or similar provision in which a franchise broker or a franchise broker representative will receive a fee if the contract or arrangement between a franchise broker or a franchise broker representative and a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor is terminated; or (iii) a portion of the royalties or other ongoing payments of franchisees in a system.
- (7) “Person” means a natural person, corporation, partnership, trust, or other entity, including an online platform, and in the case of an entity, it shall include any other entity which has a majority interest in such an entity or effectively controls such other entity as well as the individual officers, directors, and other persons in act of control of the activities of each such entity.
- (8) “Prospective franchisee” means any person that contacts or is contacted by a franchise broker or franchise broker representative to discuss franchising generally or any specific franchise. “Prospective franchisee” does not include: (i) a franchise broker or franchise broker representative; (ii) a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor; or (iii) officers, directors, or employees of a franchisor, a subfranchisor, or an affiliate of a franchisor or subfranchisor

working in their official capacity.

- (9) “Sale” or “sell” includes every contract of sale, contract to sell, or disposition of a franchise.

Section 3: Prohibited Practices

- (1) It is unlawful for any franchise broker to directly or indirectly engage in the offer or sale of a franchise in this state unless the franchise broker is registered under this act.
- (2) It is unlawful for any franchise broker representative to directly or indirectly engage in the offer or sale of a franchise in this state unless the franchise broker representative is registered under this act.
- (3) It is unlawful for any franchisor or subfranchisor to use the services of a franchise broker to directly or indirectly engage in the offer or sale of a franchise in this state unless the franchise broker is registered.
- (4) It is unlawful for any franchisor or subfranchisor to use the services of a franchise broker representative to directly or indirectly engage in the offer or sale of a franchise in this state unless the franchise broker representative is registered.

Section 4: Registration

- (1) A franchise broker and a franchise broker representative must apply for registration by filing with the director (i) a completed application in a form the director prescribes by rule or otherwise, (ii) a consent to service of process, (iii) an irrevocable consent to jurisdiction and venue in the state, and (iv) the fee prescribed by Section 8.
 - a. A franchise broker and a franchise broker representative shall be deemed duly registered for a period of one year from the effective date of registration unless the director by rule or order specifies a different period.
 - b. Registration of a franchise broker or a franchise broker representative may be renewed for additional periods of one year each, unless the director by rule or order specifies a different period, by filing with the director no later than thirty calendar days prior to the expiration thereof a renewal application containing such information as the director may require to indicate any

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substantial changes in the information contained in the original application or the previous renewal application and payment of the prescribed fee.

- c. If a material change in the information contained in an application or other required submissions should occur, a franchise broker or a franchise broker representative, as the case may be, must amend the registration on file with the director as soon as reasonably possible and in any case, before directly or indirectly engaging in the offer or sale of a franchise.
- (2) The director may require by rule or otherwise that a franchise broker or franchise broker representative pay a competency examination fee and pass a competency examination or meet certain experience requirements prior to applying for registration. A franchise broker that is not a natural person is exempt from any competency examination requirement.
 - (3) The director may require by rule or otherwise that a franchise broker or franchise broker representative complete continuing education requirements. A franchise broker that is not a natural person is exempt from any continuing education requirements.
 - (4) The director may require by rule or otherwise that a franchise broker or franchise broker representative meet certain financial or insurance requirements.
 - (5) The director may by order deny, suspend, or revoke the registration of any franchise broker or franchise broker representative if the director finds that the order is in the public interest and that the applicant or registrant, or any partner, officer, or director of the applicant or registrant:
 - a. Has filed an application for registration as a franchise broker or franchise broker representative which, as of its effective date, or as of any date after filing in the case of an order denying effectiveness, is incomplete in any material respect or contains any statement which is, in the light of the circumstances under which it is made, false or misleading with respect to any material fact;
 - b. Has willfully violated or willfully failed to comply with any provision of this act or any rule or order under this act;

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- c. Has been convicted, within the past five years, of any misdemeanor or felony involving a franchise, or any aspect of the securities, commodities, business investments, franchise, business opportunities, insurance, banking, or finance business, or of any felony involving moral turpitude;
- d. Is permanently or temporarily enjoined or restrained by any court of competent jurisdiction in an action brought by the director or a state or federal government agency from engaging in or continuing any conduct or practice involving any aspect of the securities, commodities, business investments, franchise, business opportunities, insurance, banking, or finance business;
- e. Is the subject of an order of the director denying, suspending, or revoking registration as a franchise broker or a franchise broker representative;
- f. Has engaged in dishonest or unethical practices in the franchise industry;
- g. Is insolvent, either in the sense that the person's liabilities exceed the person's assets or in the sense that the person cannot meet obligations as they mature; or
- h. Refuses to allow or otherwise impedes the director from conducting an audit, examination, inspection, or investigation, or refuses access to any business location to conduct an audit, examination, inspection, or investigation.

The director may by order summarily postpone or suspend a registration pending final determination of any proceeding under this section.

Section 5: Disclosure Obligation

- (1) A franchise broker or a franchise broker representative must provide a prospective franchisee with a disclosure statement prior to an in-person, virtual, telephonic, or electronic communication relating to any specific franchise opportunity. The disclosure statement must be prepared in a form the director prescribes by rule or otherwise, and the director may require that the disclosure statement include the disclosure of material litigation. The director may prescribe by rule or otherwise that the disclosure statement be filed with the director prior to use.
- (2) A franchise broker or a franchise broker representative must disclose to a prospective franchisee all compensation the franchise broker or the franchise broker representative will receive in connection with the offer and sale of a franchise no

later than the time the prospective franchisee receives a copy of a Franchise Disclosure Document. The director may require by rule or otherwise that a franchise broker or a franchise broker representative disclose other compensation information to the prospective franchisee. The fee disclosure statement must be prepared in a form the director prescribes by rule or otherwise.

Section 6: Recordkeeping Obligation

- (1) Every franchise broker and franchise broker representative that is registered or required to be registered must keep and maintain a complete set of books, records, and accounts related to any offers and sales of franchises as prescribed by the director by rule or otherwise.
- (2) All the records of a franchise broker and a franchise broker representative are subject at any time or from time to time to such reasonable periodic, special, or other examinations by representatives of the director, within or without this state, as the director deems necessary or appropriate in the public interest or for the protection of franchisees.
- (3) If a franchise broker or a franchise broker representative ceases to transact business, the franchise broker or the franchise broker representative must retain books, records, and accounts related to any offers and sales of franchises for a period of 10 years following the cessation of business.

Section 7: Obligations of Franchisors and Subfranchisors

- (1) A franchisor or subfranchisor that uses a franchise broker or a franchise broker representative must file with the director a notice that identifies each franchise broker or franchise broker representative that will operate in this state before the franchise broker or the franchise broker representative directly or indirectly engages in the offer or sale of a franchise for the franchisor or subfranchisor. The notice must be prepared in a form the director prescribes by rule or otherwise.

Section 8: Fees

- (1) The director must charge and collect the fees fixed by this section. The director shall not refund fees.

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- (2) The fee for filing an application for initial registration under Section 4(1) is [\$].
- (3) The fee for filing an application for renewal of a registration under Section 4(1) is [\$].
- (4) The fee for filing an amendment to the application under Section 4(1) is [\$].