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NASAA

RE: Comments on Proposed NASAA Model Broker Registration Act

Dear Folks:

Thank you for the opportunity to comment on the proposed NASAA Model Broker Registration Act ("NMBRA"). I am impressed with the thoughtfulness and experience reflected in the NMBRA. It is obvious that you have put a great deal of work into addressing this important issue of franchise broker accountability.

As you know, based on our experience, franchise brokers are a major source of misleading and fraudulent information that is provided to prospective franchisees to get them to invest in franchises that will line the pockets of the brokers and broker representatives. The information shared is often financial performance information that the franchisor cannot share directly because they did not include it in Item 19 of the FDD. The presentation of otherwise prohibited information happens verbally over the telephone, verbally and visually over video conferencing, by spreadsheet, by video, by PowerPoint slides, and many combinations. We are still hearing about brokers telling prospective franchisees they are "consultants to franchisees" and not brokers—years after NASAA has required an admonition in every FDD that brokers represent and are paid by the franchisor. Franchisees do not understand the nuances and tend to accept the word of the attractive and charming broker or broker representative.

Unfortunately, in some cases, we learn that the franchisor has provided the broker or broker representative with the data from which they prepare the unlawful financial performance representations. Consequently, Section 3, paragraph 4 of the NMBRA is a critical element. Franchisors need to clearly understand that they are responsible for the actions of their brokers. I know the NMBRA is focused on the registration requirement for brokers in this regard, but it sends a message to provide that the franchisor is in violation if they use an unregistered broker.

Another problem we encounter in situations where brokers are involved is that they are "here today and gone tomorrow". Because many brokers take the job as an interim between "real" jobs, they often work for only a short period as brokers and then move, change their email addresses, or otherwise disappear. The registration requirement together with the recordkeeping requirement of the NMBRA are good first steps in holding brokers accountable. At least, if you can find them, they are subject to the five-year recordkeeping requirement. I would suggest considering adding a requirement that they keep the state advised of their residential and email addresses for the five-year period.

Against that general background, I want to make a short list of specific recommendations for your consideration. I will organize them by Section and paragraph number in the NMBRA.

Section 3 (1), (2) and (3). I think you made a mistake by taking the "directly or indirectly" language out of the NMBRA. That language has served very well in the franchise registration and anti-fraud acts. It essentially codifies the concept that one cannot do indirectly what they cannot do directly. Without it you will find very creative franchisors, brokers and broker representatives who find creative ways to hire an hourly employee and set them up (without them understanding what they are doing) to do all of the "dirty work" for the broker or broker representative. I understand they would be elevating form over substance, but they will believe they successfully worked around the law. They will then use an arbitration clause with the franchisee to further avoid responsibility, knowing that they have an even chance of getting an arbitrator who will be arbitrary. We still encounter attorneys who argue that by putting the word "license" at the top of a contract they can avoid the applicability of the FTC Franchise Rule and the various state franchise acts.

Section 2 (2). The $5,000 per year trigger for current franchisees to avoid applicability of the law if they get involved in the offer and sale of franchises is far too high. We routinely see franchisees who will give false and misleading information to prospective franchisees at the behest of the franchisor for nothing more than an "atta-boy" or a dinner at a rather ordinary restaurant. What they are really getting is the franchisor's favor when it comes to getting some benefit or avoiding some consequence. If the franchisee is barely making $5,000 a year in true net profit, $5,000 may be enough for them to sell their soul. It incentivizes franchisors to induce current franchisees to give deceptive information, usually financial performance representations, to prospective franchisees with impunity. If the current franchisee knows that he or she will get $500 every time they give glowing reports, it creates an alternative delivery channel for the very information NASAA is trying to curtail with the NMBRA. Instead, every person who receives compensation (cash or otherwise) for encouraging a prospective franchisee to invest should be required to make full disclosure of the amount they will receive. No exceptions. As a practical matter, franchisees should never get involved in the offer and sale of franchises (unless they are selling their own unit) because that makes them a franchise seller and agent of the franchisor, with joint and several liability in some states for any violations of the state anti-fraud acts. To encourage them to get involved by allowing them to avoid the NMBRA as long as they only take $5,000 per year is setting them up for problems.

Section 4 (1)(b). In light of other sections of the NMBRA, I suspect this is a typographical error. The section reads, in relevant part, "containing such information as the director may

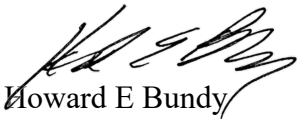
require to indicate any substantial changes….” To remain consistent with the FTC Franchise Rule and most (if not all) of the state statutes, you should replace the word “substantial” with the word “material”. That is the word used for the same purpose in the following paragraph (Section 4 (1)(c)). Materiality is a word and concept that is well understood in the franchising community. To interject a different word suggests that a “mere” material change might not trigger it—that it requires something more than “material”. Please use the word “material” and its derivatives consistently so we all know what it means.

Section 5 (1). In the third line, the trigger for requiring delivery of a disclosure document is “communication… about a specific franchise opportunity”. You should consider changing that to “any franchise opportunity identified by name or brand”. Without such a change, you will encounter brokers and broker representatives who routinely discuss multiple brands while focusing on just one and steering the prospect in that direction. The other one or two or three brands they talk about are only there for the purpose of avoiding communicating about “a specific franchise opportunity”. Unfortunately, as written, it creates an opportunity to avoid disclosure until the sale is essentially complete. Were a broker or broker representative to ask most attorneys for guidance on whether that complied with the law, most would green-light the broker.

Section 7. I recommend that you include language in all of the sections that provide for fees to the effect that fees will be adjusted annually by the director in the amount of inflation or increase in the cost of living and point to a body of measuring data, but, of course, allow the director to select another measure if the existing data is no longer available from the designated source. Otherwise, the true amount of the fee decreases annually, and when the state(s) try to catch up after 50 years, the entire industry gasps. Just do the adjustments every year, and no one will notice the pain.

I hope these comments are helpful. Again, I appreciate the opportunity to review and comment on the proposed NMBRA. It is an impressive work product, and each of you (and the others who contributed) is to be commended. I wish you the best as this proposal moves toward final adoption.

Sincerely,



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