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VIA E-MAIL

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Franchise and Business Opportunities Project Group  
North American Securities Administrators Association, Inc.  
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**Re: Comments to Proposed Statement of Policy Regarding the Use of Franchise  
Questionnaires and Acknowledgements**

Dear Ms. Seidt and Mr. Cantone:

Our firm is submitting comments to NASAA's Corporation Finance Section's and Franchise and Business Opportunity Project Group's ("NASAA") Proposed Statement of Policy regarding the use of questionnaires and acknowledgements ("**Questionnaires**") in franchise offerings (the "**SOP**").

The SOP principally discusses two types of provisions found in Questionnaires: (1) factual representations about the sales process that the franchisee experienced ("**Factual Representations**"); and (2) Anti-Waiver Provisions (as defined in the SOP). These two types of provisions have different purposes, different precedent, and should therefore be treated quite differently. We address NASAA's position in the SOP as it relates to each type of provision separately below.

**1. FACTUAL REPRESENTATIONS IN QUESTIONNAIRES.**

Questionnaires are a key component of many franchisors' franchise sales compliance programs for good reason. If a franchisor is trying to learn the truth about what happened during a franchise sales process – the best person to ask is the person most likely to be involved and impacted – namely, the franchisee. In fact, even the SOP concedes that franchisors rely on Questionnaires to "root out dishonest sales personnel and avoid sales secured by fraud." These are goals that are entirely consistent with the FTC Franchise Rule and the franchise statutes in all

registration states. In support of the right of franchisors to obtain Factual Representations, we submit the following responses to the SOP:

A. **SOP Contradicts Precedent for Evaluating Compliance Programs.** NASAA's assertion that "[q]uestionnaires... are not the most effective mechanisms for preventing fraud" lacks support and, even if taken as true, NASAA fails to provide any federal or state precedent to invalidate a franchisor's compliance practices on such grounds. Nothing in federal or state statute requires that franchisors adopt only the "most effective" means to ensure compliance. As a practical matter, all franchisors must choose a variety of methods to ensure compliance, some of which may be more effective than others. Further, there is no legal precedent suggesting that the FTC or state regulators wish to establish a subjective "effectiveness" test for compliance programs generally.

Moreover, the FTC has previously elected not to adopt certain UFOC Guidelines provisions where the FTC judged the guidelines to be "unnecessarily burdensome, without corresponding benefits to prospective franchisees."<sup>1</sup> Asking franchisees to attest to their experience during the sales process via a Factual Representation is by far the simplest method for a franchisor to effectively identify the possibility of sales violations, when compared with other methods of inquiry (i.e. recording or reading the transcript of all sales calls). Therefore, we submit that NASAA contradicts the FTC's own precedent by establishing a new heightened test for franchisor compliance programs, allowing only the "most effective" methods to stand, rather than considering the franchisor's real world administrative burden in evaluating potential compliance strategies.

B. **SOP Protects Dishonest Franchisees.** We can only think of two circumstances in which the use of Factual Representations would generate a result that is harmful to franchisees: (1) where a franchisee does not understand what it is signing or is unduly influenced by a franchisor; or (2) where the franchisee is knowingly and intentionally dishonest in its reply, so as to obtain a franchise by dishonest means. With respect to the former, we are aware of no barrier to available remedies, as franchisees have historically found relief in courts.<sup>2</sup>

With respect the latter, however, if franchisees were knowingly and intentionally dishonest in their reply to a Questionnaire, it's appropriate that their recovery should be hamstrung by their own dishonesty. The SOP's position would simply protect such franchisees from their own bad actions. In fact, the SOP cites to just such cases, such as *Braatz, LLV v. Red Mango FC, LLC*, in which the franchisee lied about its experience in the sales process to complete the franchise purchase. In the corresponding public commentary cited by the SOP, a franchisee claims it lied on a Questionnaire because the franchisee "knew [answering truthfully] would preclude [it] from making the franchise purchase." It is unreasonable to take the position that a franchisor, who granted a franchise after relying on misrepresentations by a franchisee, should not have the right to contest the franchisee's claims by pointing to the franchisee's own fraudulent attestations.

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<sup>1</sup> See FTC Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 16 C.F.R. § 436 and 437 at 15452 (2007).

<sup>2</sup> See, e.g., *Martrano v. Quizno's Franchise Co.*, No. 08-cv-0932, 2009 WL 1704469, (W.D. Pa. June 15, 2009). See also *Siemer v. Quizno's Franchise Co.*, No. 07-cv-2170, 2008 WL 904874 (N.D. Ill. Mar. 31, 2008).

Similarly, in paragraph 3 of page 5 of the SOP, NASAA adopts the opinion of two public commenters that Questionnaires “limit a franchisee’s ability to hold a franchisor accountable for fraud and deceit.” However, these positions ignore the role of a franchisee in answering Questionnaires. Questionnaires require only that a franchisee be honest in its answers to specific factual questions. If a franchisee’s answers reveal potential non-compliance by the franchisor or its agents, the franchisor can then investigate to determine whether its sales process was compliant, and take corrective actions, as applicable or necessary. Depending on the facts surrounding the sales process, the franchisee may have certain remedies under the Franchise Act, which would not have been impacted by the franchisee’s responses on the Questionnaire – provided the franchisee had been truthful in its response.

C. **Questionnaires do not Shift the Burden of Compliance.** NASAA correctly notes that it is the franchisor’s burden to police its own sales personnel and agents. However, questionnaires are one method franchisors utilize to meet this burden. Questionnaires do not, as the SOP suggests, require franchisees to investigate the sales process, or the franchisor’s compliance. Rather, Questionnaires pose factual questions to franchisees about their individual experiences during the sales process. Further, Questionnaires encourage discussion between parties where a franchisee’s answers suggest potential non-compliance. For instance, a franchisee may misunderstand financial information gained directly from existing franchisees as a representation from the franchisor. To the extent the Questionnaires expose potential wrong-doings, franchisors then have the burden to investigate the claims further and take remedial action as appropriate.

D. **Plain English Should be Evaluated on a Case-by-Case Basis.** Paragraph 3 on page 5 of the SOP states that in some cases Questionnaires violate the FTC standards that require use of plain English in franchise offerings. However, the SOP fails to provide specific examples of questions or acknowledgments that violate the plain English standards. We agree that Questionnaires should be held to a “plain English” standard, but do not believe that prohibiting Questionnaires in their entirety on this basis is appropriate. Rather, examiners may evaluate the language in such Questionnaires on a case-by-case basis, as they do for the FDD, to determine compliance with this requirement. Further, as Questionnaires are attached as exhibits to the FDD, examiners already have the opportunity to ensure Questionnaires contain “plain English.”

## 2. STATE ANTI-WAIVER PROVISIONS.

NASAA’s position that a Questionnaire seeking to undermine a state Anti-Waiver Provision be deemed invalid is reasonable. However, when drafting a statement to be included in Questionnaires to such effect, we would recommend NASAA not expand the scope of the statutory Anti-Waiver Provisions adopted by each state (as the courts are the appropriate body to interpret the scope of such Anti-Waiver Provisions) or generalize that all state laws are the same. For example, NASAA fails to point out that some states prohibit releases or waivers, whereas others simply require that the release or waiver to be express and clear.

In cases where there is uncertainty as to whether the Questionnaire contains language prohibited by Anti-Waiver Provisions, such as *Randall v. Lady of Am. Franchise Corp.* cited in the

SOP, courts are then the proper forum for determining the outcome. Courts are well-equipped to apply state Anti-Waiver Provisions to matters involving Questionnaires. In fact, the cases cited in defense of NASAA's positions involve different Questionnaires with varying language, in which the court evaluated whether the applicable Questionnaires complied with state law. NASAA appears to state only that franchisees should have the opportunity before a factfinder to evaluate the lawfulness of the Questionnaire. We agree that franchisees should have this opportunity – and they do.

### 3. PROPOSED PROHIBITED STATEMENTS.

Based on our assertions above, we believe that the SOP's prohibition on Factual Representations is unsupported in all respects. A Factual Representation is not, on its own, a waiver, disclaimer, or release. It is only an attestation as to factual circumstances associated with the sales process, which may be answered either truthfully or untruthfully. It is only if the Factual Representation is untruthful that claims arise, and at such point, there is no reasonable basis to prohibit franchisors from seeking relief accordingly.

As to the SOP's proposal in Sections II.C.1.a. and II.C.1.b., to prohibit franchisors and franchise sellers from requiring franchisees to make any statement in the Questionnaire that would either cause a reasonable franchisee to surrender or believe that they have surrendered their statutory rights or have the effect of shifting franchisor's statutory disclosure duties to the franchisees - we agree with NASAA's stated goal. However, the proposed language presented by NASAA far exceeds the scope of state Anti-Waiver Provisions and does not recognize the potential state-level variances. In order to align the proposed anti-disclaimer with the stated purpose of state Anti-Waiver Provisions, we propose the following language:

"No statement, questionnaire, or acknowledgment signed or agreed to by a franchisee in connection with the commencement of the franchise relationship shall have the effect of (i) waiving any claims under any applicable state franchise law, or (ii) disclaiming reliance on any statements made in the franchise disclosure document. This provision supersedes any other term of any document executed in connection with the franchise."

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We appreciate being provided the opportunity to submit our comments. If you would like additional clarifications or explanations, please feel free to email Amy Cheng at amy.cheng@chengcohen.com and Michael Daigle at michael.daigle@chengcohen.com or call them at 312.243.1701.

Sincerely,

CHENG COHEN LLC