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July 12, 2018

Franchise and Business Opportunities Project Group

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Re: Comments on Proposed New State Cover Sheets to Franchise Disclosure Documents

Dear Messrs. Cantone, Beatty, Staley, and Stewart,

This letter is being submitted on behalf of the law firm Gray Plant Mooty, Mooty & Bennett, P.A. (“GPM” or “Gray Plant Mooty”) in response to the request of NASAA’s Franchise and Business Opportunity Project Group (the “Franchise Project Group”) for comments on its “Proposed New State Cover Sheets to Franchise Disclosure Documents” (the “Proposal”), released on July 12, 2018. Our comments below include (A) background and general comments, and (B) specific comments on individual portions of the Proposal.

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A. Firm Background and General Comments

1. The GPM Franchise Group

Gray Plant Mooty is a full-service law firm that celebrated its 150th anniversary in 2016. Gray Plant Mooty has been involved in franchising matters for over 40 years. Currently, the GPM Franchise Group includes 30 lawyers who devote all or a majority of their practice to franchise, licensing, and distribution matters. We represent more than 350 clients or brands in franchising, licensing, and distribution, in more than 60 industries, from start-up franchisors, to some of the largest, most recognized brands in the world. In the last two calendar years, the GPM Franchise Group has represented over 250 different franchisors or franchise brands in preparing or updating FDDs, and/or filing franchise registrations or renewals, and/or counseling on U.S. franchise regulatory and transactional matters. The comments set forth in this letter are based upon, and reflect, this substantial experience.

2. Thank you to the NASAA Franchise Project Group

We would like to thank the Franchise Project Group for its commitment to making the FDD a more user-friendly tool for prospective franchisees. GPM supports your initiative and anticipates that many of your proposed revisions to the State Cover Sheets will improve the utility of FDDs.

B. Specific Comments on the Proposal

We submit for your consideration the following suggestions that we believe will both improve the utility of FDDs as well as provide prospective franchisees with greater insight into the myriad resources available from which they may be better able to evaluate franchise offerings.

1. Cover Page Entitled “How to Use this Franchise Disclosure Document”

Many of the questions presented in the proposed cover page entitled “How to Use this Franchise Disclosure Document,” are quite useful. However, due to variations among franchise brands, the diverse nature of franchise businesses, and different terminology used by different franchisors, some of the questions are phrased in a way that may confuse a prospective franchisee or are otherwise inappropriate in light of the proposed answers. We are not suggesting eliminating any questions. Rather, we have suggestions for wording that we believe will be useful to prospective franchisees. The following are the four questions which we believe should be revised:

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i. *“How much will I earn?”*

The use of the word “will” in “How much will I earn?” may be interpreted by a prospective franchisee as an assurance or suggestion that the prospect will in fact attain the sales or earnings described in Item 19 of the FDD. Such an interpretation would be inaccurate. Therefore, we recommend changing the question to read: **“How much can I earn?”**

ii. *“Is the franchise system stable and growing or shrinking?”*

As used in the proposed question, the word “system” appears to refer to the network or chain of outlets operating under the franchised brand name. The word “system” is often utilized differently within the FDD and franchise agreements to refer to the intellectual property that comprises a franchised business’ method of operation. Two different uses of the same word are likely to cause confusion. We therefore recommend replacing the word “system” with either **“network”** or **“chain.”** We also suggest removing the word “stable,” because it carries connotations that may lead readers to believe incorrectly that this question is referring to the quality of a franchised business, rather than to the quantity, or number, of company-owned and franchised outlets. Because the intent of this question is to direct prospective franchisees to the information contained in Item 20, we recommend changing the question to read: **“Is the number of company-owned and franchised outlets increasing, decreasing, or unchanged?”**

iii. *“Will my business be the only [XYZ] in my market?”*

The use of the word “market” is likely to confuse prospective franchisees, as “market” can be interpreted in at least two different ways. Here, presumably, it is intended to refer to the territorial protections afforded to prospective franchisees. According to this interpretation, additional outlets within the franchisee’s market would generally be considered detrimental to the franchisee. However, the term “market” is also often used to refer to the broader media market or region, in which the presence of more than one outlet is generally regarded as beneficial. For example, franchisees who share a media market may be able to avail themselves of group advertising, which an individual franchisee (or an owner of an individual, non-franchised outlet) might otherwise be unable to afford. The presence of additional units within a single market also suggests that the brand has local goodwill and name recognition. Given that the intent of this question is to point prospective franchisees to Item 12 and the information regarding territory and territorial protection, a more accurate and less confusing question would be: **“Will I receive territorial rights, or territorial or any other protection from same-brand competition?”**

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iv. *“Does the franchisor have a troubled legal history?”*

The word “troubled” is both pejorative and apt to cause confusion. To an inexperienced prospective franchisee, all litigation is arguably “troubled.” Therefore, to avoid bias or confusion, we recommend changing the question to: **“What is the franchisor’s litigation history?”**

v. *“What else should I know?”*

While we agree that it is useful to remind prospective franchisees to review all 23 items contained within an FDD, we think it would be helpful to also mention that there are other resources available to help them to determine whether to invest in a particular franchise, and/or in a franchised business. These include various internet sites and industry publications, as well as government records. It is also worth reiterating to prospective franchisees that they can obtain a wealth of information from both current and former franchisees, as well as from experienced franchisee attorneys and accountants. We recommend adding the following language to the original answer, so that it more fully addresses the scope of information available to prospective franchisees: *“These questions are only a few things you should look for. Review all 23 Items and all Exhibits in this disclosure document to better understand this franchise opportunity. Furthermore, you may be able to find additional information on this franchise opportunity, and the industry in which this franchise operates, from industry publications and franchising websites, governmental records (e.g., SEC filings), current or former franchisees, as well as other sources of information, including those available to you from your accountant or attorney.”*

2. Cover Page Entitled “What You Need to Know About Franchising Generally”

i. *“Operating restrictions.”*

The subheading *“Operating restrictions”* may cause confusion, as it seems to reference restrictions applicable to the operation of the franchised business itself – e.g., restrictions on the goods and services that the franchised business must, or is permitted to, offer. However, from the statement that follows the subheading, it is clear that this paragraph is meant to address covenants against competition, and not a broader discussion of franchise operations. Therefore, we recommend changing the heading to **“Restrictions on Competition”** so that the heading more accurately reflects the content of the paragraph.

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We support the implementation of these new state cover pages, and recognize that there is anecdotal evidence that some prospective franchisees either don't read the FDD completely, don't understand it, or don't retain lawyers or advisors to assist in evaluating the business opportunity. We note that the Franchise Project Group's Proposal referred to an article by Karp and Stern and a survey of franchisees by FranchiseGrade.com, that is also mentioned in that article.¹ We also saw that another FranchiseGrade.com² study, also completed in 2015, surveyed 1,122 franchisees, and sought to assess whether they read and understood FDDs.³ The survey results found that:

- i. 72% of respondents reported having a clear understanding of the obligations and commitments with the franchise agreements;
- ii. 82% reported having read through the FDD and franchise agreement; and
- iii. 76% reported that having consulted with an attorney, accountant, or franchise advisor to help them evaluate whether to invest in a particular franchised business.⁴

As you can see, this second survey suggests a much higher FDD review rate among franchisees. Therefore, it may be desirable for NASAA, either on its own, or together with interested parties in the franchise community (e.g., franchisee advocates, the IFA, franchisors, a research company, and possibly government agencies), to conduct a study designed to collect data on the scope of FDD review by prospective franchisees (including whether this varies by type of franchise, size of investment, or experience of prospect, etc.), and the type of information that prospective franchisees find useful and/or what they might wish to review in the investment evaluation process. With the upcoming FTC Rule amendment process starting, such a study could prove to be a valuable tool for government regulators, as well as for franchisors and franchisees. We are not suggesting delaying the implementation of the current NASAA

¹ See Eric H. Karp & Ari N. Stern, *A Proposal for a Mandatory Summary Franchise Disclosure Document*, 35 FRANCHISE L.J. 541, 548-49 (2016) (citing FranchiseGrade.com study for the proposition that prospective franchisees "sometimes, rarely, or never under[stand] the FDD they [are] given").

² Franchisegrade.com identifies Eric Karp as serving as United States Counsel for the company. See <https://www.franchisegrade.com/about> (visited July 11, 2018).

³ *National Survey of Franchisees 2015: An Analysis of National Survey Results*, FRANCHISEGRADE.COM 12 (2015).

⁴ *Id.*

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Proposal, but something that is a follow-up project to provide better data for the entire franchise community and the interested stakeholders.

Once again, thank you for the opportunity to submit these comments. We sincerely hope that this information will be useful in your consideration of the final revisions to be applied to the Franchise Guidelines.

Respectfully submitted,

GRAY, PLANT, MOOTY,
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