

NASAA Adopts Franchise Acknowledgment Policy That is Harmful to Franchisors

September 27, 2022

On September 18, the North American Securities Administrators Association (NASAA) adopted a Statement of Policy banning most acknowledgments and compliance questionnaires used by franchisors in the franchise sales closing process. While not unexpected, the Policy creates challenges for franchisors regarding their franchise sales practices and defending frivolous claims from franchisees.

Many franchisors rely on acknowledgements and compliance questionnaires to identify both problematic franchise sales practices and prospective franchisees that may not understand the franchise offer or documents. Lathrop GPM submitted written comments in January 2022 opposing the then-proposed Policy, alongside other law firms and the International Franchise Association, detailing significant legal, practical, and commercial concerns. With this major policy change, franchisors must take notice.

The Policy

NASAA stated that the Policy is designed to curb unfair practices of "unscrupulous" franchisors. But its impact is much greater and affects all franchisors. Effective January 1, 2023, franchisors will not be allowed to use questionnaires and acknowledgements in the franchise sales closing process. In addition, franchisors may not include similar questions and statement in their franchise agreements. Over at least the last 30 years, many franchisors have included in their franchise agreements and FDDs: (1) language that takes the form of a series of acknowledgments regarding the franchise offering; and (2) series of questions about what occurred, or did not occur, in the franchise sales process. These acknowledgments and questionnaires include questions regarding whether a prospective franchisee received some type of financial performance information different from what the franchisor disclosed in Item 19 of its FDD, and factual statements regarding a prospective franchisee's understanding of the business and its due diligence.

The Policy is intended to set standards for the proper use of such questionnaires and acknowledgments. There are several key parts of the Policy. First, the Policy provides that any questionnaires and acknowledgments must be attached to and included as part of the FDD in Item 22. If a franchisor requires a prospective franchisee to verbally respond to questions on video before entering into a franchise agreement, the Policy provides that a written script of the questions must be referenced in Item 22 of the FDD and attached as an exhibit.



Second, the Policy prohibits franchisors from requiring prospective franchisees to make any statement in any questionnaire or acknowledgment that: (1) would cause a prospective franchisee to surrender or believe they have surrendered rights to which they are entitled under the law; or (2) would have the effect of shifting the franchisor's disclosure duties under the law to the prospective franchisee.

Third, the Policy identifies a nonexclusive list of 11 specific types of questionnaires and acknowledgments that are prohibited, including:

- That the prospective franchisee has read or understands the FDD or any attachments thereto, including the franchise or other agreement.
- That the prospective franchisee is qualified or suited to own and operate the franchise.
- That neither the franchisor nor the franchise seller has made any representation, including any financial performance representation, outside of or different from the FDD and attachments thereto.
- That the prospective franchisee has had the opportunity to or has/has not actually consulted with professional advisors or consultants or other franchisees.

Finally, the Policy provides that if a franchisor uses a questionnaire or acknowledgement, the franchisor must include a specific provision in its FDD, franchise agreement, or applicable state-specific addenda that such a questionnaire or acknowledgement is not effective to waive claims under any applicable state franchise law, or to disclaim reliance on any statement made by the franchisor, franchise seller, or other person acting on behalf of the franchisor.

Lathrop GPM Opposes The Policy

While NASAA conceded that questionnaires and acknowledgments can be useful to help franchisors root out dishonest sales personnel and avoid sales secured by fraud, NASAA concluded that questionnaires and acknowledgments are not the most effective mechanisms for preventing fraud, and that they are used by unscrupulous franchisors to avoid the consequences of fraud. But in our extensive experience in the industry, we strongly believe that the "bad apples" in the over 3,500 franchise brands in the U.S. are quite few, and this Policy represents a serious overreaction that will cause a tremendous amount of collateral damage.

Additionally, the Policy runs counter to the FTC's Franchise Rule. The FTC specifically looked at issues related to questionnaires and acknowledgments in 2019 and 2020 during its review of the Franchise Rule, and before that when preparing the 2007 Amended FTC Rule. After thorough analysis, the FTC decided not to ban them and rejected most of the arguments that are now incorporated in the Policy.

Key Takeaways



NASAA is a private organization, not a government body or regulatory agency, and the Policy is not a law or regulation. However, the Policy will serve as guidelines and/or interpretations for state franchise regulators in the 14 states that have franchise registration laws. Franchisors must therefore carefully evaluate their use of questionnaires and acknowledgments going forward.

- Franchisors should assume and expect that state regulators in most of the 14 registration states will implement the guidelines and interpretations in the Policy. State franchise examiners may object to franchisors using questionnaires and acknowledgments on the basis of the Policy and may deny registration of franchise offerings without deletion or amendment of the questionnaires and acknowledgments.
- We expect some franchisors will determine that having questionnaires and acknowledgments is valuable enough to warrant two forms of FDD — one with questionnaires and acknowledgements for use in states that allow them (including the 36 so-called "non-registration states" that are subject to only the FTC Rule, and a few of the registration states), and another one (without questionnaires and acknowledgments) for use in states that follow the Policy. Such a practice may be challenging or could increase the risk that a franchisor's franchise development team may deliver the wrong FDD. But with the use of electronic file naming and delivery of state-specific FDDs, and the use of franchise-specific document management software, the challenges to delivering state-specific FDDs are reduced.
- The Policy includes a footnote (which was incorporated in the final Policy after the submission of comments from Lathrop GPM and others), stating that the Policy is not intended to prohibit a franchisor from conducting factfinding or asking prospective franchisees questions about the sales process. However, it is not clear how states will interpret that language and what types of "factfinding" and related documentation will be permitted.

Lathrop GPM's Franchise Practice Group is thoroughly evaluating this issue from transactional, regulatory, and litigation perspectives. If you have questions about the use of questionnaires and acknowledgments in the franchise sales closing process going forward, please contact us to see if we can assist you.