

USING BROKERS AND SALESPERSONS TO SELL FRANCHISES – OH MY!

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- California Department of Financial Protection and Innovation (DFPI),
- The DFPI commissioner, nor
- The North American Securities Administrators Association, Inc. (NASAA)

Agenda

- 1. Introduction to Franchise Brokers
- 2. Legal and Regulatory Framework
- 3. State-by-State Requirements
- 4. Legal Risks and Case Studies
- 5. Best Practices and Reform

Introduction to Franchise Brokers

- Who are franchise brokers?
- What services do they provide?
- How do they influence the franchise sales process?
- Why their role is growing in importance

Historical Context of Broker Use

- Brokers have long played a role in matching franchisees with franchisors.
- Initially the “Wild West” days due to fraud, their involvement has become more structured and widespread.

Updated Broker Registration Guidelines

- **California SB 919** - amends the California Franchise Investment Law by imposing annual registration and disclosure requirements on third-party franchise sellers.
- **North American Securities Administrators Association (“NASAA”) Model Franchise Broker Registration Act (“Model Act”)** – *“The [Model] Act is obligations for franchise brokers. The loosely based on Washington State’s current franchise broker registration requirements and incorporates elements of broker-dealer and securities salesperson requirements. It includes prohibited practices, disclosure obligations, and recordkeeping proposed [M]odel [A]ct is applicable to all states and is not limited to those that register franchise offerings”.*

NASAA - <https://www.nasaa.org/71980/nasaa-seeks-public-comment-on-proposed-nasaa-model-franchise-broker-registration-act/>

NASAA Model Franchise Broker Registration Act

The Franchise Broker Act, if adopted by NASAA, would be a model for states to use to regulate franchise brokers and their representatives.

NASAA Model Franchise Broker Registration Act

Section 1: Short Title

Section 2: Definitions

Section 3: Prohibited Practices

Section 4: Registration

Section 5: Disclosure Obligation

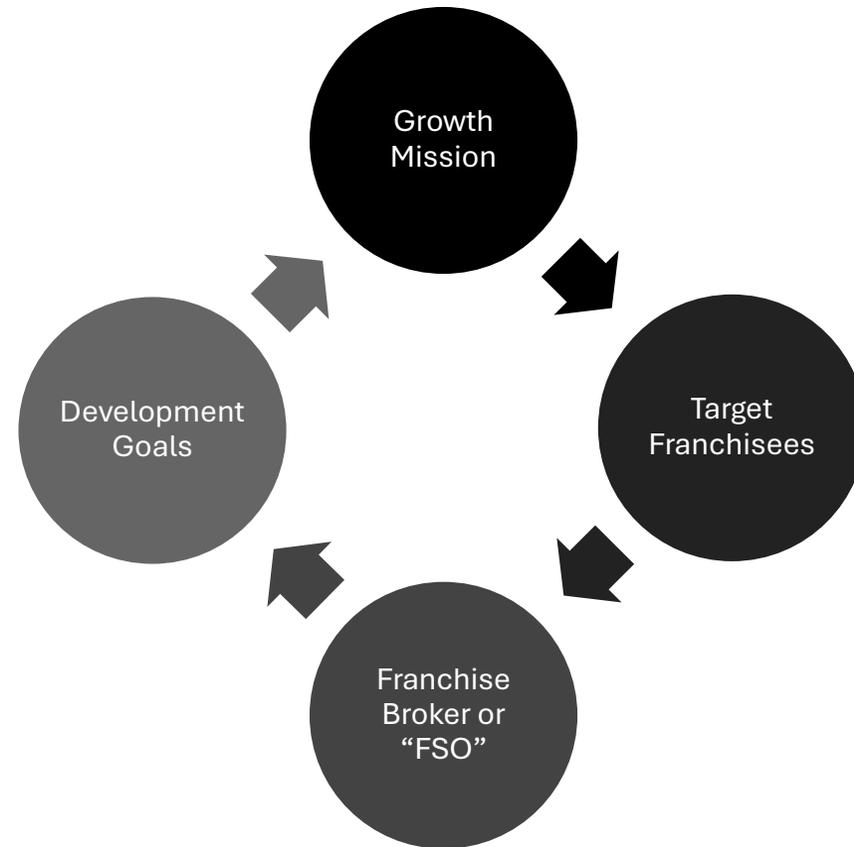
Section 6: Recordkeeping Obligation

Section 7: Obligations of Franchisors and Subfranchisors

Section 8: Fees

Role of the Franchise Broker and Salesperson

- The role of the franchise broker or franchise salesperson is to carry out the growth mission of the franchise.



Franchise Brokers vs. Franchise Sales Organization

- Franchise Brokers: Commonly referred to as Franchise Consultants, match candidates to franchises; usually compensated by franchisors.
- Franchise Sales Organizations “FSO”: help franchise brands find and recruit potential franchisees; provide a larger scope of service; compensation varies.

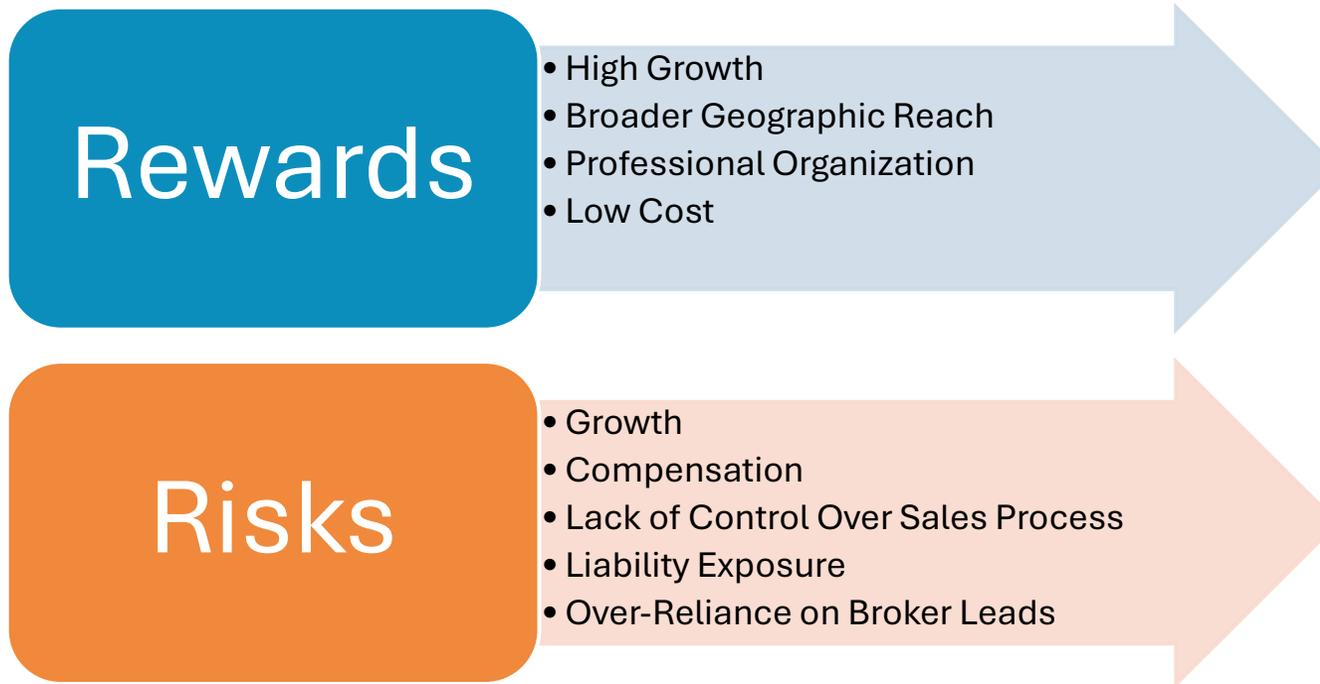
The Franchise Sale Journey

- Awareness → Inquiry → Evaluation → Discovery Day → Decision.
- Brokers typically involved from inquiry through evaluation.

The Do's and Don'ts

DO'S	DONT'S
Third-Party OR In-House	Inadequate Sales and Operations Infrastructure
Due Diligence	The Rogue Broker
Sales Contract	Over Reliance
Compliance Programs	Candidate Screening
Creative Compensations	Growth Mission
Skill Sets	

The Risks and Rewards of Using Franchise Brokers or Franchise Sales Organization



Minimizing Franchisor Liability Exposure

- In-House vs Third Party Franchise Broker
- Broker Due Diligence (i.e. background check, earnings claims, reputation status)
- Marketing Material Review
- Compliance Training
- Franchisor Oversight
- Well-Drafted Contract
 - Scope of Work
 - Development Schedule
 - Exclusivity
 - Indemnification
 - Insurance

Case Law Highlight #1

- Example: Anchored Tiny Homes Franchising, LLC made material omissions and misstatements in its franchise registration application. Specifically, the company failed to disclose critical legal actions and issues involving key personnel, including:
 1. *Failure to disclose prior litigation involving the franchisor or its principals.*
 2. *Omission of regulatory actions or previous violations that could affect the investment decision of prospective franchisees.*
 3. *Misrepresentations in the Franchise Disclosure Document (FDD) that violated California franchise law.*
- Key takeaway: Failure to disclose all material legal and regulatory history in the FDD can result in a Stop order and damage brand credibility.

THE COMMISSIONER OF FINANCIAL PROTECTION AND INNOVATION, ANCHORED TINY HOMES FRANCHISING, LLC., doing business as ANCHORED TINY HOMES
https://dfpi.ca.gov/wp-content/uploads/2024/11/Admin.-Action-Anchored-Tiny-Homes-Franchising_-LLC-Stop-Order.pdf

Case Law Highlight #2

- Example: Burgerim engaged in deceptive sales practices—including misrepresenting income potential, failing to provide accurate disclosures, and misleading franchise prospects.
- Key Takeaway: Violating the Franchise Rule can lead to a permanent sales ban, redress, and penalties.

United States of America vs. BURGERIM GROUP USA, INC., BURGERIM GROUP, INC., OREN LONI, individually and as an officer of Burgerim Group USA, Inc. and Burgerim Group, Inc., - https://www.ftc.gov/system/files/ftc_gov/pdf/burgerim_default_judgment.pdf

The FTC Franchise Rule: An Overview

- Governs franchise sales and disclosures at the federal level.
- Requires FDD (Franchise Disclosure Document) delivery before sale.

Triggers for Legal Liability

- Failing to deliver the FDD properly.
- Misrepresentations during the sales process.

Disclosure Obligations Under FTC Rule

- Franchise Sellers include anyone who offers for sale or sells a franchise.
- Brokers who qualify as franchise sellers, must ensure compliance with disclosure timing.
- Failure to comply may void franchise agreements.

State Law Layer: State-Specific Broker Registration Requirements

- Several states have franchise registration and broker regulations.
- Brokers may face additional obligations depending on the state.
- **California**: Brokers must register and disclose relationships.
- **New York & Washington**: Filing requirements for broker activity.

Best Practices for Brokers

- Regular sales trainings and compliance certifications
- Use checklists to ensure uniformity and compliance
- Ensure all documentation is identified and collected
- Ensure proper contracts are in place, that include indemnity clauses
- Ensure franchisor has proper insurance coverages

IFA's Position & Reform Recommendations

- IFA supports clarity and consistency in broker regulation.
- Encourages federal-state coordination.

Future Outlook: Regulatory Trends

- States likely to increase scrutiny of brokers.
- Possible amendments to FTC Rule regarding broker roles.
- NASAA Model Franchise Broker Registration Act

Q&A

- Open for questions and discussion.

Conclusion & Contact Info

- Thank you for attending!
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