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The Effect of Anti-Waiver Clauses in Franchise Litigation

Ronald K. Gardner
Dady & Gardner, P.A.
Minneapolis, Minnesota

Natalma (Tami) McKnew
Fox Rothschild, LLP
Greenville, South Carolina

DISCLAIMING DISCLAIMERS

The 2007 amended FTC Franchise Disclosure Rule ushered in a limited ban on disclaimers. But, as NASAA remarked in its September 6, 2022 Statement of Policy on the Use of Franchise Questionnaires and Acknowledgments (the SOP)[1], neither that action by the FTC, nor the state anti-fraud and anti-waiver laws halted "the problem of inappropriate uses of franchise questionnaires and acknowledgments in franchise offerings. That observation led to the process that resulted in NASAA's adoption of the SOP, which became effective on January 1, 2023.

In this paper, we will examine the reasoning behind the SOP, the substance of the SOP, and implications of the SOP on state laws, franchisors and franchisees.

I. NASAA rationale

The Statement of Policy itself announces the purpose behind NASAA's adoption. In summary, NASAA saw a need to prevent franchisors from using Questionnaires and Acknowledgments as a way to bypass the anti-waiver provisions of applicable state franchise laws that include anti-waiver clauses.[2] As NASAA notes on the very first page of the Statement of Policy:

> Franchisors routinely seek to use Questionnaires, Acknowledgments, and other forms of contractually required disclaimers to insulate themselves from potential liability by franchisees alleging fraud or misrepresentation in the offer or sale of a franchise. Some have been successful.[3]

Apparently frustrated by the imbalance of power in the negotiating process at the time the Questionnaires are presented, NASAA noted that the signing of a questionnaire

[1] The Statement of Policy is attached as Exhibit 1.
[2] *See, e.g.,* Cal. Corp Code § 31512; Haw. Rev. Stat. § 482E-6; 815 Ill. Comp. Stat § 705/41; Ind. Code § 23-2-2.7-1; Md. Bus. Reg. Code § 14-226; Mich. Comp. Laws § 445.1527(b); Minn. Stat.§ 80C.21; N.Y. Gen. Bus. Law Art. 33 § 687(4); R.I. Gen. Laws § 19-28.1-15; S.D. Codified Laws §37-5B-26(8); N.D. Code § 51-19-16(7); Va. Code Ann. § 13.1-571(c); Wash. Rev. Code § 19.100.180(2); Wis. Stat. § 553.76.
[3] SOP Sec I at 1.

or acknowledgment, regardless of what it said about what had actually happened in the process, was almost a fait accompli, as the SOP states:

> By the time prospective franchisees are presented with a franchise agreement or Questionnaire to sign, many are emotionally and financially invested in completing the transaction. As one commentator has noted, "[N]obody buys a franchise in a vacuum. They typically do so after being convinced of the attractiveness of the brand, the strength and utility of the franchisor's system, the support they would receive from the franchisor, and the enthusiasm they encountered at Discovery Day. None of these factors are a result of reading an FDD."[4]

Acknowledging that Questionnaires and Acknowledgments might have a role in policing the sales process and preventing fraud, NASAA believed that the harm done by Questionnaires and Acknowledgments in allowing franchisors to use them to defeat claims of fraud and misrepresentation regardless of what had happened in the franchise sales process outweighed this putative benefit. Indeed, in the SOP, NASAA cites comments made to FTC, where franchisees have candidly admitted that they changed their answers to the Questionnaires and Acknowledgments because they knew that if they answered honestly, they would not be able to go through with the sale that they had been convinced was best for them.[5]

After examining the purpose of state franchise disclosure laws, the SOP points out that a disclaimer, at the end of the day, does nothing more than attempt to change the legal effect of what actually happened in the sales process. The SOP cited the court here:

> The disclaimer cannot change the historical facts; if the dishonest franchisor made misrepresentations, then he made misrepresentations, no matter what the franchise agreement says. Thus, the disclaimer can only be an attempt to change the *legal effect* of those misrepresentations. That is precisely what anti-waiver language forbids.[6]

Based on this background, NASAA concluded that Questionnaires and Acknowledgments violated state anti-waiver provisions when they were used as

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[4] SOP Sec. I at 2.
[5] SOP at n.4.
[6] Citing to *Lady of America v. Randall*, 532 F. Supp. 2d 1071, 1088-89 (D. Minn 2007).

contractual disclaimers that release or waive a franchisee's rights under state franchise law. As NASAA put it:

> Courts that have found otherwise have not recognized or appreciated the history or purpose of the state franchise registration and disclosure laws. The state legislatures have enacted these franchise laws intended to protect franchisees from the effect of contractual disclaimers, including those that may take the form of Questionnaires and Acknowledgments.[7]

As a result of the foregoing, the Statement of Policy was adopted and is now the guidance that NASAA provides to its members regarding how Questionnaires and Acknowledgments should be treated.

Turning then to the specifics of the guidance, NASAA outlines what the inappropriate uses of Questionnaires and Acknowledgments are.

II. The Statement of Policy and State Adoption

Among the inappropriate uses of Questionnaires and Acknowledgments cited by NASAA in the SOP are that (a) franchisors can later use these vehicles to defeat claims of fraud or misrepresentation regardless of what actually occurred; (b) they shift the burden of compliance from franchisors to prospective franchisees; (c) they insulate franchisors from claims of fraud or misrepresentation by franchisees. NASAA also cited the varying approaches to enforcement of extant state anti-fraud and anti-waiver laws; in some states, despite the enactment of such laws, courts have afforded preclusive effect to disclaimers[8] in Questionnaires, Acknowledgments and in the franchise agreement.

In response to these issues and observations, NASAA adopted the SOP, the dictates of which are two:

First, "The Franchisor and its Franchisee seller(s) shall not require the Prospective franchisee to make any statement in any Questionnaires, Acknowledgements or similar documents that is subjective or unreasonable that:

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[7] SOP Sec. I at 4.

[8] The SOP focuses on the potential legal effect of Questionnaires and Acknowledgements as waiving or disclaiming sources of franchisor liability. Those effects are referred to as "disclaimers."

A. Would cause a reasonable Prospective franchisee to surrender or believe that they have surrendered rights to which they are entitled under federal or state law;

B. Would have the effect of shifting Franchisor's disclosure duties under federal or state law to the Prospective franchisee; or

C. Are otherwise Prohibited Statements under this Statement of Policy or are similar to the Prohibited Statements."[9]

The SOP then provides a specific list of eleven prohibited statements.

Second, "Franchisor must include in its FDD and franchise agreement, or applicable statement-specific addenda to the FDD and franchise agreement, the following provision:

> 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, including fraud in the inducement, or (ii) disclaiming reliance on any statement made by the franchisor, franchisee seller, or other person acting on behalf of the franchisor. This provision supersedes any other term of any document executed in connection with the franchise."[10]

In essence, the franchisor must disclaim the (potentially preclusive) legal effect of all disclaimers.

Adoption of NASAA Statements of Policy by the states is discretionary. However, since the FTC anointed NASAA as authoritative in the manner of compliance with the Franchise Disclosure Rule, NASAA's Guidelines have become authoritative. States with registration and disclosure laws will move quickly to adopt the SOP. Indeed, as of mid-February, California had already amended its Franchise Investment Law,[11] Washington had initiated the procedure to do likewise, and Maryland had administratively adopted the SOP.[12]

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[9] SOP Sec. II(C)(1) at 6.
[10] SOP Sec. II(C)(3) at 7.
[11] AB 676, adopting the SOP, was signed into law on September 29, 2022.
[12] Washington initiated process of statutorily adopting the SOP with a Notice of the proposed action on January 23, 2023 and requesting public comment; on January 23,

Adoption of the precepts of the SOP will be slower in states without franchise registration and disclosure laws. In those states, state unfair trade practice or "baby FTC" statutes are common vehicles for claims of inadequate compliance with the Franchise Disclosure Rule; those laws typically crave reference to FTC regulations.[13] This circuitous route leads to adoption of NASAA policy pronouncements in franchise cases.

Cross-pollination may ultimately affect state and federal jurisprudence in non-franchise applications, although adoption of the principles of the SOP beyond the franchise arena may not be inevitable. The SOP's preamble describes, but does not limit, its applicability to: "Questionnaires, Acknowledgments, and similar documents that appear in FDDs and applicable attachments and exhibits used in the offer and sale of franchises where an Anti-Waiver Provision or Anti-Fraud Provision applies to the offer or sale."[14] However, the FTC Disclosure Rule applies nationwide, regardless of the presence or absence of state anti-waiver or anti-fraud laws, and franchise jurisprudence is routinely applied to distribution disputes, *e.g.,* dealerships and business opportunities. Whether the SOP's condemnation of disclaimers overtakes decades of state principles affecting waiver and disclaimers in other contexts is an open question.

III. Implications and Issues

On a macro level, the SOP levels the playing field as between franchisor and franchisee, and firmly places the onus of compliance on franchisors. Implementation of the SOP should end the frustrating evisceration of state laws bemoaned by NASAA in the SOP, citing examples such as *Governara v. 7 Eleven, Inc.,* 2014 WL 4476534 (S.D.N.Y. Aug. 20, 2014) and others. It obstructs a path widely used by franchisors to escape liability and restores the vigor of state anti-waiver and anti-fraud laws.

What is a disclaimer?

2023, the Maryland Securities Commission issued an Interpretive Opinion adopting the SOP.

[13] As one typical example, South Carolina's Unfair Trade Practices Act, S.C. Code §39-5-20 provides: (a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful. (b) It is the intent of the legislature that in construing paragraph (a) of this section the courts will be guided by the interpretations given by the Federal Trade Commission and the Federal Courts to Section 5(a) (1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended." *See,* also, *Cluck-U Chicken, Inc. v. Cluck-U Corp.,* 358 F.Supp.3d 1295 (M.D. Fla. 2017) (applying Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. Sec. 501.204(1).

[14] SOP Sec. II at 5.

A crucial issue is the definition of disclaimer, which will be determined by state regulators in the registration process and by courts or arbitrators in legal proceedings. There is clarity in the list of eleven specifically-prohibited statements,[15] but less-specific prohibitions invite argument. Consider the following:

- Franchisor shall not require a prospective franchisee to make any statement "that is subjective or unreasonable."[16]

- Franchisor shall not require a prospective franchisee that would cause the prospective franchisee to "surrender or believe that they have surrendered rights to which they are entitled under federal or state law."[17]

- Franchisor shall not require statements that are "similar to the Prohibited Statements."[18]

Each of these prohibitions invites broad interpretation. As the SOP is put into practice, the parameters of these prohibitions likely will be clarified, in the first instance by state regulators. For franchisors seeking state registration, the practical answer is that the definition of disclaimer is whatever the regulator says it is.

The issue becomes more acute in litigation or arbitration, where factfinders and jurists will decide the issue. Any statement that is not specifically listed as a "Prohibited Statement" will likely be the subject of intense disagreement, even statements that are not franchise-related. For instance, consider the following common provisions in commercial contracts:

- [Franchisee] disclaims any warranty of merchantability or fitness for a particular purpose.

- The parties waive their right to a trial by jury.

- Claims shall be brought individually and not as a class.

[15] SOP Sec. II(C)(2)(a) – (k) at 6-7.
[16] SOP Sec. II(C)(1) at 6.
[17] SOP Sec. II(C)(1)(a) at 6.
[18] SOP Sec. II(C)(1)(c) at 6.

· The parties agree that the state of [ ] shall be the sole and exclusive jurisdiction and venue for the resolution of disputes.

· [Franchisee] agrees that franchisor shall not be required to post bond.

Each of the above provisions, which routinely appear in franchise agreements, would cause franchisees to "surrender or believe that they have surrendered rights to which they are entitled under federal or state law." They may not be the target of the SOP, yet the language of the SOP would appear to negate their effect.

In states without franchise-specific statutes, the precepts of the SOP will likely conflict with well-established common law principles of contract construction,[19] resulting in a potential discrepancy among the states regarding the legal effect of disclaimers and waivers in questionnaires, acknowledgments and franchise agreements. State common law reflects a wide variation in the preclusive effect afforded disclaimers and waivers. While disclaimers and waivers are less likely to be afforded preclusive effect in fraud-based claims than in breach of contract and other non-fraud claims,[20] it is difficult to perceive a predictable pattern much less any consistency.

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[19] Those general contractual principles are reflected in the cases cited in the SOP upholding contractual waivers and disclaimers despite the state's anti-waiver and anti-fraud statutes. See, *e.g., Governara v. 7 Eleven, Inc.,* 2014 WL 4476534 *6 (S.D.N.Y. Aug. 20, 2014 (dismissal granted to franchisor, court noting "Because the NYFA does not give franchisees the statutory right to purchase a franchise *while relying on verbal representations outside of a written contract,* the Agreement's non-reliance disclaimer is not proscribed *per se* by the NYFA. *See Emfore,* 51 A.D.3d at 435 (holding that the non-reliance disclaimer was "not violative of [NYFA] § 687(4) and (5) on its face"). Moreover, contrary to *Draper,* Plaintiffs do not allege that they were compelled or "require[d] ... to assent to a release, assignment, novation, waiver or estoppel ...." N.Y. Gen. Bus. Law § 687(5);" *Emfore v. Blimpy Assoc., Ltd.,* 51 A.D. 3rd 434 (N.Y. App. Div. 2008) (affirming dismissal of franchisee's fraud claims based on contractual disclaimers, noting "the disclaimers were not generalized boilerplate exclusions, but were contained in a separate rider, which plaintiff's principal read and initialed, stating specifically that she was not relying on any representations by defendants (citations omitted), but enforcing state anti-fraud law by rejecting franchisor defense of waiver via questionnaire).

[20] *See, e.g., Slack v. James,* 364 S.C. 609 (S.C. 2005) (disclaimer did not preclude fraud); *L and E Corp. v. Days Inn of America, Inc.,* 992 F. 2d 55 (4th Cir. 1993) (court reversing district court's finding of enforceable agreement based on disclaimer by potential franchisee); *Creative American Education, LLC v. The Learning Experience Systems, LLC,* 2015 WL 2218847 (S.D. Fla. May 11, 2015) (disclaimer and merger clause precluded misrepresentation claims, but did not preclude statutory, breach of contract or rescission claims); *Sherman v. Ben & Jerry's Franchising, Inc.* 2009 WL2462539 (D. Vt.

Importantly, where the SOP is adopted and implemented, disclaimers and acknowledgements may continue to have *evidentiary* but not *preclusive* effect. Prior to issuance of the SOP, courts that have declined to dismiss cases based on disclaimers have nevertheless recognized their evidentiary value. As the district court explained in *Cluck-U Chicken, Inc. v. Cluck-U Corp.,* 358 F. Supp. 3d 1295, 1311 (M.D. Fla. 2017):

> The disclaimers in the franchise disclosure document and the franchise agreement remain factually relevant and may persuade the jury on the issues of materiality of the alleged misrepresentations and omissions and the reasonableness of [franchisee's] reliance on them.[21]

In *MTR Capital, LLC v. LaVida Massage Franchise Development, Inc.,* 2020 WL 6536954 at *8 (E.D. Mich. Nov. 6, 2020) the court similarly noted:

> [A]n integration clause [may constitute] evidence[ ] that neither party has relied upon the representation of the other party made prior to the execution of the contract.

An easily predicted result of the SOP is more protracted, hence more expensive, franchise litigation and arbitration. Early dispositive actions, in particular dismissal on the pleadings, will be far less likely as exposition of the facts will not be cut short by contractual disclaimers. The scope of the SOP and the concept of "disclaimer" mature is likely to mature in the process of litigation, and in the process state common law could incorporate some of the precepts of the SOP.

What tools are left for franchisor?

Aug. 10, 2009) (court commenting that merger clauses and disclaimers "will not, as a rule preclude a claim of fraudulent inducement," yet finding that explicit disclaimers barred franchisee claims of fraudulent inducement, fraudulent non-disclosure, fraud, negligent misrepresentation and estoppel); *Legacy Academy, Inc. v. Mamilove, LLC,* 297 Ga. 15 (2015) (merger clause precluded fraud, negligent misrepresentation and RICO claims); *G6 Hospitality v. HI Hotel Group, LLC,* 2015 WL 224679 (M.D. Pa. Jan. 15, 2015) (disclaimers precluded good faith and fair dealing claim); *Dickey's Barbeque Pit, Inc.,* 2015 WL 11199080 (E.D. Tx. Sept. 18, 2015) (disclaimer barred franchisee's misrepresentation and fraudulent inducement claims); *Rocky Mountain Chocolate Factory, Inc. v. SDMS, Inc.,* 2009 WL 579516 (D. Co. March 4, 2009) (Item 19 disclaimers barred fraud counterclaim).

[21] Citing *Long John Silver's, Inc. v. Nickleson,* 923 F. Supp. 2d 1004, 1018 (W.D.Ky. 2013). One example of successful evidentiary use of a disclaimer is *Rivermont Inn, Inc. v. Bass Hotel Resorts, Inc.,* 113 S.W.3d 636 (Ky. App. 2003) (summary judgment granted based on lack of reasonable reliance in light of contractual disclaimer).

NASAA acknowledged franchisor's legitimate interest in monitoring the franchise sales process and ensuring that the franchisee understands and accepts the Franchise Agreement as written. How might franchisors address those concerns post-SOP?

· Careful wording

Informal written communications, *e.g.,* emails, with a prospective franchisee, such as "Did you read the FDD? Do you have any questions about it or anything (the salesperson) told you?"

· Informal conversation with franchisee about the sales process and his/her understanding.[22]

Utility depends on what the franchisor wants to achieve and what to risk. Is the desire to monitor the sales process only secondary to the desire to create a preclusive disclaimer? These approaches may (more or less effectively) monitor the sales process and perhaps give the franchisor an opportunity to correct any misunderstandings. But the franchisor must be willing to forego a sale if franchisee communications expose serious issues. These communications, even with optimal answers by franchisees, will not ensure a preclusive disclaimer; it is not difficult to believe that they would be considered "similar document[s],"[23] to which the SOP applies. The same would be true of a recorded conversation with a prospective franchisee.

And what do franchisees and their lawyers do with this development?

Of equal interest is how franchisees and their lawyers will use this new Statement of Policy in their efforts to establish the fraudulent sale of a franchise.

From a franchisee lawyer's perspective, what gets lost in the initial hysteria of a change like this from the franchisor bar is the difficulty that exists that establishing a fraud claim presents even in the absence of a Questionnaire or Acknowledgement.

Obviously, franchisees who have previously signed Questionnaires or Acknowledgments, will have to be able to credibly explain why they answered the Questionnaire or signed the Acknowledgment in a manner that is inconsistent with the facts that they are now claiming. This will put a high premium on the franchisee's credibility in making this claim. As a result, franchisors and their lawyers should take

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[22] A transcript of the conversation must be provided to the prospective franchisee. SOP Sec. II(B)(2), at 6.
[23] SOP Sec. II(C)(1) at 6.

some solace in the fact that there will be fertile ground for cross-examination and the ability to cast doubt on the franchisee's truthfulness.

On the flip side, however, franchisees will also have the opportunity to examine the franchisor and their salespeople for their truthfulness without having claims dismissed before any discovery taking occurs. And the other multiple elements of a fraud claim that have to be established in order to prevail should not be overlooked – besides the question of whether or not the alleged misrepresentation was actually made, franchisees will also have to establish that the allegation was material, that they reasonably relied upon it, that their reliance caused them to actually act or forbear in some manner, and that act or forbearance resulted in a direct economic harm.

Conclusion

The authors agree that the Statement of Policy will likely become the law of the land, particularly in registration states, in fairly short order. It is also likely to spawn court decisions that will then potentially spread to non-registration states, where the SOP may become a factor in common law fraud or statutory claims – particularly in states with little FTC Acts with significant reference to the FTC Rule.

The authors also agree that the SOP will likely lead to an increase in litigation. But, it seems from NASAA's point of view, that is exactly the point. Franchisees who have been legitimately defrauded, but have been unable to bring these claims because of the Questionnaires and Acknowledgments that they were induced to sign as part of the purchase of the franchise, should, from NASAA's point of view, have their day in court. So, while the SOP may lead to more litigation, it appears that NASAA's objective is that while that may be true, it will also lead to less fraud – a more desirable outcome than decreasing litigation simply for the sake of allowing franchisors to do and say whatever they feel they need to say during the sales process with near impunity. As the old Chinese proverb goes, may you live in interesting times.

NASAA STATEMENT OF POLICY REGARDING THE USE OF FRANCHISE QUESTIONNAIRES AND ACKNOWLEDGMENTS

(Adopted September 18, 2022; Effective January 1, 2023)

I. Introduction

This Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments was prepared by the Corporation Finance Section ("Section") and the Franchise and Business Opportunities Project Group ("Project Group") of the North American Securities Administrators Association, Inc. ("NASAA") to set standards for the proper use of questionnaires and acknowledgments in franchise offerings.

Background

Federal and applicable state franchise laws require a franchisor to make certain pre-sale disclosures to prospective franchisees. The disclosures are made with a Franchise Disclosure Document ("FDD") consisting of 23 items of information, with applicable attachments, including the franchise and other related agreements.

Over at least the last 30 years, franchisors have included in their franchise agreements and FDDs language that they can later use as a disclaimer of liability. One type of disclaimer takes the form of a series of acknowledgments ("Acknowledgments") in the franchise agreement regarding the franchise offering. In addition, many—but not all—franchisors require prospective franchisees, at or prior to signing a franchise agreement, to mark "yes" or "no" to a series of questions or agree to a series of representations about what purportedly occurred, or did not occur, in the franchise sales process ("Questionnaires"). Virtually all Questionnaires and Acknowledgments address whether a prospective franchisee received some type of financial performance information different from what the franchisor disclosed in Item 19 of its FDD.

Franchisors routinely seek to use Questionnaires, Acknowledgments, and other forms of contractually required disclaimers to insulate themselves from potential liability by franchisees alleging fraud or misrepresentations in the offer and sale of a franchise.[1] Some have been successful.[2]

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[1] *See*, *e.g., Martrano v. Quizno's Franchise Co.*, No. 08-cv-0932, 2009 WL 1704469, at *5 (W.D. Pa. June 15, 2009) ("Defendants pointedly assert, in their December 2008 Motion before this Court, that 'Each Plaintiff was asked directly to disclose any representation he had received other than those contained in the UFOC. In the space provided, each and every one of the plaintiffs wrote 'None'.'"); *Siemer v. Quizno's Franchise Co.*, No. 07-cv-2170, 2008 WL 904874 (N.D. Ill. Mar. 31, 2008) (franchisor's defense based in part on disclosure acknowledgment statement through which franchisee was put on notice of potential business risks).

[2] *E.g., Governara v. 7 Eleven, Inc*., No. 13-cv-6094, 2014 WL 4476534 (S.D.N.Y. Aug. 20, 2014) (granting franchisor's motion to dismiss plaintiff's claims under the anti-fraud provisions of the New York Franchise Act based in part on non-reliance disclaimers executed by the plaintiff).

The Practical Effect of Acknowledgments and Questionnaires

By the time prospective franchisees are presented with a franchise agreement or Questionnaire to sign, many are emotionally and financially invested in completing the transaction. As one commenter has noted, "[N]obody buys a franchise in a vacuum. They typically do so after being convinced of the attractiveness of the brand, the strength and utility of the franchisor's system, the support they will receive from the franchisor, and the enthusiasm they encountered at Discovery Day. None of these factors are the result of reading an FDD."[3]

Questionnaires and Acknowledgments are not the most effective mechanisms for preventing fraud.[4] They are, however, powerful defense mechanisms that franchisors can use to defeat claims of fraud and misrepresentation regardless of what has occurred in the franchise sales process. As a result, Questionnaires and Acknowledgments can allow unscrupulous franchisors to avoid the consequences of franchise fraud. Although at least one court has opined that Questionnaires and Acknowledgments can be useful to help franchisors "root out dishonest sales personnel and avoid sales secured by fraud,"[5] they do so by shifting the compliance burden from franchisors to prospective franchisees. It should be the franchisor's burden to police its own sales personnel and agents; franchisees should not have to confirm that no violations of law have occurred during their own sales process.

The FTC Franchise Rule's Position on Franchise Waivers, Disclaimers and Questionnaires

In 2007, the Federal Trade Commission ("FTC") promulgated an amended FTC Franchise Rule that included a limited ban on disclaimers made in the FDD itself and its exhibits or attachments. When the FTC promulgated the FTC Franchise Rule, it did not specifically address a franchisor's use of Questionnaires or the effect of Acknowledgments on franchisee fraud claims. In 2019, the FTC announced it was soliciting public comments on the FTC Franchise Rule. One issue the FTC raised related to the impact the FTC Franchise Rule has had on the flow of truthful information and on the flow of deceptive information to prospective franchisees.[6]

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[3] S. Dub, B. Napell, D. Oates, "Dueling Perspectives on Selected Franchise Agreement Provisions," American Bar Association 43rd Annual Forum on Franchising, at 20 (October 27-30, 2020), available at https://www.americanbar.org/content/dam/aba/events/franchising/2020/w18.pdf.

[4] *See, e.g., Braatz v. Red Mango,* 2015 WL 1893194 (N. D. Tex. Apr. 27, 2015), aff'd sub nom. *Braatz, L.L.C. v. Red Mango FC, L.L.C.*, 642 F. App'x 406 (5th Cir. 2016) (Franchisees allege they changed their answers in Questionnaire about receiving financial information because the franchisor told them that they could not open the franchise without the Questionnaire being completed in the form the franchisor required); Comment of Anonymous, posted by the FTC on December 10, 2020 ("While I signed a questionnaire saying I didn't rely on information outside of that disclosure document, that was not true, however, I knew that would preclude me from making the franchise purchase if I answered truthfully"), available at: https://www.regulations.gov/comment/FTC-2020-0064-0042.

[5] *See Emfore Corp. v. Blimpie Assocs., Ltd.,* 51 A.D.3d 434, 435 (N.Y. App. Div. 2008).

[6] *See* Disclosure Requirements and Prohibitions Concerning Franchising, Federal Trade Commission, 84 Fed. Reg. 49 (Mar. 13, 2019), available at: https://www.govinfo.gov/content/pkg/FR-2019-03-13/pdf/2019-04466.pdf.

In the years since the FTC promulgated the FTC Franchise Rule, Questionnaires and Acknowledgments have become commonplace in franchising, and some commenters have argued that the FTC should now address or even prohibit them. Those commenters point out that Questionnaires and Acknowledgments limit a franchisee's ability to hold a franchisor accountable for fraud and deceit, irrespective of the underlying facts of a franchisee's claims.[7]

Although the FTC held a public workshop in 2020 to explore issues related to both Questionnaires and Acknowledgments,[8] the FTC has not yet directly addressed whether or when those provisions violate the FTC Franchise Rule.

The Impact of State Franchise Law Provisions

Several states have enacted franchise registration and disclosure laws that include protections for prospective franchisees that are not found in the FTC Franchise Rule. [9] Modeled on securities anti-fraud laws, these state franchise laws include provisions that prohibit any person from committing fraud, making untrue statements of material fact, or omitting to state a material fact regarding a franchise offering ("Anti-Fraud Provisions"). Most of those same statues also include provisions ("Anti-Waiver Provisions") that prohibit or render void any provision or condition requiring a prospective franchisee to agree to a release, waiver or estoppel that would relieve a person from liability under that law.[10]

Although not all courts agree, many courts have concluded that franchise contractual disclaimers, including Questionnaires and Acknowledgments, violate state Anti-Waiver Provisions when they serve as a release or waiver of a franchisee's rights under a state franchise law.[11] For example, in *Randall v. Lady of America*, the franchisor argued in a motion for

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[7] *See, e.g.,* Comment from Bundy Law Firm, PLLC, at pp 7-9, posted by the FTC on December 21, 2020, https://www.regulations.gov/comment/FTC-2020-0064-0118; comment from Lagarias, Napell & Dillon, LLP, at pp. 8-14, posted by the FTC on December 17, 2020, https://www.regulations.gov/comment/FTC-2020-0064-0077.

[8] A transcript of the November 20, 2020, workshop is available at: https://www.ftc.gov/system/files/documents/videos/reviewing-franchise-rule-workshop-discussion-disclaimers-waivers-questionnaires/franchise_rule_workshop_transcript_-_discussion_of_disclaimers.pdf.

[9] *See* Cal. Corp. Code §§ 31000 through 31516; Haw. Rev. Stat. § 482E-1 through § 482E-12; 815 Ill. Comp. Stat. §§ 705/1 through 705/44 ; Ind. Code §§ 23-2-2.5; Md. Bus. Reg. Code §§ 14-201 through 14-232; Mich. Comp. Laws §§ 445.1501 through 445.1546; Minn. Stat. §§ 80C.01 through 30C.22; N.Y. Gen. Bus. Law Art. 331 §§ 680, et seq.; N.D. Cent. Code §§ 51-19-01 through 51-19-17; R.I. Gen. Laws §§ 19-28.1-1 through 19-28.1-34; S.D. Codified Laws §§ 37-5B-1 through 37-5B-53; Va. Code Ann. §§ 13.1-557 through 13.1-574; Wash. Rev. Code §§ 19.100.010 through 19.100.940; Wis. Stat. §§ 553.01 through 553.78.

[10] *See* Cal. Corp Code § 31512; Haw. Rev. Stat. § 482E-6; 815 Ill. Comp. Stat § 705/41; Ind. Code § 23-2-2.7-1; Md. Bus. Reg. Code § 14-226; Mich. Comp. Laws § 445.1527(b); Minn. Stat.§ 80C.21; N.Y. Gen. Bus. Law Art. 33 § 687(4); R.I. Gen. Laws § 19-28.1-15; S.D. Codified Laws §37-5B-26(8); N.D. Code § 51-19-16(7); Va. Code Ann. § 13.1-571(c); Wash. Rev. Code § 19.100.180(2); Wis. Stat. § 553.76.

[11] *See Coraud LLC. v. Kidville Franchise Co., LLC,* 109 F. Supp. 3d 615, 621 (S.D.N.Y. 2015) ("[New York's anti-waiver statute] bars anticipatory waivers of compliance with the NYSFA's anti-fraud provisions."]); *Hanley v. Doctors Express Franchising*, *LLC*, No. 12-cv-794, 2013 WL 690521, at *29 (D. Md. Feb. 25, 2013) ("Construed as waivers of plaintiffs' misrepresentation claims under the Maryland Fraud Law, the disclaimers are legally void."); *Randall v. Lady of Am. Franchise Corp.*, 532 F. Supp. 2d 1071, 1089 (D. Minn. 2007) (holding that a disclaimer that

summary judgment that a contractual integration clause and certain disclaimers were sufficient to defeat a franchisee's claims under Minnesota's Franchise Act. The court disagreed, holding that the Anti-Waiver Provision of the Minnesota Franchise Act invalidated the contractual disclaimers. The court reasoned that the historical truth of a franchisor's misconduct (in this case, that the franchisor made unlawful earnings claims) could not be negated by a contractual disclaimer without violating the Anti-Waiver Provision. The court explained:

> The disclaimer cannot change the historical facts; if the dishonest franchisor made misrepresentations, then he made misrepresentations, no matter what the franchise agreement says. Thus, the disclaimer can only be an attempt to change the *legal effect* of those misrepresentations. That is precisely what [the Minnesota] anti-waiver language forbids.[12]

Similarly, in *Hanley v. Doctors Express,* the court held that disclaimers and acknowledgments contained in a franchise agreement and FDD were legally inoperative to bar a franchisee's claims under the Maryland Franchise Law based on the Anti-Waiver Provision of that law to the extent that they would operate as a release, waiver, or estoppel.[13] The court relied, in part, on the statement of purpose for the Maryland Franchise Law, which was enacted in response to substantial losses suffered by franchisees when the franchisor or its representatives had not given complete information. The court noted that, given the Maryland General Assembly's clear statement of intent, waivers and releases of a plaintiff's rights under the Maryland franchise laws are void as such clauses violate a fundamental policy of the state.[14]

In the opinion of the Section and the Project Group, Questionnaires and Acknowledgments violate state Anti-Waiver Provisions when they are used as contractual disclaimers that release or waive a franchisee's rights under a state franchise law. Courts that have found otherwise have not recognized or appreciated the history and purpose of state franchise registration and disclosure laws. The state legislatures that enacted these franchise laws intended to protect franchisees from the effect of contractual disclaimers, including those that may take the form of Questionnaires and Acknowledgments. The prospective franchisee who signs a Questionnaire or series of Acknowledgments and later denies the accuracy of what was signed would have to explain such a discrepancy, but they should have that opportunity before a factfinder, rather than have their claims dismissed based solely on having signed a Questionnaire or series of Acknowledgments.

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has the effect of waiving compliance with the anti-fraud statute's prohibition of material false statements is void under the anti-waiver statute); *but see Governara*, 2014 WL 4476534, at *6-7 (holding anti-waiver statute did not void contractual reliance disclaimer; declined to follow by *Coraud*).

[12] *Randall,* 532 F. Supp. 2d. at 1088-89.

[13] *Hanley,* 2013 WL 690521 at *29 (the court noted that integration clauses and waivers are not necessarily wholly irrelevant, citing the issue of reliance).

[14] *Id.* (citations omitted).

Inappropriate Questionnaire and Acknowledgment Provisions

State regulators have observed that Questionnaires and Acknowledgments currently found in some FDDs and franchise agreements are replete with questions and representations that serve no legitimate purpose. Many Questionnaires and Acknowledgments require a prospective franchisee to acknowledge or answer questions that are subjective, unreasonable, or repeat disclosures required to be stated in the FDD. In some cases, Questionnaires require the prospective franchisee to acknowledge identical facts and statements that the franchisee must acknowledge a second time in the franchisor's franchise agreement. In other cases, these Questionnaires and Acknowledgments require prospective franchisees to agree that they understand specific disclosures made in an FDD or the terms of the franchise relationship. These provisions are inconsistent with plain English standards and the legislative policies behind state franchise laws, which were passed to protect prospective franchisees by requiring presale disclosure. State franchise laws do not allow FDDs to be used as a defense documents that serve to protect franchisors who commit fraud or make misleading material disclosures or material omissions.

II. Application of the Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments

This Statement of Policy applies to Questionnaires, Acknowledgments, and similar documents that appear in FDDs and applicable attachments and exhibits used in the offer and sale of franchises where an Anti-Waiver Provision or Anti-Fraud Provision applies to the offer or sale.

A. Definitions

This Statement of Policy uses the following terms defined in the NASAA 2008 Franchise Registration and Disclosure Guidelines.

Franchisee - Franchisee means any person who is granted a franchise.

Franchise seller - Franchise seller means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

Franchisor - Franchisor means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a "subfranchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

Person - Person means any individual, group, association, limited or general partnership, corporation, or any other entity.

Prospective franchisee - Prospective franchisee means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.

B. Attachment to FDD

1. If the Franchisor requires the Prospective franchisee to sign any Questionnaires, Acknowledgments, or similar documents before entering into the franchise agreement, the proposed form of such Questionnaires, Acknowledgments or similar documents must be referenced in Item 22 of the FDD and attached as an exhibit.

2. If the Franchisor requires the Prospective franchisee to verbally respond to any Questionnaires, Acknowledgments, or similar statements on video or other electronic media recording before entering into the franchise agreement, a written script of the proposed form of such Questionnaires, Acknowledgments or similar statements must be referenced in Item 22 of the FDD and attached as an exhibit.

C. Prohibited Provisions in Questionnaires and Acknowledgments

1. The Franchisor and its Franchise seller(s) shall not require the Prospective franchisee to make any statement in any Questionnaires, Acknowledgments, or similar documents that is subjective or unreasonable or that:

   a. Would cause a reasonable Prospective franchisee to surrender or believe that they have surrendered rights to which they are entitled under federal or state law;
   b. Would have the effect of shifting Franchisor's disclosure duties under federal or state law to the Prospective franchisee; or
   c. Are otherwise Prohibited Statements under this Statement of Policy or are similar to the Prohibited Statements.[15]

2. Prohibited Statements in Questionnaires, Acknowledgments, and similar documents include, but are not limited to, the following:

   a. That the Prospective franchisee has read or understands the FDD or any attachments thereto, including the franchise or other agreement.
   b. That the Prospective franchisee understands or comprehends the risks associated with the purchase of the franchise.
   c. That the Prospective Franchisee is qualified or suited to own and operate the franchise.
   d. That, in deciding to purchase the franchise, the Prospective franchisee has relied solely on the FDD and not on any other information, representations, or statements from other Persons or sources.

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[15] This Statement of Policy is not intended to prohibit a Franchisor from conducting factfinding or asking Prospective franchisees questions about the sales process, but Franchisors may not require a Prospective franchisee to document and sign statements that act as waivers in violations of state law.

e. That neither Franchisor nor Franchise seller has made any representation, including any financial performance representation, outside of or different from the FDD and attachments thereto.
f. That the success or failure of the franchise is dependent solely or primarily on Franchisee.
g. That the Franchisor bears no liability or responsibility for Franchisee's success or failure.
h. That reiterates or duplicates any representation or statement already made elsewhere in the FDD and attachments thereto.
i. That the Prospective franchisee has had the opportunity to or has/has not actually consulted with professional advisors or consultants or other franchisees.
j. That the Prospective franchisee agrees or understands that the Franchisor is relying on the Questionnaires, Acknowledgments, or similar documents, including to ensure that the sale of the franchise was made in compliance with state and federal law or that no unauthorized, inaccurate, or misleading statements were made.
k. That requires or suggests that the Prospective franchisee must agree to any Questionnaires, Acknowledgments, or similar documents prohibited by this Statement of Policy or provide false answers as a condition to the purchase of the franchise.

3. Franchisor must include in its FDD and franchise agreement, or applicable state-specific addenda to the FDD and franchise agreement, the following provision:

   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, including fraud in the inducement, or (ii) disclaiming reliance on any statement made by any franchisor, franchise seller, or other person acting on behalf of the franchisor. This provision supersedes any other term of any document executed in connection with the franchise.