

June 6, 2024

To: Theresa Leets, Chair of the Project Group
Bill Beatty, Co-chair of the Section
Erin Houston, Co-chair of the Section

Re: Public Comments on Proposed NASAA Model Franchise Broker Registration Act

Good day,

My name is Jeff Elgin and I am the Founder and CEO of a franchise referral network company, FranChoice, Inc., which will be affected by this proposed new broker registration act. We have been in business for almost 25 years and in that time we have referred about two hundred thousand prospective franchisees to franchise companies in the United States. Before I started FranChoice, I was a senior development executive in the franchise industry and also a multi-unit franchisee in the video rental store business back in the 1980's.

My extensive franchising experience has taught me the value of requiring the disclosure of pertinent information to prospective franchisees so that they can make the best informed decision possible when obtaining a franchise opportunity for themselves. For this reason I agree with the sentiment that additional disclosure related to brokers working in franchise sales process may very well provide a benefit greater than the cost and effort required to comply with any new disclosure requirements, so I support your efforts.

After reviewing the published draft of the NASAA Model Franchise Broke Registration Act, I would like to offer a few comments that I hope might help to clarify our understanding of some of the terms in the proposal and also to help avoid what I foresee as potential challenges related to compliance with this proposal. Please consider the following:

1. Section 2: Definitions – sub-points (3) and (4). I'm not at all clear on the distinction between a "franchise broker" and a "franchise broker representative" or the purpose to be served by creating this differentiation. It would be very helpful if you could provide one or more examples of a type of person or examples of a person's activities that would put someone into the classification of a "franchise broker representative" rather than a "franchise broker", and/or if you could provide further explanation about your purpose for creating this distinction in the proposal.
2. Section 3: Prohibited Practices – sub-points(3) and (4). I'm not sure how a franchisor is supposed to verify the information, both on an initial and ongoing basis, that would be necessary for the franchisor to ensure compliance with these two requirements without creating a cumbersome and expensive new burden on the franchisor. I fully understand the requirement of brokers to register, and the potential penalties to them if they don't, but I'm not sure why we need to use franchisors to help police compliance by brokers. There are literally thousands of people who will fall under this broker classification. There are dozens of new ones that join existing referral or sales companies every month and likely an equal number that leave. In the absence of some governmental body creating and keeping current a database of active broker registrations for franchisors to access, I'm not sure how they could possibly be sure of complying accurately with these requirements.
3. Section 4: Registration – sub-point (1) c. We ask that you more clearly define what is considered, or perhaps more importantly what is not considered, "a material change" in the disclosure information filed under this model legislation. As one example, in reviewing the new proposed California amendments contained in Senate Bill 919, California is proposing a requirement to disclose the industries of the franchise brands represented by the broker and how many brands are represented within each industry. This is information that changes constantly in most referral network business models as new franchisors are added and others eliminated from the active

inventory of franchisors they work with. Though these changes, in my opinion, are not significant to a prospective franchisee's evaluation of any franchise opportunities they are presented, if a change in this specific information about these broad categories of industries is considered "material" then thousands of referral network brokers will each be forced to submit amendments to their filings with each state - dozens of times per year. I certainly agree that any change in factors like litigation or criminal history and the like should definitely be considered "material", but on the other hand it makes more sense that we should simply update material like the franchisor counts within industry categories annually. Please see my note 4. below for further clarification on this point as it relates to broker compensation.

4. Section 5: Disclosure Obligation – sub-point (2). This section requires a franchise broker to disclose "all compensation they will receive in connection with the offer and sale of a franchise", at the point in time when the prospective franchisee receives a copy of the Franchise Disclosure Document. It is simply not possible, in the business model of a referral network, for the broker to know this answer as a specific number at this point in the process. Please allow me to explain.

Typically, referral network brokers refer the prospective franchisee to franchisors immediately after they first communicate information on that franchisor's specific franchise opportunity. Upon receipt of this referral of a prospective franchisee from a broker, franchisors typically deliver the Franchise Disclosure Document, electronically, to the prospective franchisee by the next business day. Therefore, it is probable under this proposal that any compensation related disclosure that's required from one of our brokers to a prospective franchisee will be delivered as part of, or in conjunction with, the disclosure obligation mandated in Section 5 – sub-point (1), for the sake of convenience to all parties.

At that point in time, an accurate disclosure related to the broker's compensation would fall into a range from zero dollars to infinity dollars. This is due to the fact that a broker in the referral network business model is typically only paid a fee by the franchisor if the prospective franchisee actually becomes a new franchisee with that franchisor - which, frankly, rarely happens.

Given this fact, if the broker were required to disclose his "typical" or "most common" fee for a referral, the answer would be zero. If the broker were required to disclose his "average" fee for a referral (for say the most recent calendar year) it could be calculated by dividing the total amount of all fees received by the broker by the total of all the broker's prospective franchisee referrals to a franchisor, but this number would still be relatively small.

It is only in those fairly rare circumstances that a referral network broker refers a prospective franchisee who subsequently actually does obtain a franchise that the fee is substantial. This payment structure is a recognition, by both the broker and the franchisor, that most of the broker's efforts will go totally uncompensated so the fee needs to be substantial when it is only paid on a success basis.

Even if the prospective franchisee does become an actual franchisee, then the compensation received by the broker can vary significantly depending on many factors such as:

- a) The number and type of the franchise units contracted for,
- b) The method and timing of payment(s) used to pay the required franchisor fees,
- c) State escrow requirements of the franchisor,
- d) Whether the franchise purchased is for a new unit or the resale of an existing unit,
- e) Any short term incentives or bonus programs that might be in place from the franchisor when the purchase is actually made,

- f) Any special concessions agreed to by the broker to the franchisor at the time of the purchase,
- g) Etc.

There is another issue related to this compensation disclosure in that most referral network brokers refer the prospective franchisee to multiple franchise companies at the same time. In most cases there are different compensation programs, amounts, schedules and incentive payments from franchisor to franchisor, so this would require multiple disclosures to factor in the variables when making compensation information available to a prospective franchisee.

Please consider an approach more like the current CA bill. This bill requires a disclosure of "How the third party franchise seller is compensated" rather than a specific amount. It would require a broad disclosure of various factors that may come into play such as the most common no sale fee to other alternatives such as single unit placement fees, multi-unit placement fees, territorial or development schedule fees, master license fees, resale fees, bonuses or other incentive program fees, etc. This would require a thorough explanation of the compensation potential for the broker from various activities the prospective franchisee might enter into. It would also provide a clearer explanation of what may be considered by the prospective franchisee to be the broker's "vested interest" in the prospective franchisee's purchase decision, if that is a desired goal of the regulation.

5. Section 7: Obligations of Franchisors and Subfranchisors. As was stated earlier in my point number 2. above, we support the new registration and disclosure requirements on brokers, but this requirement on franchisors would create a cumbersome and expensive new burden on the franchisor for little if any benefit to prospective franchisees. In addition, trying to stay current on this requirement for franchisors, if any changes are considered material, would realistically require them to file constant amendments to their initial filing with each state as individual brokers come and go on an almost daily basis. We recommend eliminating this requirement as impractical to implement.

Thank you in advance for your consideration of these comments and please feel free to contact me for any further clarification you may desire,

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