

WSR 23-10-048
PROPOSED RULES
DEPARTMENT OF
FINANCIAL INSTITUTIONS
(Securities Division)
[Filed April 28, 2023, 9:10 a.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 23-03-059.

Title of Rule and Other Identifying Information: North American Securities Administrators Association, Inc. (NASAA) Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments (statement of policy).

Hearing Location(s): On Wednesday, June 7, 2023, at 2:00 p.m., at 150 Israel Road S.W., Room 220, Tumwater, WA 98501.

Date of Intended Adoption: June 8, 2023.

Submit Written Comments to: Nathan Quigley, P.O. Box 9033, Olympia, WA 98507, email Nathan.Quigley@dfi.wa.gov, fax 360-902-0524, by June 7, 2023.

Assistance for Persons with Disabilities: Contact Carolyn Hawkey, phone 360-902-8760, fax 360-902-0524, TTY 1-800-833-6384, email Carolyn.Hawkey@dfi.wa.gov, by June 7, 2023.

Purpose of the Proposal and Its Anticipated Effects, Including Any Changes in Existing Rules: The proposed amendment would require franchisors to comply with the statement of policy promulgated by NASAA.

Reasons Supporting Proposal: On September 18, 2022, NASAA adopted the statement of policy. The statement of policy sets uniform standards for the proper use of questionnaires and acknowledgments in franchise offerings. The statement of policy prohibits provisions that would require a prospective franchisee to make statements that are subjective, unreasonable, or that attempt to absolve the franchisor or its agents of liability in connection with the sale of a franchise. These provisions are also inconsistent with the Franchise Investment Protection Act's antiwaiver provisions. See RCW 19.100.220(2) and 19.100.180 (2)(g). It is important to note that the adoption of the statement of policy does not represent a material change in requirements for franchise offerings in Washington. However, adoption of the statement of policy would aid franchisors in complying with existing Washington law by providing specific examples of prohibited questionnaires and acknowledgments, while also increasing compliance with antiwaiver and antifraud requirements across the states with such requirements.

Statutory Authority for Adoption: RCW 19.100.250.

Statute Being Implemented: RCW 19.100.250.

Rule is not necessitated by federal law, federal or state court decision.

Name of Proponent: Department of financial institutions (DFI), securities division, governmental.

Name of Agency Personnel Responsible for Drafting: Nathan Quigley, 150 Israel Road S.W., Tumwater, WA 98501, 360-902-8797; Implementation: Faith Anderson, 150 Israel Road S.W., Tumwater, WA 98501, 360-902-8760; Enforcement: William Beatty, 150 Israel Road S.W., Tumwater, WA 98501, 360-902-8760.

A school district fiscal impact statement is not required under RCW 28A.305.135.

A cost-benefit analysis is not required under RCW 34.05.328. DFI is not an agency identified in RCW 34.05.328.

Scope of exemption for rule proposal:

Is not exempt.

The proposed rule does impose more-than-minor costs on businesses.

Small Business Economic Impact Statement (SBEIS)

WAC 460-80-325

Concerning the NASAA Statement of Policy

Regarding the Use of Franchise Questionnaires and Acknowledgments

April 13, 2023

Introduction: The securities division of DFI (securities division) has prepared this SBEIS in connection with the proposed amendment to chapter 460-80 WAC to formally adopt the statement of policy promulgated by NASAA.

On September 18, 2022, NASAA adopted the statement of policy. The statement of policy sets uniform standards for the proper use of questionnaires and acknowledgments in franchise offerings. Specifically, the statement of policy prohibits provisions that would require a prospective franchisee to make statements that are subjective, unreasonable, or that attempt to absolve the franchisor or its agents of liability in connection with the sale of a franchise. These provisions are also inconsistent with the antiwaiver provisions in Washington's Franchise Investment Protection Act. See RCW 19.100.220(2) and 19.100.180 (2)(g). It is important to note that the adoption of the statement of policy would not represent a material change in requirements for franchise offerings in Washington. However, adoption of the statement of policy would aid franchisors in complying with existing Washington law by providing specific examples of prohibited questionnaires and acknowledgments, while also increasing compliance with antiwaiver and antifraud requirements across the states with such requirements. The statement of policy is available at <https://www.nasaa.org/wp-content/uploads/2022/09/NASAA-Franchise-Questionnaires-and-Acknowledgments-Statement-of-Policy-9-18-2022.pdf>.

The securities division is proposing to adopt new WAC 460-80-325 to explicitly require franchisors to comply with the statement of policy.

Procedural Background: On January 11, 2023, the securities division filed a CR-101 preproposal statement of inquiry with the office of the code reviser (code reviser) stating that it was considering an amendment to chapter 460-80 WAC to formally adopt the statement of policy. This notice was distributed to the securities division's interested persons list and posted to the agency's rule-making website (also known as the agency rule-making docket). Notice of the potential rule making was also shared with the vice president of state and local government relations at the International Franchise Association and the ABA Forum on Franchising's online discussion forum. On January 23, 2023, the securities division posted on the agency's rule-making docket the text of a draft rule that would add new WAC 460-80-325.

Next, the securities division prepared a survey to determine the costs associated with the proposed rule, and distributed the survey link on February 15, 2023, via email. In the email that provided the link to the survey, the securities division also provided a link to the text of the draft rule. The email requested that law firms and other organizations that received the email forward it to their franchisor clients or members so that they could complete the survey. The

survey link was emailed to 446 recipients. These recipients were the identified contact persons for all currently registered or pending franchise applications and exemption notice filings on file with the securities division. The survey was also posted to the agency's rule-making docket on February 15, 2023. Moreover, on February 16, 2023, the securities division provided the vice president of state and local government relations at the International Franchise Association with a link to the survey via email and posted the survey link on the ABA Forum on Franchising's online discussion forum. Finally, the survey link was provided to the members of the Advisory Committee of the NASAA Franchise and Business Opportunities Project Group on March 7, 2023, with the request that they forward the survey link to their franchisor clients. The survey had a deadline of March 15, 2023. However, the survey remained available on the agency's rule-making docket until March 20, 2023.

The securities division carefully considered the responses to the survey. However, the securities division received only two survey responses, one from a respondent that identified itself as a law firm representing franchisors and one from a respondent that identified itself as a broker. Thus, in addition to receiving limited responses, the securities division did not receive any responses from respondents that identified as franchisors, who are subject to the requirements of the statement of policy. As a result, the securities division did not receive sufficient data to measure the potential disproportionate impact of the draft rule on small businesses. In the absence of sufficient data to calculate disproportionate impact, the securities division has mitigated the costs to both franchisors that are small businesses and franchisors that are not small businesses to the extent possible in accordance with RCW 19.85.030(4), and determined that no changes to the draft rule amendment are necessary. The securities division now intends to proceed with rule making to amend chapter 460-80 WAC by formally proposing the draft rule in a notice of proposed rule making (CR-102) filed with the code reviser.

SECTION 1

Summary of the Proposed Rule: The securities division is proposing to add new WAC 460-80-325, requiring franchisors to explicitly comply with the statement of policy. The statement of policy mandates that franchisors include a legend in their Franchise Disclosure Documents and Franchise Agreements stating:

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.

In addition, the statement of policy generally prohibits a franchisor from requiring a prospective franchisee to make any statement in any questionnaire, acknowledgment, or similar document that is subjective, unreasonable, or that attempts to absolve the franchisor or its agents of liability in connection with the sale of a franchise. The statement of policy includes a nonexhaustive list of prohibited statements to aid franchisors in complying with the statutory provisions on which it is based. Franchisors will need to remove all prohibited statements in questionnaires, acknowledgments, and similar

documents, and include the legend set forth above after the effective date of the rule adopting the statement of policy.

SECTION 2

Identify which businesses must comply with the proposed rule using the North American Industry Classification System (NAICS) codes and the minor cost thresholds: Franchisors that offer and sell franchises in Washington will be required to comply with the proposed rule. Franchising is not limited to certain industries.

SECTION 3

Survey of Interested Persons to Determine Costs of Compliance: To obtain information to prepare an SBEIS, RCW 19.85.040 permits an agency to survey a representative sample of affected businesses to assist in the accurate assessment of the costs of a proposed rule. To that end, the securities division prepared an online small business economic impact survey to survey businesses that may be impacted by the proposed rule amendment. The statement of policy applies to franchisors offering and selling franchises in Washington. For purposes of gathering information to prepare an SBEIS, the securities division determined to send the survey link to the identified contact person of every "open" and "current" registered or exempt franchise offering in the securities division's database. "Open" means the franchisor has submitted an application for registration (initial or renewal) or has submitted a franchise notice filing (initial or renewal), but that the securities division has not yet issued a franchise registration permit or a franchise exemption notice filing acknowledgment. "Current" means the franchisor has a franchise registration permit that has not yet expired or a franchise notice filing acknowledgment that has not yet expired. The securities division reasoned that franchisors that recently made a filing with the securities division for the purposes of offering and selling franchises in Washington would likely file franchise registration or exemption filings with the securities division in the future, and would thus be subject to the draft rule. In many cases, the identified contact person for franchisors was a law firm that assists them with making state franchise filings. For this reason, in the email accompanying the survey link, the securities division requested, in part: "If you are a law firm or organization that represents or works with franchisors, please forward this notice to your franchisor clients or franchisor members." We note, however, that some of the identified contact persons for franchisors are in-house legal staff employed by franchisors, and in some cases, are officers, directors, or employees of franchisors.

The securities division distributed the survey link on February 15, 2023, via email. The survey link was emailed to 446 recipients. In the email providing the link to the survey, the securities division explained the reasons for conducting the survey and provided a link to the text of the draft rule. The online survey consisted of 20 questions. The survey asked questions to identify the respondent, to determine if the respondent met the definition of a small business under RCW 19.85.020, to identify the respondent's plans to offer and sell franchises in Washington and other registration states in the future, and to identify the respondent's current use of franchise questionnaires and acknowledgments. In addition, the survey asked whether the proposed rule amendments would cause increased costs, and then requested information on the additional costs of complying in the categories of professional services, equipment, supplies, labor, and administrative costs. The survey also allowed a free-form response for respondents to explain any other additional compliance costs. Lastly, the

survey requested data on whether the proposed amendments would result in lost sales or revenue, or the loss or addition of any jobs.

The introductory language preceding the survey questions asked respondents to complete the survey by March 15, 2023. However, the survey remained available on the agency's rule-making docket until March 20, 2023. The securities division received only two unique responses to the survey. Of the two respondents, both were small businesses as defined by RCW 19.85.020(3) because they had 50 or fewer employees. Neither survey respondent identified itself as a franchisor or an employee, officer, or director of a business that offers or sells franchises, and franchisors are the entities that would directly incur costs making any changes to comply with the statement of policy. As a result of the limited number of survey responses received and the fact that neither of the survey responses were from franchisors, the securities division lacks sufficient data to compare the cost imposed by the draft rule on businesses that are small businesses as compared to the cost imposed by the draft rule on businesses that are not small businesses.

Description of Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule: The proposed rule will not impose additional reporting or recordkeeping requirements on franchisors, whether they constitute small businesses or not. In addition, as indicated above, the proposed rule to adopt the statement of policy will help franchisors comply with antiwaiver and antifraud requirements set forth in the Franchise Investment Protection Act. To comply with the draft rule, franchisors that conduct franchise offerings in Washington should review their offering documents to ensure that they do not contain any prohibited statements and include the legend prescribed by the statement of policy.

Professional Services and Other Costs to Comply with the Proposed Rule: Franchisors may incur additional professional expenses if they hire outside counsel to conduct the necessary review and revision of documents to ensure compliance with the statement of policy. Franchisors may incur additional labor costs if their own employees conduct the review and make necessary revisions. Franchisors may also incur additional administrative costs associated with updating documents to comply with the statement of policy. We estimate that the review of the statement of policy and revision of potentially affected franchise offering documents may require approximately two hours to complete. We do not believe that franchisors will incur any additional costs for equipment or supplies to comply with the statement of policy. We do not believe that compliance with the proposed rule will cause businesses to lose sales or revenue, or that it will create or eliminate jobs.

SECTION 4

The proposed rule may impose more-than-minor costs on businesses:

RCW 19.85.030 provides that an agency must prepare an SBEIS if the proposed rule will impose more-than-minor costs on businesses in an industry. The term "minor cost" is defined to mean a cost per business that is less than three-tenths of one percent of annual revenue or income, or \$100, whichever is greater, or one percent of annual payroll.

It is important to note that the proposed rule does not substantively alter requirements to offer and sell franchises in Washington but is intended to aid franchisors in complying with existing statutory antifraud and antiwaiver provisions. See RCW 19.100.220(2) and 19.100.180 (2)(g). Adoption of the statement of policy would aid franchisors in complying with existing Washington law by providing specif-

ic examples of prohibited questionnaires and acknowledgments, while also increasing compliance with antiwaiver and antifraud requirements across the states with such requirements. Once the proposed rule is adopted, however, franchisors that conduct franchise offerings in Washington should review their offering documents to ensure that they do not contain any prohibited statements and should add the legend prescribed by the statement of policy. The costs associated with conducting such a review and making any necessary changes, as well as filing amended offering documents with the securities division, could exceed \$100; therefore, the securities division prepared this SBEIS.

SECTION 5

Determine whether the proposed rule may have a disproportionate impact on small businesses as compared to the 10 percent of businesses that are the largest businesses required to comply with the proposed rule: In accordance with RCW 19.85.030(4), while the securities division did not receive sufficient survey data to calculate the potential disproportionate impact on small businesses, the securities division has nevertheless considered methods to reduce the impact of the proposed rule on franchisors subject to the rule in Section 6 below. We do not believe that compliance with the proposed rule will cause businesses to lose sales or revenue.

SECTION 6

If the proposed rule is likely to impose a disproportionate impact on small businesses, identify the steps taken to reduce the costs of the rule on small businesses: Although the securities division did not receive sufficient survey data to calculate the potential disproportionate impact on small businesses, the securities division has nevertheless considered methods to reduce the impact of the proposed rule on franchisors subject to the rule in accordance with RCW 19.85.030(4). We discuss the methods considered and the reasons for not making modifications to the proposed rule amendment below.

Reducing, modifying, or eliminating substantive regulatory compliance: Mandating the statement of policy could ultimately save some franchisors, particularly those that offer in multiple states that substantively review and register franchise offerings, certain costs and time. The statement of policy sets uniform standards for the proper use of questionnaires and acknowledgments in franchise offerings. Specifically, the statement of policy prohibits provisions that would require a prospective franchisee to make statements that are subjective, unreasonable, or that attempt to absolve the franchisor or its agents of liability in connection with the sale of a franchise. The prohibited provisions in the statement of policy are based on state antiwaiver and antifraud provisions like those contained in Washington's Franchise Investment Protection Act. See RCW 19.100.220(2) and 19.100.180 (2)(g). Thus, the statement of policy would not represent a material change in requirements for franchise offerings in Washington. However, adoption of the statement of policy would aid franchisors in complying with existing Washington law, as well as the laws of certain other franchise registration states, by providing specific examples of prohibited questionnaires and acknowledgments. The statement of policy is a tool to help ensure that franchisors conform their offerings to preexisting and statutorily imposed antiwaiver and antifraud requirements across the states with such requirements. Increased compliance with these requirements will result in franchisors receiving less correspondence from state regulators asking for changes to documents based on these provisions, and could result in a more streamlined registration process in the long run. Finally, the securities division

has noted that many franchisors are already submitting documents that appear to be revised in an attempt to comply with the statement of policy, although it has not yet been formally adopted in Washington. The securities division believes the adoption of the statement of policy is the most time effective means of bringing franchisors into compliance with Washington law and that reducing, modifying, or eliminating the requirements of the statement of policy would eliminate these benefits and create potential compliance risks for franchisors. Accordingly, the securities division made no changes to the proposed rule.

Simplifying, reducing, or eliminating recordkeeping and reporting requirements: The adoption of the statement of policy would harmonize how different franchise registration states treat questionnaires and acknowledgments in franchise offering materials. Thus, adoption of the proposed rule could result in more franchisors using uniform offering materials in all franchise registration states, or nationwide. Using uniform offering materials would reduce the time a franchisor spends tracking what offering materials can be used in different jurisdictions. Thus, the statement of policy itself simplifies and reduces compliance burdens, although it does not create or modify any recordkeeping and reporting requirements. Further, the securities division's administrative rules do not contain significant recordkeeping or reporting requirements, and any reduction in filing requirements otherwise addressed in our rules would be out of step with statutory requirements.

Reducing the frequency of inspections: The securities division does not inspect franchisors, but the securities division does review franchise filings submitted by franchisors on at least an annual basis. This requirement is set by the Franchise Investment Protection Act. See RCW 19.100.030(4) and 19.100.070. As a result, there is no opportunity to reduce the frequency of inspections.

Delaying compliance timetables: The prohibited provisions in the statement of policy are based on state antiwaiver and antifraud provision and, as such, are also inconsistent with existing antiwaiver provisions in Washington's Franchise Investment Protection Act. See RCW 19.100.220(2) and 19.100.180 (2)(g). Thus, the statement of policy would not represent a material change in requirements for franchise offerings in Washington. In addition, as discussed above, the statement of policy has been adopted in several states that also register franchise offerings. As franchisors are also making changes to comply with the statement of policy in other jurisdictions, complying with the statement of policy in Washington now or in the near future could ultimately save some franchisors certain costs and time. Furthermore, as discussed above, the securities division has noted many franchisors have already submitted documents that appear to be revised in an attempt to comply with the statement of policy. The securities division believes the adoption of the statement of policy at this time is the most time effective means of bringing franchisors into compliance with Washington and other state requirements. Accordingly, the securities division determined that delaying adoption of the proposed rule is not warranted.

That said, the securities division contemplates that franchisors conducting franchise offerings that are already registered may update their offering materials to comply with the statement of policy at the same time they submit their next annual renewal applications. Franchisors conducting exempt offerings may choose to update their offering materials when they prepare their next annual update of the franchise

disclosure document to include updated financial statements as required by the Federal Trade Commission's franchise rule. Thus, while the proposed rule would become effective 31 days after filing the rule-making order with the code reviser and franchisors may update their documents to comply with the rule, franchisors may not file amended documents with the securities division until a filing is otherwise required.

Reducing or modifying fine schedules for noncompliance: There are no fines directly associated with a franchisor's failure to comply with the proposed rule amendments that could otherwise be reduced or modified.

Any other mitigation techniques: The securities division determined to take additional mitigation steps to reduce the overall burden of compliance. The securities division outlines these steps below.

First, in connection with the proposed rule amendments, the securities division will publish and distribute the notice of proposed rule making (CR-102) and the notice of adoption of proposed amendments (CR-103) to its interested persons list and to those who have "open" and "current" registered or exempt franchises in the securities division's database. The securities division will also post notices on our agency rule-making docket and will seek to publicize the adoption of any rule on the website of the NASAA to reach additional franchisors. This will alert franchisors to the potential adoption of the draft rule and would potentially permit some franchisors to make necessary changes to offering materials at the same time they are making a required filing with the securities division unrelated to the draft rule, which could potentially save franchisors time and filing fees. Finally, the securities division will also endeavor to provide answers to franchisor questions about compliance with the statement of policy by phone and email.

Beyond the steps outlined above, the securities division does not believe that it can reduce costs further.

SECTION 7

How the securities division has and will involve small businesses in the rule development: Since the beginning of the rule-making process, the securities division has involved interested persons, including small businesses, in the development of the proposed rules.

On January 11, 2023, the securities division filed a CR-101 pre-proposal statement of inquiry with the code reviser, stating that it was considering an amendment to chapter 460-80 WAC to formally adopt the statement of policy. This notice was distributed to the securities division's interested persons list and posted to the agency rule-making docket. The interested persons list contains many small businesses and those that advise small businesses. Notice of the potential rule making was also shared with the vice president of state and local government relations at the International Franchise Association and the ABA Forum on Franchising's online discussion forum. On January 23, 2023, the securities division posted on the agency rule-making docket the text of a draft rule that would add new WAC 460-80-325.

Next, the securities division prepared a survey to determine the costs associated with the proposed rule, and distributed the survey link on February 15, 2023, via email. In the email that provided the link to the survey, the securities division also provided a link to the text of the draft rule. The email requested that law firms and other organizations that received the email forward it to their franchisor clients or members so that they could complete the survey. The survey link was emailed to 446 recipients. These recipients were the

identified contact persons for all currently registered or pending franchise applications and exemption notice filings on file with the securities division. The survey was also posted on the agency rule-making docket on February 15, 2023. Moreover, on February 16, 2023, the securities division provided the vice president of state and local government relations at the International Franchise Association with a link to the survey via email and posted the survey link on the ABA Forum on Franchising's online discussion forum. Finally, the survey link was provided to the members of the advisory committee of the NASAA Franchise and Business Opportunities Project Group on March 7, 2023, with the request that they forward the survey link to their franchisor clients. The survey had a deadline of March 15, 2023. However, the survey remained available on the agency rule-making docket until March 20, 2023. The securities division will continue to seek the feedback of interested parties as the rule-making process continues.

SECTION 8

Identify the estimated number of jobs that will be created or lost as the result of compliance with the proposed rule: As indicated above, the securities division estimates that the review of the statement of policy and revision of potentially affected franchise offering documents may require approximately two hours to complete. Our expectation is that the vast majority of franchisors will rely on outside counsel to complete the review and revision of franchise offering documents. Thus, we do not believe that adoption of the proposed rule will create or eliminate any jobs.

SECTION 9

Summarize the results of the analysis, including the determination if costs are disproportionate: As indicated above, while the securities division did not receive sufficient survey data to calculate the potential disproportionate impact on small businesses, the securities division has nevertheless considered methods to reduce the impact of the proposed rule on franchisors subject to the rule in Section 6.

A copy of the statement may be obtained by contacting Nathan Quigley, P.O. Box 9033, Olympia, WA 98507, phone 360-902-8797, fax 360-902-0524, TTY 1-800-833-6384, email Nathan.Quigley@dfi.wa.gov.

April 27, 2023
Charlie Clark
Director

OTS-4307.1

NEW SECTION

WAC 460-80-325 NASAA statement of policy regarding the use of franchise questionnaires and acknowledgments. In order to promote uniform regulation, the administrator adopts the North American Securities Administrators Association (NASAA) Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments, as adopted September 18, 2022.

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