

## New NASAA Guidance on FPRs Amidst the COVID-19 Pandemic

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PRACTICES Franchise and Distribution

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On June 10, 2020, the NASAA Franchise and Business Opportunity Project Group (“NASAA Franchise Project Group”) issued a statement on the importance of accurately disclosing financial performance representations amidst the worldwide impact of COVID-19.<sup>1</sup> Since many franchisors have recently updated their franchise disclosure documents (“FDDs”), the critical question for franchisor becomes what, if any, subsequent updates are necessary to maintain compliance with federal and state disclosure requirements.

The statement emphasizes the need for franchisors to seriously consider whether historical financial performance representations (“Historical FPRs”) in their FDDs are accurate in 2020 (and beyond) or whether this historical data requires an amendment to qualify such data in the current environment. Franchisors should carefully consider whether the data in their most current FDD’s Item 19 has changed to such an extent so as to be deemed a “material change” under both federal and state disclosure laws requiring an update to the FDD. In fact, the state of Washington recently issued its own notice on this same topic citing the new NASAA Franchise Project Group statement and reminding franchisors of its own anti-fraud statute that makes it unlawful for a franchisor to sell a franchise using a FDD that contains “an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made not misleading.”

In its statement, the NASAA Franchise Project Group lists several factors a franchisor should consider when analyzing whether the financial representations in its FDD should be updated to comply with federal (and state) disclosure laws:

- Whether the franchise system’s businesses have been significantly impacted by the COVID-19 pandemic;
- The type of data the franchisor includes in its Historical FPR;
- The reasonable inferences a prospective franchisee can draw from the Historical FPR;
- When the franchisor estimates a prospective franchisee can expect to open for business after entering into a franchise agreement;
- Whether and how the franchisor adapts the franchise business to account for current market conditions resulting from the COVID-19 pandemic; and
- Whether and how the franchisor adapts the franchise business to account for future market conditions resulting from the COVID-19 pandemic.

While franchisors all over the United States have certainly been affected in some way by the COVID-19 pandemic, not all franchisors and not all franchise businesses have been affected equally. Some businesses have seen an increase in revenues without any changes to their business model, while others have maintained relatively steady revenues. Still others have experienced sharp and sustained declines in revenues, perhaps even despite reactive changes to their business model, such as a shift from a dine-in model to delivery. Whether a franchisor should

consider updating their FDD to reflect such changes, and whether such changes are, indeed, sufficiently “material” to prompt updates are subject to a franchisor-specific analysis.

It is imperative, however, that franchisors that include Historical FPRs in their FDD conduct this analysis and that, if necessary, they consider the implications of such an analysis. Some of the actions a franchisor may consider taking in these circumstances include, potentially: (i) removing the Historical FPR entirely from their FDD; (ii) updating the FDD to reflect updated Historical FPR information and, if applicable, file amendments with franchise registration states; and/or (iii) pausing sales until prospects in the sales pipeline can be re-disclosed with an updated FDD. One avenue that is not available to franchisors, as made clear in the NASAA Franchise Project Group’s statement, is any kind of disclaimer that the Historical FPR is not representative of what prospective franchisees can expect because of COVID-19 or suggestions that prospective franchisees should not rely on the disclosure. On the whole, however, in these times, a franchisor should consistently be considering how their franchise offering and the information in their FDD differs from the reality they are experiencing and the changes in their business model.

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<sup>1</sup> NASAA Franchise Group, Disclosing Financial Performance Representations in the Time of COVID-19 (June 10, 2020), at p. 3, available at <https://www.nasaa.org/wp-content/uploads/2020/06/FPRs-in-the-time-of-COVID-19.pdf>.