MEMO

TO	FBA Members
FROM	Eric R. Riess
DATE	August 16, 2020
SUBJECT	Broker Participation in Due Diligence / Validation Calls With Franchise Candidates

The purpose of this memo is to provide guidance regarding a broker's participation in a call by a franchisee candidate with an existing franchisee. I refer to these calls as "franchisee due diligence". Others call them "validation calls". For purposes of this Memorandum, they are one in the same.

Not everyone has the same opinion on this topic and that's OK. I have also found a lot of misinformation out there regarding the subject. My hope is that this Memorandum will clear up some of that misinformation.

Please remember that participation is legal. There is no legal prohibition against it. We obviously would never "secretly" participate in a call (i.e., secretly listen in). But short of that, it is legal.

Also keep in mind that some franchisors simply desire that their franchise sellers / brokers *not* participate in due diligence calls. As discussed further in this Memorandum, I am not sure that the concerns that drive that desire are based upon an analysis of rational risks, but if brokers are to work well with a particular franchisor, those brokers must, of course, abide by the franchisor's desires.

A broker's participation in a due diligence call does not increase the risk to either the broker or the franchisor of the franchisee with whom the call is being conducted. The information reported by a franchisee does not get imputed to the broker. The franchisee provided the information. The broker did not.

Franchisees are not, of course, bound by the same rules that franchisors and brokers are. Franchisees can say whatever they want whether not consistent with what is contained in the FDD. Franchisors and brokers, however, can only make representations consistent with those contained within the FDD.

Perhaps franchisors fear faulty memories of franchisees. Therefore, for brokers who do participate in due diligence calls, I suggest that the call always be recorded.

Recording calls is governed by eaves dropping laws. There are two types of such laws and they vary by State. There are some States that have "one party consent" laws and some States that have "two party consent" laws. The first type requires one party to the conversation to give consent. These laws are a bit silly in that the person who is physically doing the recording always consents to the recording. The two-party consent laws require everyone to the conversation to consent to the recording.

The consent is easily achieved. It is done through an announcement prior to the conversation that the conversation will be recorded. We've all heard the announcement that "This Call May Be Recorded For Quality Assurance Purposes." These announcements exist to satisfy both the one-party and the two-party consent eaves dropping laws. These announcements, when made, are deemed consent to recording by all parties to the conversation.

I do not recommend the "quality assurance" announcement nor do I recommend a simple "this call will be recorded" announcement. There is a purpose in recording the call. I believe the broker should tell the participants in the conversation what that purpose is. "I'd like to record this call because it's better than taking notes. It permits me to better listen and participate in the conversation and make accurate notes of the conversation in the future."

Rarely should a broker encounter someone who does not consent to such recording. Of course, the broker needs to have the recording going while the broker makes that announcement although the participants don't need to verbally say "OK" or similar for their deemed consent to be given. On the rare occasion when someone objects to the recording, the broker can then elect to continue the call, re-schedule the call or drop off the call and follow up with the candidate.

Short of a recording, I believe that the contemporaneous written notes should be taken of any due diligence call and that those notes should be reiterated to the candidate in writing immediately following the call. "I took the following notes from our conversation with Mrs. Smith. They are strictly the notes that I took of what Mrs. Smith told us. If your recollection of our conversation differs in any way from these notes, please let me know right away by return email. Please remember that there is no way for me to confirm or refute any information that Mrs. Smith provided to us."

Remember also that each candidate should sign an acknowledgement that they are not to rely on any representation or warranty from either the broker or the franchisor or anyone acting on behalf of the franchisor that is not contained within the Franchise Disclosure Document itself and; ideally; that they *did not* rely, in purchasing a franchise, on any representation or warranty that was made either by the broker, the franchisor or anyone acting on behalf of the franchisor that was not contained within the Franchise Disclosure Document. Remember that almost all actions against franchisors and brokers have to do with either misrepresentations within the Franchise Disclosure Document or those made outside of the Franchise Disclosure Document by a franchisor or broker that were inconsistent with those representations and warranties made within the Franchise Disclosure Document.

Each broker should make it clear to each candidate that the broker did not construct the Franchise Disclosure Document but that that document is prepared by the franchisor.

I understand that some brokers may find it uncomfortable fitting in the acknowledgements and announcements that I recommend within this Memorandum. Each broker, therefore, should make sure that his / her website also contains such understandings.

Remember that lawsuits against brokers are extremely rare. Almost all lawsuits where a broker is named as a defendant involve a broker intentionally making representations inconsistent with the FDD or consistent with the FDD while knowing that the FDD was incorrect. And without exception, any lawsuit against a franchisor or a broker begins with a franchisee who loses money. Damages are a requirement of all lawsuits by franchisees. A broker's own due diligence on whether a franchise he or she is selling is profitable, therefore, cannot be overemphasized.