

117TH CONGRESS  
1ST SESSION

# S. 1120

To establish minimum standards of disclosure by franchises whose franchisees use loans guaranteed by the Small Business Administration.

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## IN THE SENATE OF THE UNITED STATES

APRIL 14, 2021

Ms. CORTEZ MASTO (for herself, Mrs. FEINSTEIN, Ms. BALDWIN, Mr. MURPHY, and Ms. WARREN) introduced the following bill; which was read twice and referred to the Committee on Small Business and Entrepreneurship

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## A BILL

To establish minimum standards of disclosure by franchises whose franchisees use loans guaranteed by the Small Business Administration.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Small Business Admin-  
5 istration Franchise Loan Transparency Act of 2021”.

6 **SEC. 2. FINDINGS; PURPOSE.**

7 (a) FINDINGS.—Congress finds that—

8 (1) franchise businesses represent a large and  
9 growing segment of the retail and service businesses

1 of the United States and are rapidly replacing more  
2 traditional forms of small business ownership in the  
3 economy of the United States;

4 (2) the Small Business Administration guaran-  
5 tees much of the financing available in franchising;

6 (3) the Small Business Administration requires  
7 pro forma projections, including projected revenue,  
8 for the first year of operations of a franchise as part  
9 of the standard operating requirements for a  
10 franchisee to qualify for financing;

11 (4) on July 13, 2011, the Office of Inspector  
12 General of the Small Business Administration pub-  
13 lished an audit (Report No. 11–16) on loans made  
14 under section 7(a) of the Small Business Act (15  
15 U.S.C. 636(a)) (in this section referred to as “7(a)  
16 loans”) to Huntington Learning Center franchises  
17 where first year revenue projections were all signifi-  
18 cantly inflated;

19 (5) on July 2, 2013, the Office of Inspector  
20 General of the Small Business Administration pub-  
21 lished an audit evaluation (Report No. 13–17) show-  
22 ing that the Administration needed to improve the  
23 management of the 7(a) loan portfolio risk, specifi-  
24 cally with certain franchise brands that had excep-

1 tionally high default rates that continued to receive  
2 guaranteed loans from the Administration;

3 (6) in September 2013, the Government Ac-  
4 countability Office published a study (GAO-13-759)  
5 showing that over the 10-year period from 2003 to  
6 2012, 28 percent of 7(a) loans provided to fran-  
7 chises required a guarantee payment;

8 (7) the study described in paragraph (6) was  
9 based on 32,323 loans totaling \$10,600,000,000,  
10 which required \$1,500,000,000 in guarantee pay-  
11 ments;

12 (8) the report for the study described in para-  
13 graph (6) stated, “Potential franchisees should in-  
14 clude first-year revenue estimates in their SBA loan  
15 applications. However, this information is not nec-  
16 essarily available to potential franchisees in the fran-  
17 chise organization’s disclosure document.”;

18 (9) franchise companies most often collect roy-  
19 alties based on gross revenue, therefore revenue data  
20 on each franchise outlet are readily available; and

21 (10) while both the franchisor and the lender  
22 profit as a result of financing from the Small Busi-  
23 ness Administration, the total liability for the loan  
24 is born by the franchisee.

25 (b) PURPOSE.—The purposes of this Act are to—

1           (1) ensure transparency in the loan processes of  
2           the Small Business Administration so that the  
3           franchisee borrower, the lender, and the Administra-  
4           tion all have access to information that is key to the  
5           lending process;

6           (2) lower the fees and rates charged to  
7           franchisee borrowers; and

8           (3) help ensure lower default rates in order to  
9           make more money available for loans to viable fran-  
10          chise brands.

11 **SEC. 3. DEFINITIONS.**

12          In this Act—

13           (1) the term “disclosure document” means the  
14           disclosure document required to be furnished by a  
15           franchisor to a prospective franchisee under section  
16           436.2 of title 16, Code of Federal Regulations, as in  
17           effect on July 1, 2007;

18           (2) the term “Financial Performance Represen-  
19           tation Commentary” means the Financial Perform-  
20           ance Representation Commentary adopted by the  
21           North American Securities Administrators Associa-  
22           tion on May 8, 2017; and

23           (3) the terms “franchise”, “franchisee”, and  
24           “franchisor” have the meanings given those terms in

1 section 436.1 of title 16, Code of Federal Regula-  
2 tions, as in effect on July 1, 2007.

3 **SEC. 4. REQUIRED DISCLOSURES.**

4 (a) IN GENERAL.—Subject to subsection (b), a  
5 franchisor, except for a franchisor of a franchise in the  
6 lodging industry, that qualifies for guaranteed lending  
7 from the Small Business Administration for the franchises  
8 of the franchisor shall, at a minimum, disclose in the dis-  
9 closure document required to be furnished by the  
10 franchisor to any prospective franchisee the following in-  
11 formation for each of the 3 years preceding the date of  
12 the disclosure document:

13 (1) The average and median first-year revenues  
14 for all businesses operated under franchises granted  
15 by the franchisor, in accordance with the Financial  
16 Performance Representation Commentary.

17 (2) The total number of businesses operated  
18 under franchises granted by the franchisor that,  
19 during the first year of operation, either—

20 (A) ceased operations; or

21 (B) were transferred to a new franchisee.

22 (3) The average and median revenues for all  
23 businesses operated under franchises granted by the  
24 franchisor, in accordance with the Financial Per-  
25 formance Representation Commentary.

1 (b) LIMITATION.—A franchisor may not disclose to  
2 a prospective or current franchisee, directly or through a  
3 third party, any information relating to revenue that con-  
4 flicts with the information relating to revenue provided  
5 under subsection (a) in a disclosure document unless the  
6 relevant franchise purchase includes 1 or more businesses  
7 under the relevant franchise that are in existence on the  
8 date on which the disclosure is made, in which case the  
9 franchisor shall disclose to the prospective or current  
10 franchisee the relevant information relating to revenue as  
11 of the date on which the disclosure is made with respect  
12 to those businesses.

13 **SEC. 5. ENFORCEMENT.**

14 The Administrator of the Small Business Administra-  
15 tion—

16 (1) shall enforce the requirements under this  
17 Act; and

18 (2) may hold a franchisor liable for the balance  
19 of any loan obtained through a violation of this Act.

20 **SEC. 6. NO PREEMPTION.**

21 Nothing contained in this Act shall prohibit an au-  
22 thorized State official from proceeding in State court on  
23 the basis of an alleged violation of any civil or criminal  
24 statute of that State.

1 **SEC. 7. SEVERABILITY.**

2       If any provision of this Act or any application of this  
3 Act to any person or circumstances is held invalid, the  
4 remainder of this Act and its application to any person  
5 or circumstance shall not be affected thereby.

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