117TH CONGRESS
1ST SESSION

S. 1120

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

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

A BILL

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

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Small Business Administration Franchise Loan Transparency Act of 2021''.

SEC. 2. FINDINGS; PURPOSE.

(a) FINDINGS.—Congress finds that—

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

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

(2) the Small Business Administration guarantees much of the financing available in franchising;

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

(4) on July 13, 2011, the Office of Inspector General of the Small Business Administration published an audit (Report No. 11–16) on loans made under section 7(a) of the Small Business Act (15 U.S.C. 636(a)) (in this section referred to as ''7(a) loans'') to Huntington Learning Center franchises where first year revenue projections were all significantly inflated;

(5) on July 2, 2013, the Office of Inspector General of the Small Business Administration published an audit evaluation (Report No. 13–17) showing that the Administration needed to improve the management of the 7(a) loan portfolio risk, specifically with certain franchise brands that had excep-

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

(6) in September 2013, the Government Accountability Office published a study (GAO–13–759) showing that over the 10-year period from 2003 to 2012, 28 percent of 7(a) loans provided to franchises required a guarantee payment;

(7) the study described in paragraph (6) was based on 32,323 loans totaling $10,600,000,000, which required $1,500,000,000 in guarantee payments;

(8) the report for the study described in paragraph (6) stated, ''Potential franchisees should include first-year revenue estimates in their SBA loan applications. However, this information is not necessarily available to potential franchisees in the franchise organization's disclosure document.'';

(9) franchise companies most often collect royalties based on gross revenue, therefore revenue data on each franchise outlet are readily available; and

(10) while both the franchisor and the lender profit as a result of financing from the Small Business Administration, the total liability for the loan is born by the franchisee.

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

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

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

(3) help ensure lower default rates in order to make more money available for loans to viable franchise brands.

SEC. 3. DEFINITIONS.

In this Act—

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

(2) the term ‘‘Financial Performance Representation Commentary’’ means the Financial Performance Representation Commentary adopted by the North American Securities Administrators Association on May 8, 2017; and

(3) the terms ‘‘franchise’’, ‘‘franchisee’’, and ‘‘franchisor’’ have the meanings given those terms in

section 436.1 of title 16, Code of Federal Regulations, as in effect on July 1, 2007.

SEC. 4. REQUIRED DISCLOSURES.

(a) IN GENERAL.—Subject to subsection (b), a franchisor, except for a franchisor of a franchise in the lodging industry, that qualifies for guaranteed lending from the Small Business Administration for the franchises of the franchisor shall, at a minimum, disclose in the disclosure document required to be furnished by the franchisor to any prospective franchisee the following information for each of the 3 years preceding the date of the disclosure document:

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

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

(A) ceased operations; or

(B) were transferred to a new franchisee.

(3) The average and median revenues for all businesses operated under franchises granted by the franchisor, in accordance with the Financial Performance Representation Commentary.

(b) LIMITATION.—A franchisor may not disclose to a prospective or current franchisee, directly or through a third party, any information relating to revenue that conflicts with the information relating to revenue provided under subsection (a) in a disclosure document unless the relevant franchise purchase includes 1 or more businesses under the relevant franchise that are in existence on the date on which the disclosure is made, in which case the franchisor shall disclose to the prospective or current franchisee the relevant information relating to revenue as of the date on which the disclosure is made with respect to those businesses.

SEC. 5. ENFORCEMENT.

The Administrator of the Small Business Administration—

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

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

SEC. 6. NO PREEMPTION.

Nothing contained in this Act shall prohibit an authorized State official from proceeding in State court on the basis of an alleged violation of any civil or criminal statute of that State.

SEC. 7. SEVERABILITY.

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

○