

ARE FRANCHISEES WELL-INFORMED? REVISITING THE DEBATE OVER FRANCHISE RELATIONSHIP LAWS

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ABSTRACT

The most vital debate in the field of franchise contract law over the last few decades has focused on the following issue: whether franchisees should be protected by law against franchisor opportunism. Franchisor advocates suggest that franchisee protection laws, commonly known as "franchise relationship laws," are undesirable. Their opposition to such laws is based primarily on an assumption that franchisees consider all relevant information before signing a franchise contract and make a well-informed choice among the range of franchise alternatives available. In particular, franchisees are assumed to read the franchise disclosure documents made available to them, compare the various contracts and disclosure documents offered by different franchisors, and consult with a specialized franchise attorney regarding the terms of the franchise contract all prior to signing it. Since franchisees consider all of the relevant information and make a well-informed decision, they do not deserve, according to franchisor advocates, any special legislative protection that would interfere with the franchisor-franchisee free-market relationship.

Based on a significant body of existing empirical research, which has so far been overlooked in the debate over franchise relationship laws, this article will argue that the assumption that franchisees consider all relevant information before signing a franchise contract and make a well-informed choice is questionable. Briefly summarized, the argument presented in this article is as follows. New franchisees who join a franchise network normally lack prior business ownership experience. This lack of experience presents significant cognitive obstacles for novice franchisees when attempting to consider all of the relevant information before acquiring ownership of a franchise unit. Such cognitive obstacles often lead franchisees – contrary to the franchisor advocates' view – to ignore franchise disclosure documents, avoid conducting a comparison between various franchise contracts and disclosure documents, and neglect to consult with a specialized franchise attorney prior to signing the franchise contract. Given this reality, theoreticians and legislators interested in creating franchise laws that protect novice franchisees from possible opportunism by franchisors must cast doubt on the assumption that franchisees are well-informed business people and incorporate into their analyses a more reflective conception of franchisee characteristics.

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I. INTRODUCTION

The most vital debate in the field of franchise contract law over the last few decades has focused on the following issue: whether franchisees should be protected by law against franchisor opportunism. Franchisor advocates claim that franchisee protection laws, commonly known as "franchise relationship laws," are undesirable.¹ Their opposition to such laws is mainly based on an assumption that franchisees consider all relevant information before signing a franchise contract and make a well-informed choice among the range of franchise alternatives available. In particular, according to this analysis, franchisees read the franchise disclosure documents made available to them before signing the franchise contract, compare the various contracts and disclosure documents offered by different franchisors, and consult with a specialized franchise attorney regarding the terms of the franchise contract before signing it. Since franchisees consider all of the relevant information and make a well-informed decision, they do not deserve, according to franchisor advocates, any special legislative protection that would interfere with the franchisor-franchisee free-market relationship. Franchisor advocates' opposition to franchise relationship laws has been significantly influential in the development of franchise law in

¹ See *infra* Part III.

general, as is evident in state and federal policy making. To date, most states have refused to adopt general franchise relationship laws.² At the federal level, such laws have also been rejected.³

Empirical evidence, however, gives much reason to doubt the theoretical assumption that franchisees consider all relevant information before signing a franchise contract and make a well-informed choice. Briefly summarized, the argument presented in this article is as follows. New franchisees that join a franchise network normally lack prior business ownership experience.⁴ This lack of experience presents significant cognitive obstacles for novice franchisees when attempting to consider all of the relevant information before acquiring ownership of a franchise unit.⁵ Specifically, inexperienced franchisees often do not know in which subjects they are ignorant or what information they should consider before acquiring ownership of a franchise unit (the *unawareness problem*). In addition, inexperienced franchisees must invest significant cognitive efforts in discriminating between relevant and irrelevant business and legal information on franchise ownership (*screening difficulty*). Finally, inexperienced franchisees are unable to understand easily and fully the business and legal data to which they are exposed in the pre-contractual process, or how to place it in context, evaluate it, and act accordingly (*comprehension limitations*). Such cognitive obstacles often lead franchisees – contrary to the franchisor advocates' view – to ignore franchise disclosure documents, avoid

² See *infra* Part II.

³ See *infra* Part II.

⁴ See *infra* Part IV.A.

⁵ See *infra* Part IV.B.1.

conducting a comparison between various franchise contracts and disclosure documents, and neglect to consult with a specialized franchise attorney prior to signing the franchise contract.⁶

This Article proceeds as follows. Part II of this article will provide legal context by briefly reviewing the statutory framework underlying the debate over the desirability of franchise relationship laws. Part III will provide theoretical context by outlining the assumption on which franchisor advocates base their opposition to franchise relationship laws: namely, that franchisees consider all relevant information before signing a franchise contract and make a well-informed decision. Part IV will present our critique on the franchisor advocates' assumption.

II. FRANCHISE RELATIONSHIP LAWS – OVERVIEW

Franchise relationship laws are statutes that mainly govern the ongoing relationship between franchisors and franchisees.⁷ These laws have two central alleged purposes: first, to correct a perceived inequality in bargaining power between franchisors and franchisees;⁸ and second, to

⁶ See *infra* Part IV.B.2.

⁷ David Hess, *The Iowa Franchise Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors*, 80 IOWA L. REV. 333, 346–47 (1995); Thomas M. Pitegoff & W. Michael Garner, *Franchise Relationship Laws*, in FUNDAMENTALS OF FRANCHISING 183, 184 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed., A.B.A. 2008).

⁸ WIS. STAT. § 135.025(2)(b) (2011); NEB. REV. STAT. § 87-401 (2011); N.J. STAT. ANN. § 56:102 (2011); R.I. GEN. LAWS § 19-28.1-2 (2011); VA. CODE § 13.1-558 (2011); Christopher J. Curran, *Claims Against a Franchisor upon an Unreasonable Withholding of Consent to Franchise Transfer*, 23 IOWA J. CORP. L. 135,

protect franchisees against perceived abusive behavior by franchisors.⁹ The major franchisor abuses at which franchise relationship laws are aimed include:¹⁰ unjust termination of the franchise contract without adequate notice or reasonable cause,¹¹ restrictions on free association

152 (1997); Peter C. Lagarias & Robert S. Boulter, *The Modern Reality of the Controlling Franchisor: The Case for More, Not Less, Franchisee Protections*, 29 FRANCHISE L.J. 139, 141 (2010); Dennis D. Palmer, *Franchises: Statutory and Common Law Causes of Action In Missouri Revisited*, 62 UMKC L. Rev. 471, 491 (1994); Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAWYER 289, 289 (1989).

⁹ WIS. STAT. § 135.025(2)(b); *Geib v. Amoco Oil Co.*, 29 F.3d 1050, 1056 (6th Cir. 1994); *Bitronics Sales Co., Inc. v. Microsemiconductor Corp.*, 610 F. Supp. 550, 556 (D. Minn. 1985); *Hartford Elec. Supply Co. v. Allen-Bradley Co. Inc.*, 1997 WL 297256, at *3, *aff'd*, 750 A.2d 824 (Conn. 1999); *Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618, 626 (N.J. 1996); *Holiday Inns Franchising, Inc. v. Branstad*, 537 N.W.2d 724, 728–29 (Iowa 1995); *McDonald's Corp. v. Markim Inc.*, 306 N.W.2d 158, 162 (Neb. 1981); David L. Cahn and Jeffrey S. Fabian, *Mobility, the Home, and the Scope and Application of State Franchise Relationship and Termination*, 30 FRANCHISE L.J. 107, 107; Curran, *supra* note 8, at 152; Palmer, *supra* note 8, at 491; Pitegoff, *supra* note 8, at 289.

¹⁰ Lagarias & Boulter, *supra* note 8, at 143–44; Pitegoff & Garner, *supra* note 7, at 187–88; Pitegoff, *supra* note 8, at 329–31.

¹¹ *See, e.g.*, ARK. CODE ANN. § 4-72-209 (2011); CAL. BUS. & PROF. CODE §§ 20020–20021 (2011); HAW. REV. STAT. § 482E-6(H) (2011); 815 ILL. COMP. STAT. 705/19 (2011); IOWA CODE §§ 523H.7(1), 537A.10(7)(c) (2011); MINN. STAT. § 80C.14(3)(b) (2011); MISS. CODE ANN. § 75-24-55 (2011); MO. ANN. STAT. § 407.405(1) (2011); NEB. REV. STAT. § 87-404 (2011); N.D. CENT. CODE § 51-20-2(02) (2011); N.J. STAT. ANN. § 56:105 (2011); P.R. LAWS ANN. tit. 10, § 278a (2011); R.I. GEN. LAWS § 6-50-4 (2011); WASH. REV. CODE § 19.100.180(2)(j) (2011); WIS. STAT. § 135.03 (2011).

among franchisees,¹² requirements of arbitration outside the franchisee's state,¹³ and encroachment on the franchisee's territory, namely establishment of a new franchise unit in unreasonable proximity to an existing franchisee.¹⁴ Notably, such abuses often are prohibited by *mandatory* franchise relationship laws, regardless of the express franchise contract provisions.¹⁵

To date, only a minority of states have enacted general franchise relationship laws that are not restricted to particular industries.¹⁶ In addition, several states have industry-specific franchise

¹² See, e.g., ARK. CODE ANN. § 4-72-206(2) (2011); CAL. CORP. CODE §§ 31220, 31302.5 (2011); HAW. REV. STAT. § 482E-6(2)(A) (2011); 815 ILL. COMP. STAT. 705/17 (2011); IOWA CODE §§ 523H.9, 537A.10(9) (2011); MICH. COMP. LAWS § 445.1574 (2011); MINN. R. 2860.4400(A) (2011); NEB. REV. STAT. § 87-406 (2011); N.J. STAT. ANN. § 56:107(b) (2011); R.I. GEN. LAWS § 19-28.1-16 (2011).

¹³ See, e.g., CAL. BUS. & PROF. CODE § 20040.5 (2011); MICH. COMP. LAWS § 445.1574 (2011); MINN. STAT. § 80C.21 (2011); R.I. GEN. LAWS § 19-28.1-14 (2011).

¹⁴ See, e.g., HAW. REV. STAT. § 482E-6(2)(E) (2011); IND. CODE §§ 23-2-2.7-1(2), (9) (2011); IOWA CODE §§ 523H.6(1), 532A.10(6)(a) (2011); MINN. R. 2860.4400(e), (i) (2011); WASH. REV. CODE § 19.100.180(2)(f) (2011).

¹⁵ See, e.g., IND. CODE ANN. § 23-2-2.7-1(5) (West 1989). See also Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191, 258 (2010); Palmer, *supra* note 8, at 492; Pitegoff, *supra* note 8, at 307; Philip F. Zeidman, LEGAL ASPECTS OF SELLING AND BUYING, § 7.6 (3d ed. 2011), available at WESTLAW.

¹⁶ See, e.g., ARK. CODE ANN. § 4-72-201 to 4-72-210 (2007); CAL. BUS. & PROF. CODE §§ 20,000 (West 2005); CONN. GEN. STAT. § 42-133E (2006); DEL. CODE ANN. tit. 6, § 2551 (2006); HAW. REV. STAT. § 482E (2007); 815 ILL. COMP. STAT. 705/1–705/44 (2009); IND. CODE §§ 23-2-2.5-1 to 23-2-2.5-51 (2007); IOWA CODE ANN. §§ 523H.1–523H.17 (2005); MICH. COMP. LAWS §§ 445.1501–1546 (West 2005); MINN. STAT. ANN. §§ 80C.01–80C.30 (West 2006); NEB. REV. STAT. §§ 87–401 to 87–410 (2006); N.J. STAT. ANN. §§ 56:10-1 to 56:10–15 (West 2007); S.D. CODIFIED LAWS §§ 37-5A-1 to 37-5A-87 (2006); TENN. CODE ANN. §§ 47-25-1501 to -1511 (2006); VA. CODE §§ 13.1-557 to 13.1-574 (2002); WASH. REV. CODE §§ 19.100.010–19.100.940

relationship laws.¹⁷ These industry-specific statutes relate to automobile dealerships,¹⁸ alcohol beverages,¹⁹ farm equipment,²⁰ petroleum,²¹ and office products,²² among other industries.²³

At the federal level, several general franchise relationship bills have been introduced, but all were rejected.²⁴ For example, a federal franchise relationship law of general application was

(2007); WIS. STAT. ANN. §§ 135.01–135.07 (West 2006). The District of Columbia, Puerto Rico, and the Virgin Islands also have franchise relationship laws: D.C. CODE §§ 29-1201 to 29-1208 (2005); P.R. LAWS ANN. tit. 10, §§ 278–278d (2006); V.I. CODE ANN. tit. 12A, § 132 (2004).

¹⁷ See, e.g., Ernest A. Braun, *Policy Issues of Franchising*, 14 SW. U. L. REV. 155, 216 (1984); Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1512, n.29 (1990).

¹⁸ See, e.g., CAL. VEH. CODE §§ 3060–69 (1979); FLA. STAT. § 320.697 (1985); IOWA CODE §§ 322A.1–322A.17 (1985); MASS. GEN. LAWS ANN. ch. 93B, § 12A (West 1985); N.M. STAT. ANN. §§ 57-16-1 to -16 (Michie 1995). For a detailed list of State Motor Vehicle Franchise Laws, see Zeidman, *supra* note 15, at Appendix N.

¹⁹ See, e.g., KAN. STAT. ANN. § 41-410 (1989); ILL. COMP. STAT. ch. 720/6-720/9 (West 1995); MICH. COMP. LAWS §§ 436.30b et seq. (1993); N.C. GEN. STAT. §§ 18B-1200-18B-1216 (1983).

²⁰ See, e.g., KAN. STAT. ANN. §§ 16-1201 through 16-1208 (1987). For a detailed list of State Farm Equipment Franchise Laws see, Zeidman, *supra* note 15, at Appendix Q.

²¹ See, e.g., N.Y. GEN. BUS LAW §§ 199-a to 199-n. For a detailed list of State Petroleum Franchise Laws see, Zeidman, *supra* note 15, at Appendix O.

²² See, e.g., HAW. REV. STAT. 481 G-1 through G-8 (1985).

²³ Pitegoff & Garner, *supra* note 7, at 185; *Franchise Protection: Laws against Termination and the Establishment of Additional Franchises* 1990 A.B.A. SEC. ANTITRUST L. MONOGRAPH NO. 17, at 16–17.

²⁴ See, e.g., Braun, *supra* note 17, at 203–04; Robert W. Emerson, *Franchise Termination: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates*, 35 AM. BUS. L.J. 559, 563 (1998); Donald P. Horwitz & Walter M. Volpi, *Regulating the Franchise Relationship*, 54 ST. JOHN'S L. REV. 217, 218 (1980).

proposed in 1971; however, no such law has ever been adopted.²⁵ In 1992, former Democratic Congressman James H. Scheuer introduced a franchise relationship bill which ultimately was not adopted.²⁶ Similarly, former Democratic Congressman John J. LaFalce in 1993 and 1995, and Republican Congressman Howard Coble in 1998 and 1999, each proposed franchise relationship bills that did not pass.²⁷ In addition, in 2007, the Federal Trade Commission considered but eventually rejected federal regulation of the franchise relationship.²⁸ To date, there is no franchise relationship law of general application in existence.²⁹

While broad legislative efforts have failed at the federal level, franchisees in certain industries have been successful in obtaining two central federal industry-specific relationship laws.³⁰ The first federal law specifically regulating franchise relationships was the Automobile Dealer Franchise Act, commonly known as the Dealer’s Day in Court Act (ADDCA).³¹ Broadly speaking, the ADDCA provides that the franchisor must act in “good faith,” not only in

²⁵ Pitegoff & Garner, *supra* note 7, at 185.

²⁶ Federal Fair Franchising Practices Act of 1992, H.R. 5961, 102nd Cong., 2d Sess. (1992).

²⁷ Small Business Franchise Act of 1999, H.R. 3308, 106th Cong., 1st Sess. (1999); Small Business Franchise Act of 1998, H.R. 4841, 105th Cong., 2d Sess. (1998); Federal Fair Franchise Practices Act, H.R. 1717, 104th Cong., 1st Sess. (1995); Federal Fair Franchise Practices Act, H.R. 1316, 103rd Cong., 1st Sess. (1993).

²⁸ Pitegoff & Garner, *supra* note 7, at 186.

²⁹ See Emerson, *supra* note 24, at 577; Palmer, *supra* note 8, at 491; Pitegoff, *supra* note 8, at 289. Pitegoff & Garner, *supra* note 7, at 185;

³⁰ Pitegoff & Garner, *supra* note 7, at 186.

³¹ 15 U.S.C. §§ 1221–1225 (1994).

performing the franchise contract but also in terminating the contract.³² In 1978, Congress adopted another federal law, the Petroleum Marketing Practices Act (the PMPA), which sets forth procedures that a gas station franchisor must follow before it may terminate or refuse to renew a franchisee.³³

III. THE FRANCHISOR ADVOCATES' VIEW

Franchisor advocates suggest that franchisees do not need any special legal protection against franchisor abuses under franchise relationship laws or other legal regimes.³⁴ To begin with, franchisor advocates assume that franchisees are sophisticated business people. As Larry Ribstein explains, in franchise contracts “the price is set in each case by negotiations among

³² 15 U.S.C. §§ 1222 (1994).

³³ 15 U.S.C. §§ 2801–2806, 2821–24, 2841 (1994).

³⁴ *See, e.g.*, Report of the American Bar Association Section of Antitrust Law on Proposed Small Business Franchise Act, *19, available at <http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment025.htm> (last visited Jan. 2, 2012) [hereinafter Report of the American Bar Association]; James A. Brickley et al., *The Economic Effects of Franchise Termination Laws*, 34 J.L. & ECON. 101, 130 (1991); Christopher R. Drahozal, “Unfair” Arbitration Clauses, 2001 U. ILL. L. REV. 695, 765–67; Horwitz & Volpi, *supra* note 24, at 276–78; William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 29, 31 (2008); Pitegoff, *supra* note 8, at 319–20; Larry E. Ribstein, *Choosing Law by Contract*, 18 J. CORP. L. 245, 256–57 (1993); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 231–32 (1978); Mary deLeo, Note, *Emasculating Goliath: Did Postal Instant Press v. Sealy Strike an Unfair Blow at the Franchising Industry?*, 25 W. ST. U. L. REV. 117, 170–72 (1997).

sophisticated and knowledgeable parties.”³⁵ Similarly, Christopher Drahozal argues that “franchisees are much closer to the sophisticated, well-informed individual . . . than are consumers or employees, and should be treated accordingly.”³⁶

Franchisor advocates further believe that since franchisees are sophisticated business people, they consider all relevant information in order to make a well-informed choice before signing a franchise contract. As William Killion, a long-time franchisor attorney and past Editor-in-chief of the Franchise Law Journal explains, “franchisees today have a wealth of information available to them before they sign the franchise agreement...[They] have all the information that legislators and regulators have found they need to make an informed decision.”³⁷

³⁵ Ribstein, *supra* note 34, at 257.

³⁶ Thomas J. Chinonis, *Implied Covenant of Good Faith: A Two-Way Street in Franchising*, 11 DEPAUL BUS. L.J. 229, 243 (1998) (“With the widespread familiarity and popularity of franchising, franchisees also know better what to look for and what to expect in a typical franchise relationship”); Drahozal, *supra* note 34, at 766. *See also* Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight From Arbitration?*, 37 HOFSTRA L. REV. 71, 87 (2008) (“franchisees are business people, and at least some franchisees are very sophisticated business people - including publicly-traded companies”); Horwitz & Volpi, *supra* note 24, at 248 n.123 (“The modern franchisee is no longer a no-experience novice. The typical new franchisee, in many industries, is a professional franchisee – compared with the amateur franchisee of the 1950's, and the 1960's”); deLeo, *supra* note 34, at 171 (“Today's franchisees are more savvy, more educated, more likely to come from a business background and therefore more likely to be experienced in assessing risks and making informed decisions accordingly”); Pitegoff, *supra* note 8, at 315 n.111 (“Today's franchisee is frequently a trained and well-financed businessman, with a good understanding of the franchise relationship and his role in it”).

³⁷ Killion, *supra* note 34, at 31.

Additionally, franchisor advocates argue that since franchisees consider all of the relevant information, they specifically read the Franchise Disclosure Document (FDD), which must be provided to franchisees by the franchisor before signing the franchise agreement, according to the regulations of the Federal Trade Commission (FTC).³⁸ The FDD includes information which arguably warns franchisees against potential abuses by the franchisor. In particular, the FDD includes data on pending and prior lawsuits involving the franchisor.³⁹ Furthermore, the FDD must include, in a specified tabular format, the provisions of the franchisee agreement dealing with termination and arbitration.⁴⁰ In addition, when the franchisor does not offer an exclusive territory to the franchisor, the FDD must include a prescribed statement underscoring that fact and warning about the consequences of purchasing a non-exclusive territory.⁴¹ Since the FDD includes data that may warn franchisees against franchisors potential abuses, the FDD – according to franchisor advocates – guarantees the franchisee access to the basic information necessary to reach an informed decision before entering a franchise contract.⁴² As Donald Horwitz and Walter Volpi, who represented the McDonald’s Corporation, explain, “full disclosure enables prospective franchisees to make a reasoned evaluation of the potential risks and benefits of franchising.”⁴³ In a similar vein, George Hay argues that franchise disclosure

³⁸ 16 CFR § 436.

³⁹ FEDERAL TRADE COMMISSION, THE FRANCHISE RULE COMPLIANCE GUIDE 44, *available at* <http://business.ftc.gov/sites/default/files/pdf/bus70-franchise-rule-compliance-guide.pdf> (last visited, Jan. 1 2012).

⁴⁰ *Id.* at 90–93.

⁴¹ *Id.* at 83.

⁴² Killion, *supra* note 34, at 29.

⁴³ Horwitz & Volpi, *supra* note 24, at 249.

documents operate “to ensure that prospective investors are given information about the likely costs and revenues of a particular franchise opportunity in order help them make an informed choice.”⁴⁴

As sophisticated business people who consider all of the relevant information, franchisees are presumed—by franchisor advocates—to be able not only to read the FDD, but also to compare systematically the various franchise contracts and disclosure documents offered by different franchisors. As Thomas Pitegoff, Chair of the Franchise Committee of the New York State Bar Association's Business Law Section, argues, “prospective franchisees now have *hundreds* of franchises from which to choose. If the terms of one franchise are too onerous . . . the prospective franchisee may go elsewhere...”⁴⁵ The American Bar Association Section of Antitrust Law, too, explains that “armed with . . . disclosure [documents] franchisees can make informed choices among the range of franchise alternatives then available to them.”⁴⁶

⁴⁴ Report of the American Bar Association, *supra* note 34, at *19; Brickley et al., *supra* note 34, at 111; Drahozal & Wittrock, *supra* note 36, at 87; Drahozal, *supra* note 34, at 766–67; George A. Hay, *Is the Glass Half-Empty or Half-Full?: Reflections on the Kodak Case*, 62 ANTITRUST L.J. 177, 188 (1993); *See also* Killion, *supra* note 34, at 28 (“Franchisees now have through the typical franchise disclosure document detailed information about the franchise opportunity, the very information a number of states and the FTC have determined will allow the franchisee to make an informed buying decision”); Pitegoff, *supra* note 8, at 314; deLeo, *supra* note 34, at 171 (“disclosure laws ensure potential franchisees are advised of the nature and scope of the franchise agreement prior to signing”).

⁴⁵ Pitegoff, *supra* note 8, at 315.

⁴⁶ Report of the American Bar Association, *supra* note 34, at *19. *See also* Chinonis, *supra* note 36, at 243 (“Since prospective franchisees now have *hundreds* of franchises from which to choose, they can refuse to enter

Beyond their ability to compare the various franchise contracts and disclosure documents, according to franchisor advocates, franchisees, as sophisticated business people, are able to consult with a specialized franchise attorney regarding the terms of the franchise contract before signing it. As Larry Ribstein states, franchisees “have the ability and incentive to read the contract carefully or hire an attorney to do so.”⁴⁷

Ultimately, franchisor advocates conclude that since franchisees read disclosure documents, compare various franchise contracts and disclosure documents, and are able to consult with a specialized lawyer, they do not deserve any special legal protection under franchise relationship laws or a similar legal regime.⁴⁸ Such protection, in fact, would interfere with the franchisor-

agreements that may not appear fair to franchisees”); Drahozal & Wittrock, *supra* note 36, at 87; Drahozal, *supra* note 34, at 766; Hay, *supra* note 44, at 188 (“But whatever one might argue about the sophistication, or lack thereof, of copy machine purchasers, the argument seems far less plausible when applied to prospective franchisees. There are literally *thousands* of franchise opportunities available to prospective investors”); Horwitz & Volpi, *supra* note 24, at 246; Killion, *supra* note 34, at 30 (“FRANdata estimates that there are more than 2,900 active franchise systems today . . . With such a broad variety of franchisors competing with each other for franchise opportunities, it is difficult to imagine that...franchisees have little alternative but to give in to the contractual dictates of an overpowering franchisor”).

⁴⁷ See also Drahozal, *supra* note 34, at 766–67; Horwitz & Volpi, *supra* note 24, at 248 n.123; Ribstein, *supra* note 34, at 257.

⁴⁸ Report of the American Bar Association, *supra* note 34, at 19. See also for example, Killion, *supra* note 34, at 29, 31; Pitegoff, *supra* note 8, at 319–20; deLeo, *supra* note 34, at 170–72.

franchisee free-market relationship. As Paul Rubin explains, “what is involved here is a general freedom-of-contract issue.”⁴⁹

IV. THE CRITIQUE

The franchisor advocate’s assumption that franchisees consider all relevant information in order to make a well-informed choice before signing a franchise contract is questionable. New franchisees that join a franchise network normally lack prior business ownership experience.⁵⁰ This lack of experience presents significant cognitive obstacles for novice franchisees when attempting to consider all of the relevant information before acquiring ownership of a franchise unit.⁵¹

A. New Franchisees Lack Prior Business Ownership Experience

1. Explanation

New franchisees joining franchise networks typically do not possess prior business ownership experience, let alone franchise unit ownership experience.⁵² The central reason for this

⁴⁹ Rubin, *supra* note 34, at 232.

⁵⁰ See *infra* Part IV.A.

⁵¹ See *infra* Part IV.B.

⁵² See, e.g., Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 *Stan. L. Rev.* 927, 961–62 (1990); Elizabeth C. Spencer, *Consequences of the Interaction of Standard Form and*

phenomenon is the *nature* of the franchise business format, which attracts individuals of limited business ownership experience. As will be explained in greater detail below, individuals with no prior business ownership experience are attracted to the franchise business format because it provides the franchisee with the following: 1) an opportunity to join an already established business system; 2) site selection assistance; 3) initial training; 4) ongoing training; and 5) detailed operational manuals.⁵³

Firstly, as mentioned, the franchise business format provides novice franchisees with an opportunity to join an already established business system. Because a franchising system provides a business formula developed through previous high-risk yet successful experiences, many of the unavoidable business mistakes that plague the independent business owner have already been overcome in the franchise system.⁵⁴ Thus, by becoming a part of an established

Relational Contracting in Franchising, 29 FRANCHISE L.J. 31, 32 (2009). For empirical support, see *infra* Part IV.B.

⁵³ ARTHUR I. CANTOR, FEDERAL/STATE FRANCHISE AND DEALERSHIP LAWS, 677 PLI/Corp. 105, 114-115 (1990) (PLI Corp. Law and Prac. Course Handbook Series No. 677, 1990), available at WESTLAW; RICHARD J. JUDD & ROBERT T. JUSTIS, FRANCHISING: AN ENTREPRENEUR'S GUIDES 33 (4th ed. 2007); MARTIN MENDELSON, THE GUIDE TO FRANCHISING 48 (7th ed. 2004); Chinonis, *supra* note 36, at 238; Hess, *supra* note 7, at 338-39; John Stanworth & James Curran, *Colas, Burgers, Shakes, and Shirkers: Towards a Sociological Model of Franchising in the Market Economy*, 14 J. BUS. VENTURING 323, 334 (1999); Mika Tuunanen & Kimmo Hyrsky, *Entrepreneurial Paradoxes in Business Format Franchising: An Empirical Survey of Finnish Franchises*, 19 INT'L SMALL BUS. J. 47, 51 (2001); Anna Watson & John Stanworth, *Franchising and Intellectual Capital: A Franchisee's Perspective*, 2 INT'L ENTREPRENEURSHIP & MGMT. J. 337, 340 (2006); deLeo, *supra* note 34, at 123-24.

⁵⁴ MENDELSON, *supra* note 53, at 47-48; deLeo, *supra* note 34, at 123-24.

system, the inexperienced franchisee reduces his overall risk of failure.⁵⁵ This risk diminishment allows a novice franchisee to enter a field which he or she has no previous experience with an apparently increased chance of business success.⁵⁶

Under the franchise business format, the inexperienced franchisee often also receives site selection assistance. Franchisors frequently prepare a list of factors to be investigated prior to selecting the site for the new franchised unit.⁵⁷ These factors may include economic strength and potential of a particular region, availability of transportation for supplies, demographic characteristics within the community, traffic ingress and egress at sites under consideration, land development and construction costs, and location of primary business competitors.⁵⁸ The franchisors will assist the inexperienced franchisee to select an appropriate site, using their established criteria for site selection.⁵⁹

The franchise business format provides to novice franchisees not only assistance in site selection, but also an initial training program.⁶⁰ Normally, an inexperienced franchisee will receive initial training on all functions of operating the business, including finance, marketing, business

⁵⁵ deLeo, *supra* note 34, at 123–24.

⁵⁶ Hess, *supra* note 7, at 338–39; *Id.* at 123–24.

⁵⁷ JUDD & JUSTIS, *supra* note 53, at 219.

⁵⁸ *Id.* at 218–19.

⁵⁹ MENDELSON, *supra* note 53, at 96.

⁶⁰ JUDD & JUSTIS, *supra* note 53, at 21 (stating that 98.3% of franchisors offer initial training).

operations and management of personnel.⁶¹ More specifically, the newcomer franchisee will be trained on how to develop and read a balance sheet and an income statement, how to use a cash register, how to recruit, select and train employees, and how to control inventory.⁶² Indeed, empirical evidence shows that initial training represents a vital motivating factor for franchisees in the decision to purchase a franchised outlet. To illustrate, Scott Weaven and Lorell Frazer adopted a qualitative methodology to examine the motivational incentives driving the choice to enter the franchising business from the franchisee's perspective.⁶³ The sample was made up of current franchisees within the McDonald's franchise system.⁶⁴ According to the study, most single unit franchisees claimed that initial training was a primary motivation in the decision to purchase a franchise unit.⁶⁵ Franchising was perceived by franchisees as an easier method of entering self-employment in areas in which they had limited prior business experience.⁶⁶

⁶¹ JUDD & JUSTIS, *supra* note 53, at 525–26; MENDELSON, *supra* note 53, at 94–95; Robert T. Justis & Peng S. Chan, *Training for Franchise Management*, 29 J. SMALL BUS. MGMT. 87, 89 (1991); Stanworth & Curran, *supra* note 53, at 334.

⁶² JUDD & JUSTIS, *supra* note 53, at 218–19.

⁶³ Scott Weaven & Lorelle Frazer, *Investment incentives for Single and Multiple Unit Franchisees*, 9 QUALITATIVE MARKET RESEARCH: AN INTERNATIONAL JOURNAL 225, 227–237 (2006).

⁶⁴ *Id.* at 227–29.

⁶⁵ *Id.* at 233.

⁶⁶ *Id.* at 233. For similar results see, for example, Alden Peterson & Rajiv P. Dant, *Perceived Advantages of the Franchise Option from the Franchisee Perspective: Empirical Insights from a Service Franchisee*, 28 J. SMALL BUS. MGMT. 46, 51–53 (1990).

In addition, the franchise business format often provides inexperienced franchisees with ongoing training during the franchise relationship. Such training may cover marketing updates, industry trends, new products and services developments.⁶⁷ Field representatives play an important role in the delivery of ongoing training.⁶⁸ They often work directly with novice franchisees at the business site, providing expert consultation, offering on-the-spot management and operational suggestions to franchisees, and supplying video or audio materials for inexperienced franchisees.⁶⁹

Frequently inexperienced franchisees also receive detailed operational manuals. These manuals describe each major function and operating procedure of the business.⁷⁰ They often include detailed instructions on topics such as quality standards, warranties and replacement practices, customer relations and service, inventory loss prevention, and maintenance control.⁷¹

It is worth noting that new franchisees regularly lack prior business experience not only because of the *nature* of the franchise business format but also due to the fact that franchisors tend to prefer to contract with franchisees with no prior business experience.⁷² Inexperienced

⁶⁷ JUDD & JUSTIS, *supra* note 53, at 527.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* at 213; MENDELSON, *supra* note 53, at 62.

⁷¹ JUDD & JUSTIS, *supra* note 53, at 213-15; MENDELSON, *supra* note 53, at 61-66.

⁷² Lorelle Frazer, *Causes of Disruption to Franchise Operation*, 54 J. BUS. RES. 227, 228 (2001); José M. Ramírez-Hurtado et al., *Criteria Used in the Selection of Franchisees: An Application in the Service Industry*, 5 SERV. BUS. 47, 53 (2011).

franchisees, as opposed to those with experience, are relatively easy to control.⁷³ They are more likely to adapt themselves to the standard system procedures and methods of the franchise system,⁷⁴ while they are less likely to use the franchisor's know-how, trade secrets and confidential information in competition with it.⁷⁵ They are also less likely to be a difficult opponent in the event of any dispute with the franchisor.⁷⁶

2. Empirical Evidence

Empirical evidence shows that new franchisees that join a franchise network are unlikely to possess franchise unit ownership experience, or even any prior business ownership. The results of Kimberly Morrison's research examining, among other things, the personal characteristics of franchisees, illustrate this phenomenon.⁷⁷ Using a mailed questionnaire, data were obtained from 307 U.S. franchisees from four industries: restaurants, business aids and services, automotive

⁷³ Cf. MENDELSON, *supra* note 53, at 80.

⁷⁴ *Id.* at 81; Frazer, *supra* note 72, at 228; JUDD & JUSTIS, *supra* note 53, at 34; Steven C. Michael, *Investments to Create Bargaining Power: The Case of Franchising*, 21 STRAT. MGMT. J. 497, 501 (2000).

⁷⁵ MENDELSON, *supra* note 53, at 80-81.

⁷⁶ *Id.* at 81. Indeed, empirical evidence indicates that franchisors prefer to contract with inexperienced franchisees. According to Justis and Judd, only 10.6% of U.S. franchisors in the employment and personal services franchise sector require prior industry experience from their new franchisees. See JUDD & JUSTIS, *supra* note 53, at 18. See also José M. Ramírez-Hurtado et al., *supra* note 72, at 58-9.

⁷⁷ Kimberley A. Morrison, *An Empirical Test of a Model of Franchise Job Satisfaction*, 34 J. SMALL BUS. MGMT. 27 (1996).

products and services, and non-food retailing.⁷⁸ The sample was randomly compiled by a research firm and was composed of franchisees from 46 states.⁷⁹ According to the study, only 20% of the sample actually had been business owners before becoming franchisees.⁸⁰

Another empirical study conducted by Alden Peterson and Rajiv Dant shows even more strongly that most new franchisees lack prior business ownership experience.⁸¹ Using a mailed questionnaire, data were obtained from 74 random U.S. franchisees of a major nationwide franchise system in the service industry.⁸² According to the study, only 6.7% of the sample had owned an independent business prior to joining the franchise system.⁸³

Interestingly, empirical studies show that franchisees often lack not only prior business ownership experience but also experience in the same business as their franchise. For example, Anderson, Condon & Dunkelberg conducted an empirical study among U.S. franchisees.⁸⁴ Using a mailed questionnaire, data were obtained from 61 franchisees.⁸⁵ According to the results of the study, only 38% of the franchisees had worked in the same business as their franchise.⁸⁶ Patrick

⁷⁸ *Id.* at 29-30.

⁷⁹ *Id.* at 30.

⁸⁰ *Id.*

⁸¹ Peterson & Dant, *supra* note 66.

⁸² *Id.* at 49.

⁸³ *Id.* at 50.

⁸⁴ Robert L. Anderson et al., *Are Franchisees "Real" Entrepreneurs?*, 4 J. BUS. & ENTREP. 97 (1992).

⁸⁵ *Id.* at 99.

⁸⁶ *Id.* at 100.

Kaufmann's study produced a similar outcome, where among 63 U.S. franchisees who completed his questionnaires, approximately 70% had purchased franchises in business sectors in which they had no specific work experience.⁸⁷

What is more, there is empirical evidence that lack of prior business inexperience is not unique to U.S. franchisees and is in fact a global phenomenon, prototypical to the *nature* of the franchise business format. For instance, Russell Knight conducted an empirical study among Canadian franchisees in order to examine, among other things, their personal characteristics.⁸⁸ Using a mailed questionnaire, data were obtained from 105 franchisees in a variety of well-known franchises across Canada.⁸⁹ According to the results of the study, 72% of franchisees had no previous business management experience before joining the franchise system.⁹⁰ In another Russell Knight study, conducted with a similar sample, 89% of Canadian franchisees had no previous experience in franchising before joining the franchise system.⁹¹

Lack of prior business experience among franchisees was also documented in Australia. To illustrate, Nerilee Hing conducted an empirical study that included an examination of

⁸⁷ Partick J. Kaufmann, *Franchising and the Choice of Self-Employment*, 14 J. BUS. VENTURING 345, 353, 358 (1999).

⁸⁸ Russell M. Knight, *The Independence of the Franchisee Entrepreneur*, 22 J. SMALL BUS. MGMT. 53 (1984).

⁸⁹ *Id.* at 54.

⁹⁰ *Id.* at 56.

⁹¹ Russell M. Knight, *Franchising from the Franchisor and Franchisee Points of View*, 24 J. SMALL BUS. MGMT. 8, 10 (1986).

franchisees' personal traits.⁹² Data were obtained from nine restaurant franchise companies and 127 of their franchisees.⁹³ The study's findings determined that most franchisees had no prior entrepreneurial business experience.⁹⁴ Similarly, Scott Weaven and Carmel Herington adopted a qualitative methodology for examining the personal characteristics of Australian female franchisees, among other factors.⁹⁵ According to the study, most female franchisees had limited business experience.⁹⁶

Indeed in England, studies also found a general lack of prior business experience among franchisees. For example, John Stanworth conducted an empirical study examining various aspects of U.K. franchising including the franchisees' personal characteristics.⁹⁷ Data were obtained from 249 franchisees using a mailed questionnaire, followed by in-depth interviews.⁹⁸ The franchisees were chosen from a variety of business sectors, including fast food, dry cleaning and hygiene services, and printing services.⁹⁹ The study yielded the result that two-thirds of franchisees had no self-employment experience prior to joining the franchise system.¹⁰⁰

⁹² Nerilee Hing, *Franchisee Satisfaction: Contributors and Consequences*, 33 J. SMALL BUS. MGMT. 12 (1995).

⁹³ *Id.* at 15, 17.

⁹⁴ *Id.* at 19.

⁹⁵ Scott Weaven & Carmel Herington, *Female Franchisors: How Different are they from Female Independent Business Owners?*, 7 ACAD. MKTG. SCI. REV. 1 (2006).

⁹⁶ *Id.* at 13.

⁹⁷ John Stanworth, *The Franchise Relationship*, 4 J. MKTG. CHANNELS 161 (1995).

⁹⁸ *Id.* at 162.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 163.

Additionally, lack of prior business experience among franchisees was documented in Spain. For example, Jose Ramirez-Hurtado and Bernardino Quattrociochi conducted an empirical study among Spanish franchisees, which obtained data using a mailed questionnaire from 220 Spanish franchisees.¹⁰¹ Similar to the studies conducted in other countries, 60.7% of the franchisees surveyed had no previous business ownership experience.¹⁰²

B. Inexperienced Franchisees Ignore Relevant Information

Inexperienced franchisees tend to sign franchise contracts on the basis of inadequate pre-investment investigation and evaluation. More specifically, franchisees – in contrast with the franchisor advocates' view – ignore franchise disclosure documents, avoid conducting a comparison between various franchise contracts and disclosure documents, and refrain from consulting with a specialized franchise attorney before signing the franchise agreement. Below we will first provide a theoretical explanation for this phenomenon. Second, we will present empirical evidence supporting the existence of the phenomenon.

¹⁰¹ Jose M. Ramirez-Hurtado & Bernardino Quattrociochi, *An Update of the Franchisee Motivations: A Study in Spain*, 4 J. APPLIED ECON. SCI. 210, 212 (2009).

¹⁰² *Id.* at 213.

1. Explanation

A prospective franchisee who aspires to own a franchise unit usually needs to search for complex information about potential franchise opportunities. This information is business ownership oriented; namely, it deals with many financial and legal aspects that typify the ownership of a business. To begin with, it is necessary that a prospective franchisee will estimate the sales revenue, costs, cash flow, net income and loss of various franchise ownership options. In addition, the franchisee must investigate the legal risks involved in the relationship between the franchisee's unit and its employees, suppliers, franchisor and customers. As will be explained in more detail below, since the vast majority of prospective franchisees lack prior business ownership experience, they will face significant cognitive obstacles when attempting to consider all of the relevant information before acquiring ownership of a franchise unit. More specifically, the novice franchisee will face three cognitive obstacles: the unawareness problem, screening difficulty, and comprehension limitations.

Novice franchisees, who recently have decided that they want to own a franchise, normally suffer from an unawareness problem. They are typically unaware of all the business and legal risks involved in owning a franchise unit.¹⁰³ Furthermore, inexperienced franchisees may be unaware of where to look for the most accurate and qualified information on franchise ownership. As a result of franchisees' unawareness, they will be forced to invest major cognitive efforts in order to ascertain which risks are unknown to them and where to seek accurate

¹⁰³ Spencer, *supra* note 52, at 32.

information regarding those risks.¹⁰⁴ Such a task is extremely challenging, given that conducting a high-quality investigation into the matter demands that one knows enough to know what is not known.¹⁰⁵

Not only do inexperienced franchisees face an unawareness problem, but they must also cope with a screening difficulty. In particular, they must expend great cognitive efforts in order to differentiate between relevant and irrelevant business and legal information on franchise ownership, in which they most likely have never engaged.¹⁰⁶ Such a screening task presents a real challenge, since novice franchisees who wish to make an optimal franchise investment decision must examine an overwhelming amount of complex information before signing a franchise contract. Specifically, at a preliminary stage the franchisee generally must invest time in the following steps:¹⁰⁷ reading complex franchise directories,¹⁰⁸ reading articles in franchise

¹⁰⁴ Hadfield, *supra* note 52, at 978 n. 232 (“[I]nexperience of the franchisee ... make[s] the identification of franchisor opportunism very difficult”). See also Robert G. Lord & Karen J. Maher, *Alternative Information Processing Models and Their Implications for Theory, Research, and Practice*, 15 ACAD. MGMT. REV. 9, 14 (1990).

¹⁰⁵ Cf. Naomi Miyake & Donald A. Norman, *To Ask a Question, One Must Know Enough to Know What is Not Known*, 18 J. VERBAL LEARNING AND VERBAL BEHAVIOR 357, 357 (1979).

¹⁰⁶ Cf. Joseph W. Alba & J. Wesley Hutchinson, *Dimensions of Consumer Expertise*, 13 J. CONSUMER RES. 411, 419 (1987).

¹⁰⁷ INTERNATIONAL FRANCHISE ASSOCIATION, AN INTRODUCTION TO FRANCHISING 13-14 (2001), available at http://www.franchise.org/uploadedFiles/Franchise_Industry/Resources/Education_Foundation/Intro%20to%20Franchising%20Student%20Guide.pdf [hereinafter AN INTRODUCTION TO FRANCHISING].

business publications,¹⁰⁹ attending business trade shows and expositions, and conducting related research on the internet. Following this preliminary stage, the franchisee will have to contact selected franchisors in order to acquire detailed business and legal information regarding each individual franchise opportunity. She then will receive a massive amount of material requiring business and legal analysis.¹¹⁰ This material will include lengthy promotional items, operational items, and complex legal items including the Franchise Disclosure Document (FDD).¹¹¹ Upon receipt of detailed material on selected franchise opportunities, the franchisee may be required to take the following additional steps:¹¹² interview potential franchisors,¹¹³ interview existing

¹⁰⁸ Famous franchise directories include: “The Franchise Opportunities Guide,” “The Executives’ Guide to Franchise Opportunities,” “Bond’s Franchise Guide,” “The Franchise Annual,” “Franchise Handbook,” and “How Much Can I Make?” *Id.*

¹⁰⁹ Major relevant franchise business publications include: Franchise Times, Franchising World, and Franchise Update. *Id.*

¹¹⁰ ROBERT HAYES, THE FRANCHISE HANDBOOK: A COMPLETE GUIDE TO ALL ASPECTS OF BUYING, SELLING OR INVESTING IN A FRANCHISE 34-35 (2006).

¹¹¹ *Id.* at 35, 37; the FDD is a complex document which contains, as required by the FTC's rules, 23 specific items of detailed information about the offered franchise, its officers, and other franchisees. *See FTC Issues Updated Franchise Rule*, FEDERAL TRADE COMMISSION JAN. 23, 2007), available at <http://www.ftc.gov/opa/2007/01/franchiserule.shtm>.

¹¹² *See* Navigate the Paper Trail, ENTREPRENEUR (last visited Aug. 1, 2011), available at <http://www.entrepreneur.com/article/36392-1>.

¹¹³ Such interviews may include an examination of the following business aspects: franchisor business experience, the total investment required to setup and operate a franchise, franchisor training plans, franchisor products, franchisor advertisement and marketing methods and plans, and the franchisor’s ongoing business support to its existing franchisees. *See e.g.*, AN INTRODUCTION TO FRANCHISING, *supra* note 107, at 27-29.

franchisees,¹¹⁴ examine lengthy and complex franchise agreements, review audited financial statements, and conduct trade-area surveys.¹¹⁵

In addition to the screening difficulty, franchisees face comprehension obstacles at the pre-contractual stage. Again, most inexperienced franchisees lack an adequate base of knowledge on what it takes to own any business, let alone a franchise unit. Specific to this context, they generally lack adequate knowledge of franchise ownership terminology, the attributes of a franchise owned unit, criteria for evaluating a franchise system, and criteria for comparing different franchise systems. Given this lack of knowledge, inexperienced franchisees find it difficult to comprehend and evaluate the complex legal and business data available to them at the pre-contractual stage.¹¹⁶ Indeed, prospective franchisees often report that when they read legal FDDs, they are seized by a condition dubbed "MEGO—My Eyes Glaze Over."¹¹⁷

¹¹⁴ Such interviews may include an investigation of the following business aspects: level of training, quality of products or service, level and promptness of support, operations and quality of the operations manuals, earnings potential/claims, and any problems or difficulties with the franchisor. *See, e.g.,* AN INTRODUCTION TO FRANCHISING, *supra* note 107, at 30-31.

¹¹⁵ *See* Navigate the Paper Trail, *supra* note 112.

¹¹⁶ *Cf.* Merrie Brucks, *The Effects of Product Class Knowledge on Information Search Behavior*, 12 J. CONSUMER RES. 1, 3 (1985); *see also* Susan T. Fiske et al., *The Novice and the Expert: Knowledge-Based Strategies in Political Cognition*, 19 J. EXP. SOC. PSYCHOL. 381, 384-85 (1983); Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 726 (2011).

¹¹⁷ Andrew A. Caffey, *Franchise Research Basics: How to Compare Similar Opportunities*, ALL BUSINESS (NOV. 16, 2009), available at <http://www.allbusiness.com/franchises/buying-a-franchise/13420130-1.html#ixzz1ffLMIAbF>.

Given the significant unawareness, screening and comprehension obstacles that novice franchisees face at the pre-contractual stage, they frequently discount important information already at that stage.¹¹⁸ The dismissal of information occurs in order to simplify cognitively the complex pre-contractual investigation.¹¹⁹ In the process of simplification, novice franchisees eliminate data from consideration on the basis of expediency rather than importance.¹²⁰ The incompetence of novice franchisees ultimately causes them to base their decisions on relatively shallow aspects that might be relatively quick and easy to judge, such as franchise advertisements, newspaper articles, and franchise prices.¹²¹ In contrast with the franchisor advocates' view, the significant cognitive obstacles faced by novice franchisees actually lead them to ignore franchise disclosure documents, avoid conducting a thorough comparison of

¹¹⁸ Cf. John Kim et al., *Consumer Expertise and the Vividness Effect: Implications for Judgment and Inference*, 18 ADV. CONSUMER RES. 90, 90 (1991) (“Novices are likely to underprocess information because they lack the cognitive resources required to construe the inferential implications of a large set of product-related information”). See, e.g., Alba & Hutchinson, *supra* note 106, at 419.

¹¹⁹ Cf. Alba & Hutchinson, *supra* note 106, at 419.

¹²⁰ Cf. *Id.*

¹²¹ Cf. Fred Selnes & Sigurd Villads Troye, *Buying Expertise, Information Search, and Problem Solving*, 10 J. ECON. PSYCHOL. 411, 415, 425 (1989); Akshay R. Rao & Kent B. Monore, *The Moderating Effect of Prior Knowledge on Cue Utilization in Product Evaluations*, 15 J. CONSUMER RES. 253, 255 (1988); Meryl Paula Gardner, *Advertising Effects on Attributes Recalled and Criteria Used for Brand Evaluations*, 10 J. CONSUMER RES. 310, 312-13 (1983); Robert A. Baron & Michael D. Ensley, *Opportunity Recognition as the Detection of Meaningful Patterns: Evidence from Comparisons of Novice and Experienced Entrepreneurs*, 52 MGMT. SCI. 1331, 1340 (2006).

various franchise contracts and disclosure documents, and refrain from consulting with a specialized franchise attorney before signing the franchise agreement.

2. Empirical Evidence

In fact, there is ample empirical evidence supporting the conclusion that the significant cognitive obstacles that novice U.S. franchisees face at the pre-contractual stage lead them to ignore important data, as emphasized above. For example, Kimberly Morrison's study, based on data collected by a mailed questionnaire from 307 U.S. franchisees in various industries, revealed that most franchisees ignored the franchise disclosure documents before investing in the franchise.¹²² In addition, her study demonstrated that most franchisees did not consult with a lawyer before the signing of the franchise contract.¹²³ Likewise, Anderson, Condon & Dunkelberg obtained data from 61 franchisees using mailed questionnaires.¹²⁴ According to their data, franchisees examined only an average of about three different franchise chains before selecting the franchise they own. This fact stands in sharp contrast with franchisors' advocates' assumption that franchisees possess the cognitive ability to compare numerous – it is safe to assume hundreds – of franchise contracts available at the market, before signing the franchise agreement.¹²⁵

¹²² Cf. Morrison, *supra* note 77, at 29-31.

¹²³ *Id.* at 31.

¹²⁴ Anderson, *supra* note 84, at 99.

¹²⁵ See *supra* note 35.

Furthermore, empirical studies show that the lack of adequate pre-investment investigation conducted by inexperienced franchisees is not unique to U.S. franchisees. Franchisees' inadequate inquiry is a global phenomenon, which is derived from the fact that franchisees are, by their very nature, inexperienced.¹²⁶ To illustrate, Frazer, Marrilees and Wright, adopting a qualitative methodology, conducted in-depth interviews with 18 Australian franchisors, current franchisees, and ex-franchisees.¹²⁷ One general conclusion that emerged from those interviews was that potential Australian franchisees who lack business experience tend to enter franchising on the basis of little or no research or investigation.¹²⁸ Likewise, Weaven, Frazer and Giddings conducted in-depth interviews with 24 Australian franchising experts, such as franchisors, franchising consultants, franchising academics, franchise brokers, and mediators.¹²⁹ Most of the interviewees agreed that franchisees who had no prior business experience tended to seek relatively little advice from lawyers and other advisors prior to entering franchise agreements.¹³⁰ In a related study, John Stanworth, using mailed questionnaires and interviews, obtained data from 380 U.K. franchisees in a variety of industries.¹³¹ According to his study, most of those franchisees who had consulted with advisors before signing the franchise contract were

¹²⁶ See *supra* Part IV.A.

¹²⁷ Lorelle Frazer et al., *Power and Control in the Franchise Network: An Investigation of Ex-Franchisees and Brand Piracy*, 23 J. MKTG. MGMT. 1037, 1044 (2007).

¹²⁸ *Id.* at 1048.

¹²⁹ Scott Weaven et al., *New Perspectives on the Causes of Franchising Conflict in Australia*, 22 ASIA PACIFIC J. MKTG. AND LOGISTICS 135, 138 (2010).

¹³⁰ *Id.* at 148.

¹³¹ John Stanworth, *Franchising and the Franchise Relationship*, 1 THE INT'L REV. OF RETAIL, DISTRIBUTION AND CONSUMER RES. 175, 183-84 (1991).

convinced that their advisors were not knowledgeable about franchising,¹³² indicating that those franchisees who consulted with a legal advisor did not consult with a specialized one. Likewise, Hatcliffe, Mills, Purdy and Stanworth obtained data from 169 U.K. franchisees through mailed questionnaires and interviews.¹³³ According to their study, most franchisees seriously considered only one or two franchise chains before selecting the franchise they owned.¹³⁴

Notably, these empirical studies – showing that novice franchisees around the world do not conduct adequate research and investigation prior to signing the franchise contract – confirm the anecdotal statements of various franchise specialists. Two such specialists, Andrew Selden and Rupert Barkoff, both of whom served as Chairs of the American Bar Association Forum on Franchising, state that “many franchisees never consult a lawyer in the process of buying a franchise.”¹³⁵ Similarly, Elizabeth Spencer, a scholar, specialized in franchising, states that “many franchisees are unaware of the need for advice or are unable to secure the quality of advice they need.”¹³⁶ Likewise, Keith Kanouse, a U.S. franchise attorney boasting 22 years of

¹³² *Id.* at 186.

¹³³ Mark Hatcliffe et al., *Prospective Franchisees*, in 1 FRANCHISING IN BRITAIN REPORT 1, 4 (Lloyds Bank Plc/IFRC, 1995).

¹³⁴ *Id.* at 9.

¹³⁵ Andrew C. Selden & Rupert M. Barkoff, *Counseling Franchisees*, in FUNDAMENTALS OF FRANCHISING 289, 291 (Rupert M. Barkoff & Andrew C. Selden eds., 3rd ed. 2008).

¹³⁶ Spencer, *supra* note 52, at 32; *See also* Robert W. Emerson, *Franchisees Without Counsel: Presumed Competent* (Jan. 12, 2012) (unpublished manuscript, on file with author) (detailing a 2008-09 survey of franchisor attorneys who found that a large number of prospective franchisees were completely unrepresented or were poorly counseled about federal and state franchise laws and the interpretation thereof).

experience in franchise matters, claims that most prospective franchisees simply do not read franchise disclosure documents.¹³⁷

V. CONCLUSION

As a key, initial step in evaluating franchise regulation schemes, we must understand that the opposition to franchise relationship laws is largely based on the assumption that franchisees are sophisticated business people who (1) consider all relevant information and (2) make a well-informed choice among the range of franchise alternatives available to them before signing a franchise contract. However, empirical evidence raises much doubt regarding this assumption. In reality, new franchisees are likely to be lacking prior business experience. This lack of experience presents significant cognitive obstacles for novice franchisees at the pre-contractual stage. Inexperienced franchisees must invest significant cognitive efforts in identifying the risks about which they are ignorant and then find accurate information on them. Novice franchisees must also expend significant cognitive efforts in order to differentiate between relevant and irrelevant information. Moreover, it is extremely difficult for inexperienced franchisees to comprehend the entirety of the data to which they are exposed in the pre-contractual process. Given these cognitive obstacles, franchisees often discount important information at the pre-contractual stage. Franchisees ignore disclosure documents, do not compare various franchise opportunities, and refrain from consulting with a specialized franchise attorney. Given this reality, theoreticians and legislators interested in creating franchise laws that protect novice

¹³⁷ Roberta Maynard, *Choosing a Franchise*, 84 NATION'S BUSINESS 56, 62R (1996).

franchisees from possible opportunism by franchisors must cast doubt on the assumption that franchisees are sophisticated, well-informed business people and incorporate into their analyses a more reflective conception of franchisee behavior. The assumption that franchisees consider all relevant information before signing a franchise contract has little theoretical or empirical support in actual practice and thus opens the door to reconsider the adoption of franchise relationship laws.