ARTICLE

TRANSPARENCY IN FRANCHISING

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Prospective franchisees often enter into the franchisor-franchisee relationship without truly knowing what they are getting into, leading to franchisee confusion, disappointment, and frustration. As a countermeasure, the FTC's Franchise Rule compels pre-contract disclosures intended to foster a prospective franchisee's understanding of the franchisor, its network, and the proposed franchise arrangement. The Rule should create stronger franchises and deter misconduct. Securing legal assistance during the negotiation phase can very much help aspiring franchisees; legal counsel can explain the disclosure document, clarify and perhaps improve the franchise contract, and ensure that the potential franchisee's interests are understood, represented, and, in some cases, advanced.

Franchise parties require more transparency. The Franchise Rule itself is not so much the problem as is how the Rule is interpreted and enforced. Prospective franchisees may not understand the laws and guidance the FTC has set forth. Furthermore, third-party legal websites may lead franchisees astray and muddy the franchising waters. A survey conducted for this Article seems to indicate there is a psychological deterrent to procuring the "traditional" legal services offered by lawyers. Approximately 2,700 survey respondents, provided with numerous types of hypothetical situations, ultimately determined the threshold amounts at stake before they would hire a lawyer. Results of these and other surveys indicate the centrality of franchisee access to and control of legal

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information; unfortunately, economic irrationality often takes hold, as, for example, respondents often think in terms of percentages when the rational approach is to evaluate a monetary expense by looking at real dollar value.

Filling the gap for unrepresented franchisees may be Internet-based companies, such as LegalZoom and Rocket Lawyer, offering information and forms to would-be franchisees. While their services and products usually are less expensive, these websites are inadequate substitutes for the guidance of traditional lawyers. Indeed, these and other legal information companies distinguish what they do from the personal, professional representation offered by traditional lawyers; implicitly, we see how the traditional lawyer's counsel may be what potential and current franchisees need most. The wide availability of online law forms and information sites only exacerbates transparency concerns, especially as many potential franchisees forego traditional counsel in favor of a "do it yourself" approach. Clearly, increased regulation for online legal self-help companies may be appropriate. Many franchisees rely on insufficient information, have an overconfidence bias, fail to undergo an adequate cost-benefit analysis, and overlook the franchise relationship's information asymmetry. Legal counsel can be a vital asset for franchisees, particularly since the FTC is an infrequent enforcer and has left the regulation of franchising substance to state law.

In summary, this Article presents some possibilities for promoting greater transparency through regulatory reform. There could, for instance, be required earnings claims, heightened agency review of franchisor statements, and expanded agency pursuit of franchisor deception or other violations of statutes or rules. Franchisee protection may also occur through the active involvement of franchisee associations in negotiating and forming the franchise relationship. Finally, an expanded set of claims enabling franchisees to bring a private right of action could help furnish them a fair, ultimate recourse to preserve and protect their statutory rights. Equally important, such an expansion of the litigation target zone (franchisee suits including a cause of action based on a serious

Franchise Rule infraction) may make franchisors more careful to obey the law and to respect the needs of franchisees.

I. INTRODUCTION

Much of the dissatisfaction and disappointment experienced by many prospective franchisees during and after the franchise formation process stems from one overarching problem: a lack of transparency when creating their franchisor-franchisee relationships. There is a detailed federal disclosure scheme intended to reduce the ambiguity inherent in the relationship,[1] but it often fails to address problems adequately. Although the scheme aims to thwart franchisor deceptions and omissions by requiring franchisors to release timely information, the current regulatory environment does not provide franchisees with a clear view of the franchise relationship's most vital components—i.e., the nature of the franchisor's business and of the proposed franchise—*before* they execute the franchise agreement.

With analysis and proposals, this Article seeks to promote both franchise parties' interests and to prevent transparency problems. It presents an overview of what the traditional, normative solutions to the transparency problem offer to franchisors and franchisees.[2] Just as important, it examines how franchisees can engage in due diligence.[3] Among other things, it outlines the importance of obtaining experienced franchise counsel. A survey conducted for this Article suggests

[1] *See infra* Part III.

[2] These solutions include common-law self-advocacy, such as suits for misrepresentation. *See infra* note 265 and accompanying text.

[3] *See infra* Sections V.A–.B.

that there may be a psychological deterrent to procuring "traditional" legal services, but the exclusive use of online legal services[4] for gathering information or for drafting franchise documents[5] is exceptionally risky.

This Article also presents possible reforms designed to improve transparency. There could be *required* franchisor earnings claims, heightened agency review of franchisor statements, and agency pursuit of franchisor deception or other violations of statutes or rules. Franchisee protection may also come from franchisee associations' active involvement in negotiating and forming the franchise relationship. Perhaps most importantly, expanding private rights of action for franchisees could help franchisees exercise their last, and likely best, recourse in the face of regulatory violations. This expansion of the litigation "target zone"[6] may also make franchisors more careful to obey the law and to respect the needs of franchisees.

With transparency in mind, this Article examines business franchising regulation techniques, including required disclosures meant to prevent deceptive behavior by franchisors. The Article also briefly evaluates other avenues of legal recourse for those common, but certainly far from universal, circumstances when persons have, quite predictably and foolishly, purchased a franchise. Part II of the Article outlines basic issues and concerns about transparency. Part III discusses federal regulations, the franchise relationship, franchisor misrepresentations, and the need to oversee online legal service providers that are contributing to franchisee ignorance. Part IV of the Article then shifts away from governmental regulation to assess the level of common-law self-advocacy available to franchisees. Part V introduces

[4] *E.g.*, LegalZoom, Rocket Lawyer, Avvo Advisor, Incfile, and UpCounsel.

[5] *See infra* Section V.B.

[6] This larger zone might include actions for breach of contract, misrepresentation, violation of a duty of good faith and fair dealing, and unfair competition, among many other possible claims grounded in franchisor wrongs. The franchisee's cause of action might also include claims directly based upon one or more Franchise Rule infractions.

empirical evidence in the form of a survey and reconciles earlier observations with analysis of the current regulatory environment's effectiveness, or lack thereof, in facilitating franchise agreement transparency. Finally, Part VI describes actions franchisors can take to improve franchising outcomes, and Part VII recommends steps franchisors or franchisees can take to improve transparency and promote their own interests.

II. THE TRANSPARENCY PROBLEM

A. The Problem

Envision yourself as a middle manager, frustrated with your job and unhappy with your income. You desire some control over your work environment and your future. You contemplate a career transition, after which you will no longer be someone's employee but instead a business owner with the rewards of higher pay and less structure. The idea of being an entrepreneur intrigues you, but you remain risk averse.

These considerations of flexibility, control, and risk tolerance lead you to explore some small business opportunities. Specifically, you begin to consider franchise opportunities. Your first stop is a franchisor's website.[7] Soon, a franchise sales representative woos you, promising an opportunity that you believe will meet your needs and maybe even fulfill your dreams. Next, you return to the internet, which seems to be a one-stop shop for legal information. There is plenty of material discussing franchisees and franchisors, with sources ranging from law firms' online pages to online legal services.[8]

After some basic research, you feel confident and decide to purchase a franchise. You, however, make the decision to

[7] For an example of such a website, see generally *U.S. Franchising*, MCDONALD'S, http://corporate.mcdonalds.com/mcd/franchising/us_franchising.html [https://perma.cc/74J4-J5ZX] (last visited Nov. 21, 2020).

[8] For example, online service provider LegalZoom offers a brief summary of franchising. *See* Belle Wong, *How To Start a Franchise*, LEGALZOOM, https://www.legalzoom.com/articles/how-to-start-a-franchise [https://perma.cc/V3X2-RMLE] (last updated Apr. 20, 2018).

forego traditional legal representation. Quickly, you realize that your business model and practices are far more controlled as part of a franchise system than the model and practices of a genuine entrepreneur. You may feel like you have substituted one job for another—still adjusting your actions to meet demands and requirements placed upon you. The main difference between life as an employee and life as a franchisee is that you had to pay a heavy start-up cost to become a franchisee,[9] and this has translated into earnings well below what you had envisioned.[10]

Sadly, franchisees find themselves in this situation every day. The franchisee's inability to foresee this reality often stems from a lack of transparency when the franchisor and franchisee form a franchise relationship.[11] The internet and its numerous sources of legal information only muddle the situation by giving franchisees a false sense of understanding, causing them to forego seeking advice from experienced franchise attorneys.[12] This lack of transparency in the creation of the franchisor-franchisee relationship is as important as any other franchising issue, because incomplete and imprecise communication about the true nature of the franchise opportunity is directly responsible for problems such as franchisee confusion, disappointment, and frustration.[13]

[9] *See* Renee Bailey, *How Much Does It Cost to Open a Fast Food Franchise in the United States?*, FRANCHISE DIRECT, https://www.franchisedirect.com/information/howmuchdoesitcosttoopenafastfoodfranchiseintheunitedstates/ [https://perma.cc/2SPT-PHFF] (last visited Dec. 20, 2020) (reporting estimated initial franchise investment requirements ranging from as low as $95,700 to as high as $3,398,600).

[10] *See* Jason Daley, *An Investigative Report on Franchise Profits*, ENTREPRENEUR (Oct. 21, 2013), https://www.entrepreneur.com/article/228698 [https://perma.cc/45JX-VTB3] (summarizing a report finding that 51.5% of food franchises earn profits of less than $50,000 a year and that the average profit is $82,033—not "too bad, until you factor in the initial investment").

[11] I survey regulatory responses to this problem and some of their shortcomings *infra* Section III.B.

[12] For a discussion of this problem, see *infra* Section V.B.

[13] *See* Kerry Miles, *Communication and Lack of Trust in Franchising*, FRANCHISEED (Mar. 22, 2018), https://www.franchise-ed.org.au/franchisor/communication-lack-trust-franchising/ [https://perma.cc/X5LL-

B. Solutions

The problems that arise after the formation of an ironclad contract are not easily resolved by the franchisee. In fact, the issues may not be resolvable at all. Franchisee unhappiness and failure sometimes accompany the proper functioning of a franchise system under the very terms and restrictions of the franchise agreement and the operations manual. For example, franchisees may encounter decreases in net profits because of increases in product costs from mandatory vendors.[14] Likewise, a franchisee's mandatory franchise fees may diminish high gross sales.[15]

These problems may result from a lack of transparency before franchisees accept the terms and restrictions that will bind them in their franchise relationships, leading to surprises in their business ventures. The long terms of franchise contracts compound these problems.[16] Such lengthy obligations are often necessary for franchisees to recoup their

SBXN] ("[According to a recent study] [t]ransparency was one of the messages reiterated throughout the public and the media when discussing how to prevent and solve a range of everyday franchise problems. . . .[, but only] half of franchisees . . . believe[d] in the accuracy of information provided by their franchisor.").

[14] Typically, a franchisor requires a franchisee to purchase certain goods from particular vendors approved by the franchisor. *See* Rick Grossman, *What Franchisees Need to Know About Vendor Contracts*, ENTREPRENEUR (Jan. 20, 2017), https://www.entrepreneur.com/article/286682 [https://perma.cc/K7BL-U433]. This can be hard on franchisees when they can get the same product for a cheaper price somewhere else. *See id.*

[15] *See* Michael Seid, *Pricing of Franchises: How To Charge for Fees (Initial, One-Time, Ongoing, Advertising) and Direct or Indirect Sales*, MSA WORLDWIDE, https://www.msaworldwide.com/blog/pricing-of-franchises/ [https://perma.cc/3SBB-WD6A] (last visited Dec. 20, 2020) (discussing fee setting); FED. TRADE COMM'N, A CONSUMER'S GUIDE TO BUYING A FRANCHISE 1–2, 8 (2015), https://www.ftc.gov/system/files/documents/plain-language/pdf-0127_buying-a-franchise.pdf [https://perma.cc/6YMB-Z79P] (discussing ongoing fees as well as required renovation and design costs).

[16] Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 691 tbl. C (finding the median term of a franchise in 2013 was ten years).

initial investment,[17] but a commitment to this long-term relationship locks in surprise terms.

From the outset, the franchisor should clearly communicate everything about its business network and the duties of each party. This communication protects the franchisor from potential liability and helps a prospective franchisee become informed and capable. The methods currently used to communicate this information to prospective franchisees, however, have proven ineffective.[18] Providing this information to the franchisee in writing does not immediately make the information or its implications transparent. A franchisee may misread the contract terms or misjudge the franchise relationship, or a misinterpretation may arise from the franchisor's words, conduct, or other factors.[19] Often, though, an experienced franchise attorney could overcome these misconceptions easily.[20]

The law can be a powerful tool to remedy the problems created by a lack of transparency, but the law should also strive to prevent these problems. The key goal in designing a legal solution should be providing more transparency in franchisor-franchisee relationships and thereby minimizing the success rate of deceptive practices and misleading claims. If regulatory measures can clarify the ambiguity in franchise relationships, then the law should impose on parties—e.g., franchisors—a duty to employ those means necessary to prevent franchise relationships from forming in a state of misunderstanding. That is, as opposed to reactive and remedial protections alone, the ideal solution provides the franchisee with a clearer view of the nature of the franchisor's

[17] The franchise agreement's initial term "should be of sufficient length for a franchisee to reasonably amortize the initial investment to achieve an adequate and fair return on investment." FAIR FRANCHISING STANDARDS § 5.1 (AM. ASS'N OF FRANCHISEES & DEALERS 2012).

[18] For a discussion of the current regulatory scheme, see *infra* Part III.

[19] *See* Robert W. Emerson, *Fortune Favors the Franchisor: Survey and Analysis of the Franchisee's Decision Whether to Hire Counsel,* 51 SAN DIEGO L. REV. 709, 723–24 (2014) (noting the likelihood that unrepresented franchisees will not understand their complex franchise agreements).

[20] *See id.*

business and the proposed franchise relationship before a franchise contract is executed.

III. FEDERAL REGULATION

"[W]henever I go down to Washington and meet with the SEC and complain to them that the industry is either overregulated or the burdens are too great they all start to roll their eyes, just like all of our children do whenever we talk about the good old days." ~ Bernard Madoff [21]

A. The FTC and Consumer Protection

Business franchises are increasingly popular business arrangements in both domestic and global marketplaces.[22] The arrangement serves both the franchisor's need to expand its business and the franchisee's preference to minimize risk by operating a tried and tested business plan. Business franchising is so popular that many foreign jurisdictions—including Japan and the European Union—have specific codes of ethics outlining the proper behaviors and requirements of the franchise parties.[23] Moreover, the International Franchise

[21] philoctetesctr, *The Future of the Stock Market*, YOUTUBE (Jan. 23, 2009), https://www.youtube.com/watch?v=B2YZdzzYtlE (transcript on file with the Columbia Business Law Review) (begin viewing at twenty-six minutes, fifty seconds). This, of course, is not intended to imply that most regulated industries are replete with fraudsters, let alone criminal schemes of the magnitude perpetrated by Bernie Madoff, but it is instructive to see that complaints of overregulation may not always be good faith assessments of regulatory burdens.

[22] *See* Emerson, *supra* note 16, at 641, 642 & n.2. A number of studies find that, "[i]n the United States, franchised businesses account for one-third of all retail sales, with approximately 750,000 operating franchised units employing over eight million people." *Id.* at 642 (footnotes omitted).

[23] *See, e.g.*, *generally* THE EUROPEAN CODE OF ETHICS FOR FRANCHISING (EUR. FRANCHISE FED'N 2003), http://www.eff-franchise.com/Data/Code%20of%20Ethics.pdf [https://perma.cc/45L3-FKMC]; *JFA's Code of Ethics*, JAPAN FRANCHISE ASS'N, http://jfa.jfa-fc.or.jp/jfas_Code_of_Ethics_English.html [https://perma.cc/EB9L-4FSJ] (last visited Dec. 20, 2020). For many nations, self-regulation may be the proven pathway when governmental regulation is, temporarily, quite unlikely. *See* John Pratt & James Barrett, *Franchising in the United*

Association has taken great strides to promote its own code of ethics.[24] But, however well-intentioned, a code of ethics may lack the coercive power to ameliorate the bad behavior of franchisors. Code violations may be insufficient to prompt judicial or arbitral remedies unless the misdeeds are severe enough to breach, implicitly or expressly, standards found in statutes, regulations, or case law.[25]

Fortunately, in the United States, franchisees enjoy legal protections from the deceptive practices of franchisors through an independent agency, the Federal Trade Commission (FTC), with broad jurisdiction to regulate franchised businesses.[26] Section 5(a) of the FTC Act gives the agency the authority to prevent businesses from engaging in unfair or deceptive trade practices.[27] In effect, a franchisee duped into buying a franchise is comparable to a customer fooled into buying a bad product. Fittingly, it is the Bureau of Consumer Protection, a part of the FTC meant to protect consumers against unfair or deceptive acts or practices in

Kingdom, 38 FRANCHISE L.J. 1, 4 (2018) (noting that United Kingdom clearly leaves franchise regulation to self-regulation through a voluntary body that represents the interests of the franchise sector).

[24] *See Our Mission Statement, Vision & Code of Ethics*, INT'L FRANCHISE ASS'N, https://www.franchise.org/about-us/mission-statement-vision-code-of-ethics [https://perma.cc/DZC9-EC4L] (last visited Dec. 20, 2020).

[25] *See* Robert W. Emerson, *Franchising Hard Law and Soft Law*, *in* HANDBOOK OF RESEARCH ON FRANCHISING 137, 152–54 (Frank Hoy, Rozenn Perrigot & Andrew Terry eds., 2017).

[26] In 1914, the 63rd Congress enacted, and President Woodrow Wilson signed, the act creating the FTC, the Federal Trade Commission (FTC) Act, Pub. L. No. 63-203, ch. 311, 38 Stat. 717 (1914) (codified as amended at 15 U.S.C. §§ 41–58 (2018)). This legislation was one attempt to combat trusts (coercive monopolies) and provide consumer protection—both significant political concerns of the Progressive Era. *See* Andrew M. Scott, *The Progressive Era in Perspective*, 21 J. POL. 685, 691–93 (1959).

[27] 15 U.S.C. § 45(a)(2) ("The [Federal Trade] Commission is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.").

commerce, that also regulates similar franchisor conduct affecting franchisees.[28]

Section 5(a)'s prohibition of unfair and deceptive acts and practices against consumers and competitors is broad.[29] This prohibition applies to nearly all persons and business entities.[30] The FTC's policy statement on deception includes the following:

> The Commission will find an act or practice deceptive if there is a misrepresentation, omission, or other practice, that misleads the consumer acting reasonably in the circumstances, to the consumer's detriment. The Commission will not generally require extrinsic evidence concerning the representations understood by reasonable consumers or the materiality of a challenged claim, but in some instances extrinsic evidence will be necessary.[31]

In other words, a franchisor's act or practice is deceptive if it misleads a reasonable franchisee to the franchisee's detriment.

FTC guidance helps to determine whether an act or practice qualifies as "deceptive."[32] For example, in analyzing small business advertising, the FTC adopts the reasonable consumer's perspective and looks at the advertiser's express and implied claims, nondisclosures that may leave a consumer with a misimpression about the product, and the evidence the

[28] Andrew Smith, Bureau of Consumer Prot., *About the Bureau of Consumer Protection*, FED. TRADE COMM'N, http://www.ftc.gov/bcp/about.shtm [https://perma.cc/4BHQ-8Y8S] (last visited Dec. 21, 2020) (describing the Bureau's methods of stopping "unfair, deceptive, and fraudulent business practices"). Common concerns for the Bureau include false advertising and identity theft. *See id.*

[29] *See* 15 U.S.C. § 45(a)(1).

[30] *See id.* § 45(a)(2).

[31] Letter from James C. Miller III, Chairman, Fed. Trade Comm'n, to Hon. John D. Dingell, Chairman, H. Comm. on Energy & Com. (Oct. 14, 1983), https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf [https://perma.cc/G8F9-6B44].

[32] *See id.*

advertiser had to support its claims.[33] The advertisement is deceptive if it misleads about "material" information.[34]

The FTC and the courts similarly analyze claims and misrepresentations to franchisees. In determining whether an act or practice is deceptive to a franchisee or prospective franchisee, courts consider whether the franchisor's representation, omission, or practice was likely to mislead a reasonable person.[35] Thus, the Commission is unlikely to pursue "puffery"[36] or representations of opinion because a reasonable person would not take either as fact.[37]

B. The Franchise Rule

The FTC has the authority to regulate franchisors under the Franchise Rule,[38] which it promulgated in 1978 and later

[33] *See id.*

[34] *See id.* "Material information" is information which influences the customer's decision to buy or use a product. *See* Fed. Trade Comm'n v. Colgate-Palmolive Co., 380 U.S. 374, 386–87, 391–92 (1965).

[35] *See* Bartholomew v. Burger King Corp., 15 F. Supp. 3d 1043, 1051–52 (D. Haw. 2014) (quoting Yokoyama v. Midland Nat'l Life Ins. Co., 594 F.3d 1087, 1092 (9th Cir. 2010)).

[36] Puffery is

> [t]he expression of an exaggerated opinion—as opposed to a factual misrepresentation—with the intent to sell a good or service. Puffing involves expressing opinions, not asserting something as a fact. Although there is some leeway in puffing goods, a seller may not misrepresent them or say that they have attributes that they do not possess.

Puffing, BLACK'S LAW DICTIONARY (11th ed. 2019) (bullet point omitted).

[37] *See* Cal. Dental Ass'n v. Fed. Trade Comm'n, 526 U.S. 756, 778 n.14 (1999) (discussing puffery); Intermountain Stroke Ctr., Inc. v. Intermountain Health Care, Inc., 638 F. App'x 778, 786–87 (10th Cir. 2016) (discussing puffery and opinions).

[38] 16 C.F.R. §§ 436.1–436.11 (2020). The authority for this rule comes from section 18 of the FTC Act, providing that the FTC may prescribe "rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce" within the meaning of FTC Act section 5(a)(1). 15 U.S.C. § 57a(a)(1)(B) (2018). Under the Act, FTC rulemaking proceedings cannot commence unless the Commission has reason to believe that the practices to be addressed by the rulemaking are "prevalent." *Id.* § 57a(b)(3).

revised in 2007.[39] Specifically, the Franchise Rule regulates the disclosure and marketing of franchises.[40] The FTC periodically reviews the Franchise Rule to evaluate whether it is still effective in the marketplace.[41] On January 22, 2007, the Franchise Rule was amended, completely modifying the disclosure and timing requirements for franchisors.[42] One can see how franchisees (and society) might benefit from a rule that tries to maintain transparency in the marketing and advertising of business franchises by requiring disclosure of facts that are material to proposed franchise relationships.[43]

But franchisees are not the only active proponents of the Rule. When the FTC surveyed public opinion on the Franchise Rule in 2004, the Commission also received favorable comments from franchisors. Among the franchisors in support was "Cendant, a publicly traded company that owns several franchise systems including Howard Johnson, Ramada,

[39] *See* Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444, 15,445 (Mar. 30, 2007) (to be codified at 16 C.F.R. pts. 436, 437); Robert W. Emerson, *Franchise Contracts and Territoriality: A French Comparison*, 3 ENTREPRENEURIAL BUS. L.J. 315, 334–36 (2009) (discussing the development of the FTC's regulatory authority over franchises).

[40] 16 C.F.R. § 436.5 (requiring twenty-three specific items of franchisor disclosure); *id.* §§ 437.2–.7 (containing key provisions of the "Business Opportunity Rule," which regulates disclosure documents, earnings claims, records, and sales conducted in foreign languages).

[41] *See, e.g.*, *Reviewing the Franchise Rule: An FTC Workshop*, FED. TRADE COMM'N, https://www.ftc.gov/news-events/events-calendar/franchise-rule-workshop [https://perma.cc/GGF5-JBN5] (last visited Mar. 1, 2021) (describing the FTC's November 2020 "online public workshop" held "to explore a number of issues related to the FTC's Franchise Rule").

[42] The amended Franchise Rule went into effect on a voluntary basis on July 1, 2007, and its disclosure requirements became mandatory for all U.S. franchisors on July 1, 2008. *Amended Franchise Rule FAQ's*, FED. TRADE COMM'N, https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs [https://perma.cc/CCX2-4BZH] (last updated July 2, 2014).

[43] *Cf.* BRENT A. OLSON, CALIFORNIA BUSINESS LAW DESKBOOK § 34:9, Westlaw (database updated Dec. 2019) (describing the Franchise Rule's focus on disclosure rather than substantive regulation).

Century 21, Coldwell Banker, ERA, and Avis Rent-A-Car."[44] Franchisor support is less surprising when one considers that the Rule not only protects franchisees but also confers broad benefits to honest franchisors as well; an FTC Rule that limits deceptive business practices by competing franchisors confers a benefit on franchisors who engage in ethical sales practices.

1. Mandatory Disclosures

The Franchise Rule and the FTC's larger disclosure scheme have a few key provisions. First, all franchisors must supply prospective franchisees with a minimum level of disclosure.[45] This includes information on the nature of the franchise opportunity as well as information related to recurring funding requirements and fees.[46] Furthermore, the franchisor must disclose the number of new franchise locations and company-owned operations that the franchisor

[44] STEVEN TOPOROFF, EILEEN HARRINGTON & J. HOWARD BEALES, III, BUREAU OF CONSUMER PROT., FED. TRADE COMM'N, DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING 5–6 (2004), https://www.ftc.gov/sites/default/files/documents/reports/staff-report-bureau-consumer-protection-federal-trade-commission-and-proposed-revised-trade/0408franchiserulerpt.pdf [https://perma.cc/6A9U-A3UX].

> Other franchisors supporting the Rule include[d]: Better Homes & Gardens Real Estate Service, Re/Max Corporation, and The Prudential Real Estate Affiliates, Inc.; Snap-On, Inc.; Little Ceasars [sic]; The Southland Corporation (7-Eleven); Medicap Pharmacies; Forte Hotels; Pepsico Restaurants (Pizza Hut, Taco Bell, KFC, Inc.); Atlantic Richfield Company (ARCO); and Papa John's Pizza.

Id. at 6 n.16 (citations omitted).

[45] As amended in 2007, the Rule's disclosure provisions mandate that the franchisor reveal relevant data that can be helpful to the franchisee in making a wise purchasing decision. *See* Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. at 15,444 (detailing the amendments made to the disclosure rules). In addition to the requirements discussed in the text, the Franchise Rule requires that the franchisor offer the franchisee basic company information such as the identities of company officers and directors. *See* 16 C.F.R. § 436.5(b).

[46] *See* Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. at 15,447, 15,485.

is planning to open in the upcoming year.[47] The franchisor must also reveal the history of any failed or closed franchises or company-owned operations,[48] as well as its prior litigation with franchisees.[49]

Despite the goals of disclosure, and even though the FTC's Bureau of Consumer Protection is primarily tasked with enforcing laws prohibiting misrepresentation in the marketplace,[50] franchisors still mislead franchisees. For example, franchisors have to reveal the contact information and addresses of other franchisees in the area operating the same business.[51] Franchisors occasionally have responded to this requirement with opportunistic behavior, using a "franchisor's pet's" testimonials and statements of experience to misrepresent or otherwise falsely promote the business to prospective franchisees.[52]

A duplicitous franchisor may even induce a prospective franchisee to enter into a franchise agreement based on the exaggerations or outright falsehoods of the franchisor's employee.[53] The franchisor, knowing that representations made through its employee are false or at least in reckless disregard of the truth, runs the risk of liability during the

[47] *See* 16 C.F.R. § 436.5(t)(2)(iii)(G)(iii)–(iv).

[48] *See id.* § 436.5(t)(2)(ii)(E)–(I), (iii)(E)–(H).

[49] *Id.* § 436.5(c)(1), (3).

[50] *See* Margaret Krawiec et al., *FTC Trends in Consumer Protection*, 31 LOY. CONSUMER L. REV. 225, 226 (2019) (noting the FTC's enforcement focus on "imposter scams, improper debt collection practices, and identify theft").

[51] 16 C.F.R. § 436.5(t)(4).

[52] *Cf.* Hanley v. Drs. Express Franchising, LLC, No. ELH-12-795, 2013 WL 690521, at *19, *38 (D. Md. Feb. 25, 2013) (dismissing a fraud claim against a firm assisting Doctors Express in marketing its franchises but mentioning the possibility of a negligent misrepresentation claim).

[53] For an example of misconduct by a franchisor's employee, see Gordon Drakes, *Misrepresentation in Franchising - Important Lessons from Recent High Court Case*, LEXOLOGY (Oct. 16, 2018), https://www.lexology.com/library/detail.aspx?g=568b4b6d-c1f5-4cb7-9303-cb43b56197b4 [https://perma.cc/Q2V6-Q6BE] (discussing a case, *Ali v. Abbeyfield VE Ltd.* [2018] EWHC (Ch) 669, 2018 WL 01509193 (Eng.), involving false information provided by a franchise employee).

franchise recruitment sales process.[54] Another example of franchisor deceptive practices is when potential franchisees call a current franchisee and hear a story about how wonderful it is being a franchisee for company *X*, but fail to realize that they are essentially talking to a company robot reciting scripted lines.[55] Prospective franchisees can be lured into these schemes through various advertisements, soliciting through false earning projections and phony claims regarding the franchisor.[56]

2. Earnings Claims

Additionally, the Franchise Rule gives the franchisor discretion as to whether to make an "earnings claim" (or "financial performance representation" (FPR) to franchisees detailing the earnings a franchisee may make upon joining the franchise system.[57] There is much debate about whether earnings claims should be mandatory.[58] The FTC has maintained continuously a position against mandatory disclosure, voicing concerns that these claims might mislead franchisees and that "mandating earnings disclosures might impose burdens and costs on existing franchisees (that would have to release their earnings information to their franchisor)

[54] *See id*. (highlighting the fact that franchisors should invest in training sales staff so that they are aware of legal risk associated with communications to prospective franchisees).

[55] Some franchisors have manipulated even the phone numbers themselves, disguising them in order to make a foreign operation appear local. *See* Fed. Trade Comm'n v. USA Beverages, Inc., No. 05-61682 CIV, 2005 WL 5654219, at *3 (S.D. Fla. Dec. 6, 2005).

[56] *Id*.

[57] *See* FED. TRADE COMM'N, *supra* note 15, at 12. "The amended Rule uses the broad[er] term 'financial performance representation,'" instead of "earnings claim." *See* FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE 85 n.16 (2008), https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf [https://perma.cc/FDD2-3ET3] [hereinafter FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE].

[58] *See, e.g., generally* Marvin E. Rooks, *It Is Time for the Federal Trade Commission to Require Financial Performance Representations to Prospective Franchisees*, 11 WAKE FOREST J. BUS. & INTELL. PROP. L. 55 (2010).

without any record support showing that such increased burdens and costs are outweighed by benefits to prospective franchisees."[59] If the franchisor does make a claim regarding earnings, the franchisor must substantiate the claim with data or other proof that the claim is thorough and not merely premised on opinion.[60]

Item 19 (dealing with FPRs) is perhaps the most important aspect of the Franchise Disclosure Document (FDD), as most would-be franchisees home in on the key question: will a franchise bring a good return on the franchisee's investment?[61] Indeed, even when a franchisor does not intend to mislead, the falsity of its disclosure still matters.[62]

[59] David L. Cahn & Will K. Woods, *Item 19 Earnings Claims—A Disclosure Most Franchisors Should Try To Make*, 20 FRANCHISE L.J. 122, 122 (2001) (internal quotation marks omitted) (quoting Franchise Rule, 64 Fed. Reg. 57,294, 57,309 (Oct. 22, 1999) (to be codified at 16 C.F.R. pt. 436)); *see also* Elliot Ginsburg, *How To Safeguard Against Franchise Fraud in 2019*, FRANCHISE GATOR (Jan. 28, 2019), https://www.franchisegator.com /articles/safeguard-against-franchise-fraud-12736/ [https:/perma.cc/46X9-KM2G] (describing a prohibited practice known as "shilling" where existing franchisees are paid by the franchisor to disclose positive things about the franchise as a whole).

[60] *See* Cahn & Woods, *supra* note 59, at 123.

[61] Dan Matthews, *Should I Have a Financial Performance Representation (FPR) in My FDD?*, DRUMM L. (Oct. 30, 2019), https://drummlaw.com/blog/financial-performance-representation/ [https://perma.cc/8GVR-UF29]. Franchisors must have a "reasonable basis" for any FPR at the time they make it; what constitutes a reasonable basis—and the information needed to support an FPR—is fact-specific and dependent on the representation made. *See* N. AM. SEC. ADM'RS ASS'N, NASAA FRANCHISE COMMENTARY ON FINANCIAL PERFORMANCE REPRESENTATIONS, (2017), http://nasaa.cdn.s3.amazonaws.com/wp-content/ uploads/2017/05/Financial-Performance-Representation-Commentary.pdf [https://perma.cc/V326-HQGN]; 16 C.F.R. § 436.5(s)(3) (2020); SUSAN GRUENEBERG & DAVID J. KAUFMANN, THE NEW ITEM 19 COMMENTARY AND OTHER ADVANCED PERFORMANCE FINANCIAL REPRESENTATION ISSUES 10–21 (2017), https://www.franchise.org/sites/default/files/TheNewItem19 CommentaryandOtherFPRIssues.pdf (on file with the Columbia Business Law Review) (describing the North American Securities Administrators Association's commentary on earnings claim disclosures).

[62] *See supra* note 61 (discussing the "reasonable basis" standard for FPR disclosures).

Thus, inaccurate FPR disclosures, regardless of intent, can be the source of franchise litigation. It remains to be seen if, and to what extent, a franchisor will be liable for misleading prospective franchisees by presenting an FPR based on data that reflects franchise financial performance from a pre-COVID-19 pandemic period.[63] Arguably, in order to avoid lawsuits, it may be appropriate for franchisors to include a cautionary statement combined with an assertion of good faith in making the FPR.[64]

IV. THE REALITY OF THE LAW: FILLING THE GAPS MOVING FORWARD

Transparency is not just an issue in franchise relations but is an integral issue to all contracts. Considering the necessity of transparency in all contractual relations, is there any reason to afford special protection to franchisees? The concept

[63] *See* Matthews, *supra* note 61 ("Item 19 tends to be high risk from a litigation standpoint, and should a franchisee become unhappy with the franchise relationship, its attorney will likely try to pick apart the Item 19 to find anything unreasonable or misleading."); Eleanor Vaida Gerhards, *FDD Item 19 Financial Performance Representations in the Age of COVID-19*, FOX ROTHSCHILD LLP (Apr. 14, 2020), https://franchiselaw.foxrothschild.com/2020/04/articles/draf ting -tips/fdd-item-19-financial-performance-representations-in-the-age-of-covid-19/ [https://perma.cc/4GF9-AZ85]; *see also generally* Stuti Murarka, *Item 19 During COVID-19*, FRANCHISE LAW., Summer 2020, at 3.

[64] *See* Gerhards, *supra* note 63. Otherwise, if the negative impacts of COVID-19 cause a material change to the franchisor's financial condition or any FPR in Item 19, or if the franchisor files for bankruptcy, the franchisor must amend the FDD. *See COVID-19: Key Questions Franchisors Are Asking*, DLA PIPER (Apr. 6, 2020), https://www.dlapiper.com/en/us/insights/publications/2020/04/covid19-key-questions-franchisors-are-asking/ [https://perma.cc/3K5N-KXEW]; 16 C.F.R. § 436.7(d) ("When furnishing a disclosure document, the franchise seller shall notify the prospective franchisee of any material changes that the seller knows or should have known occurred in the information contained in any financial performance representation made in Item 19 (section 436.5(s))."); Michael Gray, *Revisiting Franchise Agreements in Light of COVID-19*, LAW360 (Apr. 2, 2020, 4:21 PM), https://www.law360.com/articles/1258162/revisiting-franchise-agreements-in-light-of-covid-19 [https://perma.cc/WXX5-EG52] (describing franchise agreement provisions that merit review).

of relative power[65] provides a credible reason for this special consideration. Historically, franchisees have been in weaker positions relative to the franchisor, such that they have little or no bargaining power and are susceptible to deception at the hand of the franchisor.[66] This rationale alone supports the argument for some additional forms of protection.

If additional disclosure regulation is unnecessary or—at the very least—is unlikely to be enacted, then what other reforms could help resolve some of the problems in the fundamentally unfair relationship between franchisees and franchisors? The fact that hefty disclosures are still insufficient for franchisee needs[67] lends itself to the argument that disclosure requirements will never be a complete solution to the problem. Instead, more needs to be done outside of the disclosure context to protect naïve and ignorant franchisees from getting into unfair relationships. This may be accomplished through governmental or other organizations, such as franchisee advocacy groups, becoming more involved in the franchise formation process and pushing for best practices or substantive provisions that go beyond disclosure.[68]

Consider, for example, integration clauses. As part of the formation process, integration clauses may limit provisions

[65] Relative power is the "power that one person or entity has in relation to another person or entity." *Relative Power Law and Legal Definition*, USLEGAL, https://definitions.uslegal.com/r/relative-power/ [https://perma.cc/96X3-ZFRE] (last visited Jan. 22, 2020).

[66] *See* Robert W. Emerson & Steven A. Hollis, *Bound by Bias? Franchisees' Cognitive Biases*, 13 OHIO ST. BUS. L.J. 1, 35 (2019).

[67] *See infra* Part V.

[68] During the decisionmaking phase, franchisee advocacy groups may encourage or assist potential franchisees with obtaining legal counsel and other professional services, alerting prospective franchisees to the risks they are undertaking, and putting them in touch with franchise owners and managers able to give insights from their own experiences. These groups may also assist in suits later filed against franchisors. *See* 3 W. MICHAEL GARNER, FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 17:31, Westlaw (database updated Nov. 2020) (describing the issues associated with, and the threshold showing needed to establish, franchise associational standing).

that would render an advantage to the franchisee.[69] Typically, these bars to the introduction of parole evidence shield the franchisor from liability. Restricting integration clauses would prevent franchisors from erecting barriers to franchisees offering evidence of words or conduct that occurred prior to the signing of the franchise agreement. If franchisors faced the risk of this evidence being admissible against them in a common-law action, it is possible they may stop making misleading oral representations. I similarly question, on the grounds of fairness, the franchisor's limitation of franchisee disputes to arbitration.

However, neither of these solutions addresses the underlying problem of transparency. If a franchisor uses an integration clause or limits dispute resolution to arbitration, this information will appear clearly somewhere in the contract. These provisions are not necessarily harmful or against public policy because, contractually, they merely put the franchisees on notice of their rights.[70] Furthermore,

[69] *See* Robert W. Emerson, *Franchising and the Parol Evidence Rule*, 50 AM. BUS. L.J. 659, 680–86, 728 (2013) (noting that public policy concerns and basic notions of fairness have favored franchisees' use of parol evidence in contravention of franchise contracts' integration clauses). I have argued that, with its higher level of sophistication and its greater bargaining power, the franchisor often should face the dismissal of contract defenses based on an integration clause. *See id*. at 727 (contending also that courts should oppose holding parties to a merger clause in relatively complex franchise transactions and transactions involving a relatively high volume of long or technical documents). Therefore, courts must "face reality and uniformly incorporate franchisee protections that often, and fairly, override the parol evidence rule." *Id.* at 728. "[T]he franchisor, with [a] disclaimer, [sh]ould have to (1) acknowledge the potential conflict between [its] oral representations and the written [franchise agreement], and (2) expressly admonish franchisees that the pro-franchisor, written provisions are the contract, not any extracontractual, supposed promises to the contrary." *Id.* at 726–27.

[70] *See* Paul Grote, *United States: State and Federal Courts Continue To Reject Public Policy Challenges to Arbitration Clauses*, DREW ECKL & FARNHAM, LLP (June 17, 2019), https://www.mondaq.com/unitedstates/arbitration-dispute-resolution/815610/state-and-federal-courts-continue-to-reject-public-policy-challenges-to-arbitration-clauses [https://perma.cc/WTE4-7BBS] (discussing the enforceability of arbitration clauses); Peter C. Lagarias, *The Misuse of Integration, No Representation,*

franchisees might decide to enter an inherently unfavorable agreement in which they are the weaker party and contract some legal rights away if they expect that the potential benefits of the franchise arrangement greatly outweigh the value of these rights. Thus, the solution to the problem of transparency must balance the contracting powers of the franchisor with the business expectations of the franchisee.

V. FRANCHISEES AND FRANCHISORS

The inherent legal complexity of franchising relationships often leaves inexperienced franchisees unsure and uninformed. Considering the limited effectiveness of federal disclosure laws and common-law remedies, franchisees need to be more proactive and diligent in protecting themselves. Urging caution for prospective franchise purchasers, however, cannot be the only answer. Analysis of the current regulatory environment's effectiveness, or lack thereof, in facilitating franchise agreement transparency indicates that required disclosures and other administrative interventions should be much more robust.

A. Franchisees Taking Stock in Themselves and the Franchise Network

Two interrelated franchisee tendencies make the transparency issue worse: (1) some franchisees are unwilling to objectively assess franchise opportunities, and (2) these same franchisees tend to misinterpret claims brought forward by franchise salespeople. These behavioral factors are observed among franchisees who are overly excited about the potential for a new venture; confirmation bias guides their reception and processing of information.[71] This may be due to

and No Reliance Clauses in the Name of Contract Certainty, 18 FRANCHISE L.J. 3, 3–4 (1998) (discussing reasons advanced by courts and commentators for and against integration clauses).

[71] *Cf.* Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193, 209–13 (2013) (considering the cognitive biases and informational and reasoning deficits common among franchisees).

overconfidence on the part of the franchisee, both in their business savvy and in their expectations of success. In fact, seventy percent of Americans said they knew enough about franchising to explain it to a friend.[72] In reality, most Americans have very little—if any—understanding of the intricacies of forming a franchise relationship.[73] Moreover, this false sense of confidence can lead a prospective franchisee into a business relationship that a critical assessment of the franchise opportunity—both as to the franchise system and the franchisee's own strengths and weaknesses—would not recommend.

Because of their overconfidence, franchisees often overlook a number of important issues. For example, they may not critically assess their own managerial abilities,[74] the strengths of the franchisor's brand[75] and network,[76] or the

[72] *See* Michael E. Cobo, *How Potential Jurors View Franchising*, 21 FRANCHISE L.J. 182, 182 (2002).

[73] *See* Robert W. Emerson, *Franchisors' Liability when Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609, 651–59 (1992).

[74] *See* Andrew C. Selden, *Organization Design for Successful Franchising*, 20 FRANCHISE L. J. 1, (2000) (noting that franchisee interests "are rarely taken into account in any systematic fashion in system decision making," affecting a franchisee's managerial style). Owning and operating a franchise can be difficult and grueling work that demands constant supervision and around-the-clock hours. Prospective franchisees typically must consider the success they have had with any past endeavors requiring large commitments of time and effort. *See What to Expect in Your First Year as a Franchisee*, FRANCHISE BUS. REV., https://franchisebusinessreview.com/post/what-to-expect-first-year-franchisee/ [https://perma.cc/DGF7-WF9X] (last visited Mar. 2, 2021) (dispelling a common myth that once a franchisee opens a franchise, customers will start flowing in).

[75] *See* Cara Waters, *The Six Key Success Factors for Franchises*, SMARTCOMPANY (Sept. 25, 2014), https://www.smartcompany.com.au/business-advice/franchising/the-six-key-success-factors-for-franchises/ [https://perma.cc/P8RM-PMDD] (reporting an Australian study including "brand names" among the six most important factors for franchisee success). Brand strength could involve product or service quality, low prices, or unique offerings.

[76] *See* ANDREW J. SHERMAN, FRANCHISING & LICENSING: TWO WAYS TO BUILD YOUR BUSINESS 6 (2d ed. 1999) (noting the importance of well-developed operating manuals, comprehensive training programs for franchisees, and proven methods of operation and management); Lisa Price,

threats to franchisee business success.[77] While a franchise system's longevity often depends upon its ability to adapt its product offerings and to stay relevant,[78] prospective franchisees may overvalue trendy but perhaps unsustainable franchises.

Consider just one example: vaping.[79] Small scale vaping franchises are unlikely to survive a convergence of numerous state regulations,[80] pending state court lawsuits,[81] and

Pros and Cons of Franchising (As a Buyer), SMALL BUS. TRENDS, https://smallbiztrends.com/2020/05/pros-and-cons-of-franchising.html [https://perma.cc/SA5C-K8YW] (last updated Aug. 20, 2020) (observing the importance of the franchisor's network).

[77] *See* Chris Myers, *The Top Ten Red Flags To Watch Out for When Buying a Franchise*, FORBES (July 6, 2018, 4:18 PM), https://www.forbes.com/sites/chrismyers/2018/07/06/the-top-ten-red-flags-to-watch-out-for-when-buying-a-franchise/?sh=273d2d3f6082 [https://perma.cc/WLW7-YKHC] (listing red flags indicating the riskiness of a franchise opportunity). Presumably franchisees face more risk when they deal with franchisors that pursue inexperienced prospective franchisees too eagerly or that offer uncompetitive advertising, pricing, or locations.

[78] *See* Edward Wood Dunham & Kimberly S. Toomey, *The Evolution of the Species: Successfully Managing Franchise System Change*, 24 FRANCHISE L.J. 231, 231 (2005) ("To prosper long-term, franchisors must adapt to changing demographics, consumer preferences, competitors, and technology by modifying their business concepts, operating procedures, products, and services."); James W. Denison, *Why It's Tough To Have Hard-And-Fast Rules About Operations Manuals*, 30 FRANCHISE L.J. 239, 239 (2011) (explaining that franchisors need flexible operations manuals to enable adaptation of their franchise systems).

[79] For an overview of vaping, see Kristine Nickel, *E-Cigs: The Newest Fad Is Hurting Teens*, YOUR OBSERVER (Oct. 17, 2019), https://www.yourobserver.com/article/e-cigs-the-newest-fad-is-hurting-teens [https://perma.cc/3AMN-GSH4].

[80] For a list of regulating states with explanations of their respective vaping regulations, see Terry Turner, *Juul Ban*, DRUGWATCH, https://www.drugwatch.com/e-cigarettes/juul-ban/ [https://perma.cc/5FLB-WRUH] (last modified Sept. 21, 2020). "There is no federal excise tax on e-cigarettes. . . . Nineteen states and the District of Columbia have imposed taxes on e-cigarettes." *E-Cigarettes: Facts, Stats and Regulations*, TRUTH INITIATIVE, https://truthinitiative.org/research-resources/emerging-tobacco-products/e-cigarettes-facts-stats-and-regulations [https://perma.cc/4LSG-G35W] (last updated Dec. 2, 2020).

[81] For example, thirty-nine states are "investigating the marketing and sales practices of e-cigarette maker Juul Labs." *Louisiana Is Among 39*

stricter federal regulations.[82] For one industry giant, Juul Labs, the cost of mounting lawsuits totals billions of dollars in losses.[83] Moreover, prior to the COVID-19 pandemic, all vaping franchises and businesses were required by May 12, 2020 to file applications with the Food and Drug Administration (FDA) proving their products' benefit to public health; if they failed to do so, they "risk[ed] having [their products] yanked from the market."[84] As a result of delays caused by the pandemic, the FDA obtained approval from a federal court to push back the May 12th deadline to September 9, 2020.[85] In spite of that brief reprieve, small sellers such as Saffire Vapor were, as predicted, unable to afford "the hundreds of thousands, or even millions of dollars

States Investigating Juul's Marketing, THE ASSOCIATED PRESS (Feb. 26, 2020), https://apnews.com/ee3ea7e8f5bfadc9ee94280e7a9056d6 [https://perma.cc/DK6T-JB3P]. The company also "is facing lawsuits by teenagers and others who say they became addicted to the company's vaping products." *Id.* Moreover, Arizona's attorney general obtained a preliminary injunction barring Eonsmoke from marketing or selling its vaping products in the state. *Arizona Gets Court Order Blocking Vaping Firm's Products*, THE ASSOCIATED PRESS (Feb. 20, 2020), https://apnews.com/334209e1b5d534855696079abc109032 [https://perma.cc/5UQE-5LBT].

[82] *See* Oliver Dunford, *This Regulation Could Put Every Small Vape Manufacturer in the U.S. out of Business by May 12*, PAC. LEGAL FOUND. (Feb. 25, 2020), https://pacificlegal.org/may-vape-regulation/ [https://perma.cc/Z5ZE-59C7] (describing FDA "Deeming Rule" treating e-cigarettes as tobacco products for regulatory purposes). The D.C. Circuit recently rejected constitutional challenges to the Deeming Rule. Jooce v. Food & Drug Admin., 981 F.3d 26, 30–31 (D.C. Cir. 2020).

[83] *See* Michelle Chapman, *Cost of Juul Stake Continues To Mount for Marlboro Maker*, THE ASSOCIATED PRESS (Jan. 30, 2020), https://apnews.com/3eea9f387caa0683cc01212e51878cde [https://perma.cc/3Z3Z-MQKP] (describing Altria Group, Inc.'s $4.1 billion write-down of its $13 billion investment in Juul in the wake of litigation against the e-cigarette manufacturer).

[84] Laurie McGinley, *Vaping Battle Heats up as FDA Deadline Looms*, WASH. POST (Feb. 24, 2020, 3:43 PM), https://www.washingtonpost.com/health/vaping-battle-heats-up-as-fda-deadline-looms/2020/02/24/9c516e82-42ca-11ea-aa6a-083d01b3ed18_story.html [https://perma.cc/4V7X-RS3D].

[85] Matthew Perrone, *Virus Outbreak Delays US Government Review of E-Cigarettes*, THE ASSOCIATED PRESS (Apr. 23, 2020), https://apnews.com/e22198dbf725cf28a52b05e0df6c6458 [https://perma.cc/LA7B-56F6].

. . . it would cost to [complete] the exhaustive application[s] for" their products.[86] An industry group estimated that 13,000 small businesses would permanently close their doors without a rollback of the FDA requirement.[87] Thus, the future profitability of vaping franchises that cannot afford to meet the FDA requirement is doubtful. Indeed, the FDA issued its first warning letters to ten firms that manufacture and sell electronic nicotine delivery system products and that did not submit a premarket tobacco product application by the September 9, 2020 deadline.[88]

Because of the risks of franchise opportunities and the flawed decisionmaking tendencies of franchisees, a large step in advancing franchisee self-education—hence improving the franchisee's choices—is for the franchisee to seek counsel from an experienced franchise attorney.[89] The benefit of procuring traditional legal counsel is enormous. Franchisees with no business experience are unlikely to be able to understand the twenty-three disclosure items that a franchisor provides in the FDD.[90] It seems even less likely that franchisees will understand the legality of the disclosure document and whether it satisfies the Franchise Rule's requirements.

A lack of legal understanding should never be an excuse for not reading the franchise disclosures.[91] Even a

[86] McGinley, *supra* note 84.

[87] *Id.*

[88] Press Release, FDA, FDA Warns Firms to Remove Unauthorized E-Liquid Products from Market in First Letters Issued to Manufacturers that Did Not Submit Premarket Applications by Deadline (Jan. 15, 2021), https://www.fda.gov/news-events/press-announcements/fda-warns-firms-remove-unauthorized-e-liquid-products-market-first-letters-issued-manufacturers-did [https://perma.cc/34EK-X57G]. This premarket review ensures that tobacco products "undergo . . . robust scientific evaluation by the FDA." *Id.* (internal quotation marks omitted).

[89] The current regulations recognize the importance of this step. *See* 16 C.F.R. § 436.3(e)(3) (2020) (requiring on the cover page of the FDD a statement advising prospective franchisees to "[s]how your contract and this disclosure document to an advisor, like a lawyer").

[90] *See id.* § 436.5 (describing these disclosure items, many of which involve detailed business information).

[91] *Cf.* Coombs v. Juice Works Dev., Inc., 81 P.3d 769, 774 (Utah Ct. App. 2003) (rejecting the franchisee's argument that a forum selection

sophisticated, experienced franchisee would be remiss in not hiring an attorney experienced in franchise law to evaluate carefully every word of key documents—especially the franchise agreement.[92] Many franchises require an initial investment greater than $500,000.[93] With so much at stake, franchisees should not forego counsel. Further, franchise agreements are not necessarily adhesion contracts: in the right settings, franchisees' lawyers have bargained for more favorable terms for franchisees.[94]

Nevertheless, a significant number of individuals do not hire an attorney.[95] The allure of doing one's own online legal research is the ready accessibility of so much information through simply a free internet search. However, the monster under the water's surface is not easily seen, and it may take someone with experience to discover it.[96] Certainly, people with little or no business experience often are attracted to franchises because becoming a franchisee provides them with a business plan, intellectual property (IP), and support networks.[97] But none of those positive features (plans, IP, support), nor a layperson's online research, substitutes for the

clause in the franchise agreement was invalid in the absence of unfairness because the franchisee failed to read the franchise agreement). This principle is widely accepted for all contract law. *See* 27 RICHARD A. LORD, WILLISTON ON CONTRACTS § 70:114, Westlaw (database updated Nov. 2020) ("The failure to read an agreement (even though literate) is no excuse for pleading ignorance of the contents of the unread contract." (citing 17A C.J.S. *Contracts* §§ 194–95 (2020)).

[92] *See* Emerson, *supra* note 19, at 715 & n.29, 718 (noting that franchisors often recommend that franchisees seek counsel but also that, at closings, counsel represented only 26.07% of franchisees).

[93] *See* Bailey, *supra* note 9.

[94] *See* Emerson, *supra* note 19, at 721–22.

[95] According to my survey of a large sample of 2,697 business students, only 49% would always hire an attorney for a business transaction. Robert W. Emerson, Deciding Whether to Hire a Lawyer Survey: 2017-2019 (completed 2019) (on file with author).

[96] *See* Uri Benoliel & Xu (Vivian) Zheng, *Are Disclosures Readable? An Empirical Test*, 70 ALA. L. REV. 237, 253 (2018) (indicating that, in an empirical study of 523 franchise disclosures, on average a prospective franchisee needed over twenty years of education to understand the FDD on the first reading).

[97] *See* Emerson & Benoliel, *supra* note 71, at 203–06.

understanding that comes from actually running or counseling businesses, including knowledge of and familiarity with problems that often arise upon entering a franchise relationship. A skilled, experienced attorney can help the prospective franchisee identify any issues before signing a franchise agreement.

B. Hiring a Franchise Lawyer: The Popularity of Online Legal Services and the Need for Regulation

1. The Troubling Substitution of Online Legal Service Providers for Traditional Lawyers

For many prospective franchisees, online legal service providers serve as the first stop for legal research.[98] With the ever-rising accessibility of the internet, the marketplace for legal service providers is growing and becoming more competitive.[99] Franchisees can avoid the high cost and uncertainty of traditional firms and access the quick and predictable transactions of an online provider.[100] Companies such as Avvo Advisor, UpCounsel, and LegalZoom offer various services that may include, among other things, "do-it-yourself" document drafting, referral, and consulting.[101] These broad offerings may convince consumers that they can find all they need to know online. As a result, those consumers may enter situations they are ill-prepared to handle.

Moreover, legal service providers target individuals who currently cannot afford legal services, accommodating the "do-it-yourself" attitude of modern society.[102] The effective

[98] For a review of some reasons that consumers have begun to shift away from traditional legal services, see *infra* Section V.E.2–.3. Presumably these same reasons push many prospective franchisees toward online legal services.

[99] *See* Gordon J. Glover, *Online Legal Service Platforms and the Path to Access to Justice*, FLA. BAR J., Jan. 2016, at 88, 88–89.

[100] *See id.*

[101] *Id.*

[102] *See* Brooke Moore, *The Middle Class, an Untapped Legal Marketplace*, LAW PRAC. TODAY (Dec. 14, 2016), http://www.lawpracticetoday.org/article/middle-class-untapped-legal-

marketing of online legal service providers has caused traditional law firms to lose their market share.[103] For example, LegalZoom's website states that its "goal is to make legal help accessible to average Americans."[104] With advertising like this, it is easy to see why the average legal consumer would think that these companies offer the only legal assistance that persons need to start and maintain a business. It is equally easy to see why these legal service providers are becoming more successful and prominent in the market: the middle class is both the average legal consumer and the prime target of online legal service providers.[105] Even if consumers know that a traditional lawyer would be more helpful, they may instead choose online services for reasons such as cost.[106]

While more and more people are turning to online legal services, there are concerns regarding both the ethics and efficacy of these services.[107] In responding to these concerns, professional regulators should understand the types of services offered by these companies and the community's perception of these services. Regulating online legal services as law firms may be difficult when companies like LegalZoom explicitly warn that they are neither law firms nor substitutes for law firms.[108] Online legal service providers that provide

marketplace/?utm_source=prifla&utm_medium=email&utm_campaign=1216Syndicate [https://perma.cc/2PLN-WC5Y].

[103] *See* JAMES W. JONES ET AL., THE CTR. FOR THE STUDY OF THE LEGAL PRO. & THOMSON REUTERS, 2016 REPORT ON THE STATE OF THE LEGAL MARKET 9–11 (2016), https://peermonitor.thomsonreuters.com/wpcontent/uploads/2016/01/2016_PM_GT_Final-Report.pdf [https://perma.cc/2WMU-9RVU] (discussing factors responsible for the declining market share, including increased use of "alternative service providers").

[104] *About Us*, LEGALZOOM, https://www.legalzoom.com/about-us [https://perma.cc/E3Z4-JD6T] (last visited Mar. 3, 2021).

[105] *See* Moore, *supra* note 102.

[106] *See infra* Section V.E.1.i.

[107] *See, e.g.*, Janson v. LegalZoom.com, Inc., 802 F. Supp. 2d 1053, 1064–65 (W.D. Mo. 2011) (holding that LegalZoom self-help services constituted unauthorized practice of law in Missouri because they resembled drawing of legal documents without regulation).

[108] *Attorney Advice*, LEGALZOOM, https://www.legalzoom.com/attorneys/ [https://perma.cc/D3PX-XE9X] (last

these warnings put themselves outside the scope of regulations—like the Model Rules of Professional Conduct and similar codes[109]—specifically designed for lawyers and the lawyer-client relationship.[110]

2. The FTC and Potential Regulation of Online Legal Service Providers

This avoidance of lawyer-oriented regulation suggests that business-oriented regulation may be appropriate.[111] The FTC can use its authority over businesses to regulate this growing industry by ensuring that online legal service providers offer a more comprehensive understanding of franchises (and other legal relationships) to their customers.[112] While the actions of online legal service providers are not misdirection per se, regulation could protect consumers who are unable to make a

visited Jan. 4, 2021) ("[LegalZoom is] not a law firm, or a substitute for an attorney or law firm.").

[109] *See* MODEL RULES OF PRO. CONDUCT pmbl., cmt. 13 (AM. BAR. ASS'N 2020) (noting that the Rules define the "relationship [of lawyers] to our legal system").

[110] *See Questions & Answers*, LEGALZOOM, https://www.legalzoom.com/qa/personal [https://perma.cc/NY9Q-K2FN] (last visited Jan. 4, 2021) (answering legal questions but qualifying the answers with the following statement: "The information is not, nor is it intended to be . . . legal advice. You should consult an attorney for individual advice regarding your own situation. Answering this question does not in any way constitute legal representation and any information you provide is not protected by attorney-client privilege.").

[111] State action appears to be the best way to regulate online legal service providers that sell to franchisees services which have insignificant impacts on legal outcomes. For example, a state's professional regulatory body may wish to use a paternalistic approach to online legal market regulation. On the libertarian paternalist approach to regulation, see generally Tom Ginsburg, Jonathan S. Masur & Richard H. McAdams, *Libertarian Paternalism, Path Dependence, and Temporary Law*, 81 U. CHI. L. REV. 291 (2014).

[112] 15 U.S.C. § 45(a)(2), (b) (2018) (providing this authority); *see also* Nat'l Petroleum Refiners Ass'n v. Fed. Trade Comm'n, 482 F.2d 672, 685 (D.C. Cir. 1973) ("[T]he [FTC] has the responsibility to protect the consumer from being misled[.]" (citing Fed. Trade Comm'n v. Sperry & Hutchinson Co., 405 U.S. 233, 239–44 (1972))).

rational economic choice between traditional legal representation and online legal services.[113]

Take an example near the border of misdirection: the LegalZoom website contains a tab titled "Business Formation,"[114] and clicking this tab leads to a page touting a long list of "[a]dditional business services."[115] This could give potential business owners the impression that using a website is all they need to create and run a successful business, causing them to forego traditional legal help. Colloquially, these potential owners "don't know what they don't know."[116] A website may not describe the law thoroughly, and even a perfect legal description alone does not help consumers apply the law to their situation or objectives. This application is where traditional legal counseling excels, and some sort of federal regulation may be necessary to help consumers appreciate the warnings hidden in online legal services' websites.

Indeed, an informed consumer may find a number of reasons to hire a traditional law firm instead of an online legal service provider. The traditional firm's first advantage lies in the prevention of problems.[117] Online legal service providers rarely provide legal advice; instead, they provide access to

[113] Federal laws already regulate online advertising, customer privacy, spam, timely delivery of merchandise, and online intellectual property. *See* Arlette Measures, *About Internet Business Regulations*, CHRON, https://smallbusiness.chron.com/internet-business-regulations-5267.html [https://perma.cc/L9JB-BAJ9] (last visited Jan. 5, 2021). In the legal context, it is easier to see the price tag of the attorney's services than the legal advantages an attorney can provide, but the "rational" option depends on both cost and benefit.

[114] LegalZoom Main Page, LEGALZOOM, https://www.legalzoom.com [https://perma.cc/6VGP-2HAU] (last visited Jan. 4, 2021).

[115] LegalZoom Business Services, LEGALZOOM, https://www.legalzoom.com/business/business-formation/ (on file with the Columbia Business Law Review) (last visited Jan. 4, 2021).

[116] Knowing something is knowledge. Knowing what you don't know is wisdom. As Socrates observed, "[t]he truth, I suppose, they would not wish to state, namely, that it is become quite clear that they pretend to knowledge and know nothing." REGINALD E. ALLEN, SOCRATES AND LEGAL OBLIGATION (Reginald E. Allen trans., 1980).

[117] *See* ROBERT W. EMERSON, BUSINESS LAW 13 (6th ed. 2015).

self-help services at the consumer's direction.[118] In contrast, traditional lawyers are familiar with the relevant franchise principles and the applicable cases, statutes, and other laws that will assist a beginning franchisee.[119] Consequently, a traditional law firm would be better able to identify and ameliorate problems that may arise during the franchisor-franchisee relationship than a legally unsophisticated franchisee navigating a legal help website.

Furthermore, the lawyer can "investigat[e], draft[], negotiat[e], advis[e], and advocate" on behalf of the franchisee.[120] As an adviser, a franchise lawyer can boil down the legalese of an FDD and its twenty-three required disclosures into terms comprehensible by the average franchisee.[121] Additionally, the lawyer's entire range of skills may be essential when negotiating with a franchisor, even if the franchisee does have business knowledge and previous experience.[122] The franchisee without counsel may not receive a deal as profitable nor as fair as a franchisee with counsel.[123] In a worst-case scenario, the franchise agreement may be so unconscionable that a court will deem it void.[124]

[118] For example, in late 2020, LegalZoom advertised "access to independent attorneys and self-help services at your specific direction." *Legal Forms*, LEGALZOOM, https://www.legalzoom.com/forms (on file with the Columbia Business Law Review) (last visited Nov. 18, 2020).

[119] *Cf.* EMERSON, *supra* note 117, at 13 (describing traditional lawyers' familiarity with legal principles and sources).

[120] *See id.*

[121] *See* Emerson, *supra* note 19, at 720. For the twenty-three items of required disclosures contained in the FDD, see 16 C.F.R. § 436.5(a)–(w) (2020).

[122] *See* Emerson, *supra* note 19, at 714.

[123] *Id.* at 717.

[124] *Id.*

C. Further Examination of the Rule, Required Disclosures, and the Cooling-Off Period

1. Form and Timing of Disclosure

The required disclosure document can be quite a lengthy read for prospective franchisees. The sheer number of pages in the typical disclosure can be intimidating and is probably a reason so many franchisees skip the important step of carefully evaluating the material information contained inside the document.[125] However, as with general warranties under the Uniform Commercial Code, failure to read is not a defense.[126] Franchisors also need not provide disclosure directly to the franchisee but may provide it to an agent representing the franchisee, such as an attorney.[127]

The disclosure requirements only apply to franchises.[128] The FTC relies primarily on the nature of the relationship between franchisee and franchisor in its definition of whether a business arrangement is a franchise. The FTC defines a business as a franchise if it has three basic elements: "(1) [a] promise to provide a trademark or other commercial symbol; (2) [a] promise to exercise significant control or provide significant assistance in the operation of the business; and (3) . . . a minimum payment of at least $500 during the first six

[125] The typical FDD is not just lengthy but highly complex and filled with jargon. *See* Benoliel & Zheng, *supra* note 96, at 253 (using the Gunning Fog Index linguistics readability tool to study 523 FDDs and concluding that, while the average franchisee has fourteen years of education (completed community college), prospective franchisees need, on average, more than twenty years of education to understand FDDs on the first reading).

[126] This is an application to franchise agreements of the usual rule for contracts. *See, e.g.*, Washington v. Claassen, 545 P.2d 387, 391 (Kan. 1976) ("When a person signs a written contract he is bound by its terms, in the absence of fraud, undue influence or mutual mistake as to its contents, regardless of the person's failure to read and understand its terms." (citing Lumbar v. Erickson, 266 P. 737 (Kan. 1928)).

[127] *See* 16 C.F.R. § 436.1(r) (2020).

[128] FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE, *supra* note 57, at 1.

months of operations" from the franchisee to the franchisor.[129] Additionally, any entity that makes these representations and requires such a payment is a franchisor regardless of whether it possesses a trademark or the means to support a prospective franchisee.[130]

2. A Cooling-Off Period

The Franchise Rule requires a franchisor to give a prospective franchisee a minimum of fourteen calendar days between the franchisee's receipt of the disclosure document and the execution of a binding agreement or payment of money in connection with acquiring the franchise.[131] This "cooling-off period" reflects the FTC's intent in promulgating the Franchise Rule and its subsequent amendments "[t]o prevent deceptive and unfair practices in the sale of franchises . . . and to correct consumers' misimpressions about franchise

[129] *Id.*; 16 C.F.R. § 436.1(h). A separate code governs some sales involving consideration of more than $500. Specifically, the Business Opportunity Rule now governs the sale of business opportunities. 16 C.F.R. § 437; *see also* FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE, *supra* note 57, at 6. The Business Opportunity Rule originally required twenty-two distinct disclosures, modeled closely after the Franchise Rule, by sellers of business opportunities to prospective buyers. *See* Business Opportunity Rule, 76 Fed. Reg. 76,816, 76,818 (Dec. 8, 2011) (to be codified at 16 C.F.R. pt. 437). The FTC, however, was concerned that these disclosure requirements imposed too great a burden on sellers of business opportunities. *See* Disclosure Requirements and Prohibitions Concerning Business Opportunities, 75 Fed. Reg. 68,559, 68,559–60 (proposed Nov. 8, 2010) (to be codified at 16 C.F.R. pt. 437). The agency since has modified the Rule to require only six items in its disclosure document. 16 C.F.R. § 437.3(a)(1)–(6) (listing the disclosure items: identifying information, earnings claims, legal actions, cancellation or refund policy, references, and receipt).

[130] FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE, *supra* note 57, at 1.

[131] 16 C.F.R. § 436.2(a) (2020). This period allows a potential franchisee to comb through potentially hundreds of pages of disclosure documents. Kristine Biason, *Franchising and the Golden 14-Day Rule*, LEGALVISION (Feb. 18, 2016), https://legalvision.com.au/franchising-and-the-golden-14-day-rule/ (on file with the Columbia Business Law Review). Additionally, franchisees are encouraged to seek professional legal advice during this time. *Id.*

. . . offerings."[132] It also reflects the FTC's solution to bargaining inequality between franchisors and franchisees[133]: "redoubled consumer education efforts"[134] rather than enactment of franchise relationship laws that could impose additional compliance burdens upon franchisors.[135]

Additionally, the cooling-off period supports the goal of transparency, as it should give prospective franchisees adequate time to look into the "deal" and change their minds about investing in, and thereby joining, a franchise network. In 1999, when the FTC extended the period from ten to fourteen days, it stated, "As long as the prospective franchisee has a minimum number of days in which to review the franchisor's disclosures, that should suffice to combat deceptive franchise sales."[136] However, in Australia, a common-law country, a seven-day cooling-off period has had minimal effects on the franchise relationship as a whole.[137]

[132] Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444, 15,445 (Mar. 30, 2007) (to be codified at 16 C.F.R. pts. 436–37).

[133] On bargaining inequality, see Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAW 289, 289 (1989) ("[State] 'franchise relationship laws,' were designed to correct a perceived inequality in bargaining power, and thereby to protect franchisees against perceived abuses by franchisors."); Steven C. Michael, *Investments To Create Bargaining Power: The Case of Franchising*, 21 STRATEGIC MGMT. J. 497, 508–10 (2000) (discussing bargaining power in franchising relationships); George F. Carpinello, *Testing the Limits of Choice of Law Clauses: Franchise Contracts as a Case Study*, 74 MARQ. L. REV. 57, 70 (1990) ("The superior bargaining power held by franchisors has led to the enactment at the federal level of the Automobile Dealer Franchise Act, which requires the franchisor to act in good faith in the performance of the agreement, or in the termination, or refusal to renew the agreement." (footnote omitted)).

[134] Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. at 15,452–53.

[135] *See id.* at 15,448.

[136] Franchise Rule, 64 Fed. Reg. 57,294, 57,301 (proposed Oct. 22, 1999) (to be codified at 16 C.F.R. pt. 436). The ten business day rule was sometimes confusing because the franchisor had to exclude "federal holidays, some of which are not observed in every state." *Id.*

[137] *See* Robert W. Emerson, *Franchisees as Consumers: The South African Example*, 37 FORDHAM INT'L L.J. 455, 469 (2014). Note that in Australia the seven-day period is on the verge of doubling to fourteen days.

Thus, further cooling-off regulation probably would have little to no positive effects for the U.S. franchise system and could even have negative effects, since the addition of further regulation could discourage foreign franchise expansion[138] and pose unnecessary roadblocks for potential franchises.

Nevertheless, during the 2007 amendment process for the Franchise Rule, Advisory Committee member and renowned franchise lawyer Howard Bundy wanted to further require franchisors to disclose everything to the potential franchisee before the franchisee must "travel or make other financial commitments as a precondition to receiving additional information."[139] The FTC declined to include Bundy's addition for two reasons: (1) it believed the requirement that franchisors "furnish disclosures . . . upon reasonable request" addressed Bundy's concern, and (2) it wanted to avoid an "imprecise" or overbroad rule.[140]

D. FTC Actions and Franchisee Lawsuits

Historically, a case against a franchisor would include claims of both a § 5(a) violation and a Franchise Rule violation.[141] However, between 2003 and 2006, the FTC brought several cases based solely on § 5(a) violations rather

See Sean O'Donnell & Derek Sutherland, *Government Releases Its Response to the 2019 Franchising Code Review*, HWL EBSWORTH (Aug. 21, 2020), https://hwlebsworth.com.au/government-releases-its-response-to-the-2019-franchising-code-review/ (on file with the Columbia Business Law Review). This statutory right to cool off will apply "to a transfer of an agreement to a new franchisee; [or] where the transferee is required to enter into a 'substantially new agreement' with the franchisor." *Id.* However, "[i]t will not be extended to renewals or extensions of agreements." *Id.* The fourteen days only start after the "last of certain events have occurred. Those events include the agreement being signed, payment being made, disclosure documents being received and if applicable a copy of the terms of the lease being received." *Id.*

[138] Emerson, *supra* note 137, at 471.

[139] Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. at 15,470.

[140] *Id.*

[141] *See* CLARENCE C. CRAWFORD ET AL., U.S. GOV'T ACCOUNTABILITY OFF., GAO/HRD-93-83, ENFORCEMENT OF THE TRADE REGULATION RULE ON FRANCHISING 17 app. 3, tbl.III.1 (1993).

than under both provisions.[142] Similarly, from 2015 onwards the FTC has brought various cases based solely on § 5(a) violations.[143] Between 2003 and 2006, the United States, as an individual plaintiff, also brought quite a few cases for violations of the Franchise Rule.[144] However, since adopting the Franchise Rule in 1978, the FTC has not regulated franchising beyond the signing of the franchise agreement (i.e., after the franchisor makes required disclosures) even though it has authority to do so under § 5(a).[145] This is

[142] *See, e.g.*, Ex Parte Temporary Restraining Order with an Asset Freeze, an Accounting, Limited Expedited Discovery, and Other Equitable Relief and Order for Defendant to Show Cause Why Preliminary Injunction Should Not Issue at 2, Fed. Trade Comm'n v. Guerra, No. 04-cv-1395-Orl-22KRS (M.D. Fla. Sept. 22, 2004); Fed. Trade Comm'n v. Bryant, No. 04-CV-897-J-32MMH, 2004 WL 2504357, at *1 (M.D. Fla. Oct. 4, 2004); Fed. Trade Comm'n v. Fin. Res. Unlimited, Inc., No. 03 C 8864, 2006 WL 1157612, at *62 (N.D. Ill. Apr. 25, 2006). More recently, the FTC has brought a section 5(a) case against Amazon relating to its in-app purchase options. *See* Fed. Trade Comm'n v. Amazon.com, Inc., 71 F. Supp. 3d 1158, 1160 (W.D. Wash. 2014).

[143] *See, e.g.*, Fed. Trade Comm'n v. HES Merch. Servs. Co., No. 12-cv-1618-Orl-22KRS, 2015 WL 892394, at *2 (M.D. Fla. Feb. 11, 2015); Fed. Trade Comm'n v. Com. Planet, Inc., 815 F.3d 593, 596–97 (9th Cir. 2016); Fed. Trade Comm'n v. Lead Express, No. 20-cv-00840-JAD-NJK, 2020 WL 2615685, at *4 (D. Nev. May 19, 2020).

[144] United States v. Lasseter, No. 03-1177, 2005 WL 1638735, at *1 (M.D. Tenn. June 30, 2005); United States v. Money Movers Inc., No. 05-80101-Civ, 2005 WL 3704837 (S.D. Fla. May 10, 2005); *cf. also* United States v. Am. Merch. Techs., Inc., No. 05-20443-CIV, 2005 WL 2396608, at *1 (S.D. Fla. Aug. 30, 2005)

[145] Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 119 (2004). One reason for this lack of enforcement, mentioned by FTC staff in 2001, is that the "FTC generally lacks the authority to intervene in private franchise contracts and related relationship issues. Rather, these issues are generally considered matters of contract law that traditionally have been governed at the state level." U.S. GOV'T ACCOUNTABILITY OFF., GAO-01-776, FEDERAL TRADE COMMISSION: ENFORCEMENT OF THE FRANCHISE RULE 8–9 (2001) (footnote omitted), https://www.govinfo.gov/content/pkg/GAOREPORTS-GAO-01-776/html/GAOREPORTS-GAO-01-776.htm
[https://perma.cc/V9P9-FJ8Y]. The FTC's view in 2001, reflected in its enforcement policy today, is that "post-sale relationship issues generally do not pertain to business opportunities because business opportunity

problematic because most franchise disputes presumably do not arise until the post-sale, post-signing phase when opaque contract terms become clear in practice.

We thus can see the reason franchisees and their representatives have long advocated for a Franchise Rule amendment creating a private right of action for franchisees against any franchisor that allegedly has violated the Franchise Rule's disclosure obligations.[146] The drafters of 2007's Amended Franchise Rule did not adopt this legal remedy, and federal courts are resistant to providing such a right without statutory authorization.[147] Thus, franchisees remain entirely dependent on the FTC and its discretionary authority to enforce the Franchise Rule against franchisors.[148] Although the FTC can be relentless in the claims it pursues, the agency's limited capacity, staff, and resources restrict the number of cases it can bring to court.[149] These limitations are

problems predominately involve pre-sale rather than post-sale issues." *Id.* at 8 n.8.

[146] As of now, franchisees must rely on state law for a private cause of action. *See* DALE E. CANTONE, KIM A. LAMBERT & KAREN C. MARCHIANO, SO IT REALLY IS A FRANCHISE: BRINGING NON-COMPLIANT FRANCHISORS INTO COMPLIANCE 11–12 (2014), https://docplayer.net/14064257-So-it-really-is-a-franchise-bringing-non-compliant-franchisors-into-compliance.html (on file with the Columbia Business Law Review).

[147] *See* Douglas C. Berry, David M. Byers & Daniel J. Oates, *State Regulation of Franchising: The Washington Experience Revisited*, 32 SEATTLE U. L. REV. 811, 822 n.67 (2009) (collecting pre-amendment cases); Bethany L. Appleby, Robert S. Burstein & John M. Doroghazi, *Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations*, 36 FRANCHISE L.J. 429, 429 & n.2 (2017) (collecting post-amendment cases).

[148] *See* David J. Meretta & Eric H. Karp, *Regulation FD: Roadmap to Better Relations Between Franchisors and Franchisees*, 26 FRANCHISE L.J. 117, 119 (2007) (discussing the FTC's authority to seek damages and injunctive relief against franchisors that violate the disclosure requirements).

[149] For some insight into these resource issues, see Letter from Joseph Simons, Chairman, Fed. Trade Comm'n, to Hon. Frank Pallone, Jr., Chairman, H. Comm. on Energy & Com. (Apr. 1, 2019), https://energycommerce.house.gov/sites/democrats.energycommerce.house.gov/files/documents/FTC%20Response%20to%20Pallone-Schakowsky.pdf [https://perma.cc/9D45-HBE4] (urging additional funding for FTC staff and noting that the FTC has only forty full-time equivalent staffers "devoted to privacy and

particularly relevant for franchise cases, as business franchising typically has not been the main focus for the FTC other than in the drafting of the Franchise Rule.[150]

E. The Absence of Traditional Representation

1. Explanations for the Failure to Hire Franchise Lawyers

Before turning to original empirical evidence on the topic,[151] it is worth surveying some plausible reasons that franchisees forego the benefits of traditional legal representation despite the risks this entails and the limited remedies available to franchisees. Avvo's research on barriers to procuring traditional legal services is a good starting point.[152]

i. Cost

The first barrier Avvo discovered was the cost of traditional legal counsel:

> [S]ome people just don't have the money, even if they, like 58 percent of those surveyed, think lawyers are worth every penny you pay them. 7 in 10 consumers told us that they considered hiring a lawyer at some point during the course of their legal issue but didn't go through with it because of the price tag.[153]

data security issues"); *History of the ICO*, INFO. COMM'R'S OFF., https://ico.org.uk/about-the-ico/our-information/history-of-the-ico/ (on file with the Columbia Business Law Review) (last visited Feb. 3, 2021) (explaining that the relevant British agency maintains over 500 staff and handled more than 16,000 data protection complaints in 2017–18).

[150] *See* Smith, *supra* note 28.

[151] *See infra* Section V.E.2.

[152] Nika Kabiri, *Why People Don't Hire Lawyers – and No, It's Not Because They Hate You (Part 3 of 5)*, AVVO: LAWYERNOMICS (Dec. 3, 2015), https://lawyernomics.avvo.com/legal-marketing/why-people-dont-hire-lawyers-and-no-its-not-because-they-hate-you-part-3-of-5.html [https://perma.cc/Y6Q9-NHYC].

[153] *Id.*

Commentators also note that consumers often see the variability of billable hours as a tremendous cost risk,[154] and consumers may assume that the time needed to speak with an attorney is too long.[155]

A related explanation is that consumers may consider an attorney a last resort and not a preemptive measure.[156] Perhaps middle-class consumers assume that attorneys are too expensive for their average transactions, thus creating the demand for easily accessible and low-cost (or free) legal services.

It is important to recognize that cost would act as a deterrent for some and as a bar for others. For the general population of prospective franchisees, we might assume that cost *deters* rather than prevents hiring legal counsel. These franchisees' own cost-benefit analyses—albeit probably flawed due to cognitive biases and information asymmetry[157]—would lead them to believe that legal counsel is more expensive than it is worth.[158]

[154] *See* Jeff Gray, *Are Lawyers Facing the End of the Billable Hour?*, GLOBE & MAIL (Nov. 27, 2013), https://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/the-end-of-the-billable-hour/article15641507/ [https://perma.cc/8WFG-BPYY].

[155] There is a wide variety of information an attorney is likely to gather before agreeing to represent an individual. *See* Peggy Goodman, *Initial Interview with a Potential Client*, LEXISNEXIS (Jan. 31, 2008), https://www.lexisnexis.com/legalnewsroom/lexis-hub/b/how-to-build-your-professional-skills/archive/2008/01/31/initial-interview-with-a-potential-client (on file with the Columbia Business Law Review). Thus, the consumer must take time to meet and follow up with an attorney. Consumers can bypass this time cost if they can find the relevant legal information online.

[156] *See* Suzanne Englot, *Attorneys as Compliance Officers: Using the Law as a Preventative Measure Instead of a Last Resort*, MASS. BAR ASS'N SECTION REV., Jan./Feb. 2019, at 4.

[157] *See* Emerson & Hollis, *supra* note 66, at 16–21 (discussing anchoring, reactance, confirmation, and information biases).

[158] It is interesting to note that the average initial franchising fee is between $20,000 and $35,000, Jeff Elgin, *Is the Price Right?*, ENTREPRENEUR (Aug. 14, 2006), https://www.entrepreneur.com/article/164820 [https://perma.cc/9UFF-WAFD], while the average retainer fee for FDD review by a traditional law firm is between $2,000 and $5,000. Kevin B. Murphy, *Cost to Review Franchise Disclosure Documents (FDD)*, HGEXPERTS.COM,

ii. Control

Avvo further discovered that the consumer's "need for control" is the most significant deterrent from seeking legal counsel.[159] The cost barrier is the primary deterrent only once an individual is considering hiring an attorney.[160] With respect to the need for control, Avvo's

> recent research reveals that the desire to maintain control over one's case is the primary reason why the thought of talking to a lawyer isn't appealing. But only 1/3 of legal consumers told us they want control when handling their legal case, and once a lawyer is hired, 60 percent say they want their lawyer to take charge.[161]

What could be done to help a client retain some form of control while working with an attorney?

A client's need for control can be accommodated at the formation of the lawyer-client relationship. Different models of decisionmaking allow different allocations of authority between lawyers and clients,[162] although the client always determines the goals of representation, while the lawyer (within limits) determines the means.[163] Among these models are the lawyer-centered model, the client-centered model, and the collaborative model.[164] As its name suggests, the lawyer-centered model gives the lawyer the ultimate responsibility

https://www.hg.org/article.asp?id=5388 (on file with the Columbia Business Law Review) (last visited Jan. 5, 2021).

[159] Kabiri, *supra* note 152.

[160] *Id.* Avvo did not indicate whether the cost had a compounding effect on the need for control for individuals who reportedly did not seek legal counsel because of the need to control the case. *See id.*

[161] *Id.*

[162] *See* Donald G. Gifford, *The Synthesis of Legal Counseling and Negotiation Models: Preserving Client-Centered Advocacy in the Negotiation Context*, 34 UCLA L. REV. 811, 814–22 (1987) (discussing models involving different degrees of client participation).

[163] *See* MODEL RULES OF PRO. CONDUCT r. 1.2(a) (AM. BAR ASS'N 2020).

[164] G. NICHOLAS HERMAN & JEAN M. CARY, A PRACTICAL APPROACH TO CLIENT INTERVIEWING, COUNSELING, AND DECISION-MAKING § 2.03 (2009).

for making decisions in the representation.[165] In the client-centered model, the client is more involved in identifying problems and solutions and in making decisions.[166] The collaborative model is a hybrid of the previous two models, leaving decisionmaking authority to the client but keeping the lawyer involved in the decisionmaking process.[167] No model is better or worse than the others, and the model chosen depends more often on the client than the lawyer. The lawyer is meant to cater to the client, after all.

iii. Room for Negotiation

In addition to cost and control, another barrier to procuring legal services is the franchisee's false assumption that the franchise agreement is non-negotiable, and, therefore, hiring an attorney would be futile.[168] On the contrary, the use of an attorney is an important tool for determining which parts of the franchise agreement can be negotiated.[169] This knowledge would also help combat the transparency problem often

[165] *See* Michael D. Zimmerman, *Where We Have Been and Where We May Be Headed: Some Thoughts on the Progress of the Utah Judiciary*, UTAH BAR J., Feb. 1998, at 18, 20; *cf. also* Binny Miller, *Give Them Back Their Lives: Recognizing Client Narrative in Case Theory*, 93 MICH. L. REV. 485, 498–502 (1994) (discussing the flaws of a traditional approach that ignores the client). As these sources illustrate, the lawyer-centered model is also called the "traditional" model.

[166] *See* Katherine R. Kruse, *Fortress in the Sand: The Plural Values of Client-Centered Representation*, 12 CLINICAL L. REV. 369, 371 (2006) ("Client-centered representation . . . [in one form is] an approach to legal counseling that seeks to minimize lawyer influence on client-decision making, relying on strategies of lawyer neutrality.").

[167] *See* THOMAS L. SHAFFER & JAMES R. ELKINS, LEGAL INTERVIEWING AND COUNSELING IN A NUTSHELL 275–283 (4th ed. 2005) (discussing the need for lawyers both to listen to and challenge clients).

[168] *See* Ronald K. Gardner, Jr. & Julianne Lusthaus, *Representing Franchisees*, *in* FUNDAMENTALS OF FRANCHISING 244, 245 (Rupert M. Barkoff et al. eds., 4th ed. 2016) ("[Some prospective franchisees] believe or are told that the franchise agreement is not negotiable, so there is no point incurring the costs of retaining counsel.").

[169] *Id.*

present at the creation of franchisor–franchisee relationships.[170]

Without an attorney, franchisees are less capable of understanding a franchise business structure and its implications for franchisee rights and obligations.[171] Yet, even if a franchisee gets past the need for control, the high cost of an attorney, and the false assumption that an attorney will not be able to accomplish more than the franchisee can on the franchisee's own initiative, franchisees still often forego traditional legal services.[172]

2. Survey Data on the Procurement of Legal Services

i. Methodology and Limitations

To understand people's perception of the legal system, I conducted an exploratory survey at the University of Florida, collecting data on trends in legal decisionmaking across demographics and across economically variable situations.[173] The University of Florida study collected online survey responses from 2,697 undergraduate business students and MBA students over the course of three years.[174] This survey

[170] On the transparency problem, see *supra* Section II.A.

[171] *See* Emerson, *supra* note 19, at 772 ("[T]he investors who most need the assistance of a legal expert are the ones whose limited skills and self-awareness make them the least likely to realize that fact. They . . . overestimate their ability to understand legal concepts and to negotiate terms.").

[172] Franchise industry experts and attorneys have cast significant doubt on the effectiveness of the FTC disclosure rule in part because of franchisees' misplaced confidence. According to many franchise attorneys and industry experts, "most prospective franchisees simply do not read franchise disclosure documents." *See* Uri Benoliel & Jenny Buchan, *Franchisees' Optimism Bias and the Inefficiency of the FTC Franchise Rule*, 13 DEPAUL BUS. & COM. L.J. 411, 428 (2015). Franchisees, while optimistically biased towards future success, avoid reading disclosure documents and miss out on informative data about future risks. *See id.* at 414, 430.

[173] Emerson, *supra* note 95.

[174] *Id.*

was completely voluntary, with a 58.4% response rate.[175] Each student took the survey remotely via the survey provider, Qualtrics.[176] Survey respondents were given hypothetical situations in which they were to determine threshold amounts at stake in a deal beyond which they would hire an attorney.[177]

The survey method has several limitations. First, the test is voluntary, which diminishes the randomization of the survey. Additionally, several subcohorts, such as students reporting to have previously been franchisees, are underrepresented.[178] This underrepresentation leads to results that are not statistically significant but narrative at best.[179] Despite these limitations, since I administered the survey through a business course, the cohort shares a resemblance in terms of interest to individuals who enter into franchise negotiations, although there is a difference in ages[180] and, presumably, corresponding experience. Thus, the survey population is pseudo-representative but powered with enough external validity to understand trends in legal decisions across demographics.

ii. Findings

The survey's most pronounced and important finding is that business-oriented persons tend to have at least a general grasp of trends in the legal market.[181] Clearly many—if not most—potential users of legal services understand the legal market's traditional dynamics: larger entities can hire lawyers who are perceived to be more likely to succeed than lawyers hired by entities with fewer financial resources.[182]

[175] Each year about 1,500 undergraduates and forty MBA students had access to the survey. *Id.* Thus, over the course of three years, a total of approximately 4,620 students had access.

[176] *Id.*

[177] *Id.*

[178] *Id.*

[179] *Id.*

[180] *Id.*

[181] *Id.* question 12. The respondents were university business students at the undergraduate and graduate level. *Supra* text accompanying note 174.

[182] Emerson, *supra* note 95.

This understanding reflects the common practice of large national or global law firms, which attempt to recruit employees from among graduates of the higher-ranked law schools.[183] These law firms typically cater to the legal needs of the wealthy—usually large corporations and high-profile clients.[184] As a result, wealthy individuals have disproportionate access to attorneys who are graduates of higher-ranked law schools.

The survey data also suggest that a potential consumer of legal services understands the consequences of this disproportionate access. When asked which attorney is "more likely to be superior in ability," respondents were over three times as likely to respond that a business attorney would be superior in ability than a consumer rights attorney.[185] Likewise, respondents were about 4.6 times as likely to respond that they believed an employer's attorney is superior in ability to an employee's attorney.[186] Most pertinent to this study, respondents were over seven times more likely to report that a franchisor's attorney would be superior in ability to a franchisee's attorney.[187]

These findings may indicate a psychological deterrent to procuring legal services. It is the basic economic theory that people are rational beings, and, as such, maximize

[183] *See* Karen Sloan, *Explore the Data Behind the Go-To Law Schools*, LAW.COM tbl.% of Graduates at the 100 Largest Firms (Mar. 5, 2020, 6:55 PM), https://www.law.com/2020/03/05/explore-the-data-behind-the-go-to-law-schools-3/ (on file with the Columbia Business Law Review) (showing the high percentage of graduates of top-ranked law schools at large firms).

[184] *See, e.g.*, *Our Firm*, GRAY ROBINSON, http://www.gray-robinson.com/p/2/Our-Firm [https://perma.cc/RE4B-8NXD] (last visited July 25, 2020) (advertising that the firm provides legal services to *Fortune* 500 companies); *cf. also Global Annual Review 2020*, PWC, https://www.pwc.com/gx/en/about/global-annual-review-2019.html [https://perma.cc/KVP8-JJKN] (last visited Nov. 20, 2020) (noting that professional services network PwC serviced eighty-four percent of the companies on the *Fortune* Global 500 list).

[185] Emerson, *supra* note 95, question 14.

[186] *Id.*

[187] *Id.*

opportunity via cost-benefit analysis.[188] Procuring legal services is just like any interaction subject to this sort of analysis. If the public perceives that franchisor lawyers will be superior to franchisee lawyers, a franchisee may decide it is not worth it to hire an attorney assumed to be inferior. One possible shortcoming of the traditional cost-benefit analysis, however, is the existence of information asymmetry when contracting.[189] For example, attorneys may be able to negotiate certain non-price terms of a franchise contract, but prospective franchisees may believe they cannot.[190]

iii. Economic Irrationality

Most prospective franchisees who consider buying a franchise never consult an attorney.[191] Furthermore, in the rare circumstances where franchisees do hire attorneys, they usually are not attorneys who specialize in franchise law.[192] According to a survey conducted in 2011 and 2014, franchisor attorneys indicated that, in recent franchise closings they attended, only twenty-six percent of franchisees were represented by counsel.[193] Interestingly, the data suggest that individuals who have been franchisees in the past are no more likely to hire an attorney.[194] In addition to that apparent

[188] *Cf.* A. R. Prest & R. Turvey, *Cost-Benefit Analysis: A Survey*, 75 ECON. J. 683, 683–85 (1965) (discussing the use of cost-benefit analysis to make decisions).

[189] *See* Howard C. Ellis, *Employment-At-Will and Contract Principles: The Paradigm of Pennsylvania*, 96 DICK. L. REV. 595, 623–25 (1992) (giving examples of information asymmetry between contracting parties).

[190] *See supra* Section V.E.1.iii. A survey conducted for an earlier article found that, when franchisees were represented by attorneys, seventy-four percent of the time those attorneys engaged in negotiation of the franchise terms. Emerson, *supra* note 19, at 722.

[191] Gardner & Lusthaus, *supra* note 168, at 245; *see also* Emerson, *supra* note 19, at 774.

[192] *See* Gardner & Lusthaus, *supra* note 168, at 245 ("Many prospective franchisees . . . never consult a lawyer, let alone one with experience in franchising."); Emerson *supra* note 19, at 719.

[193] Emerson, *supra* note 19, at 718.

[194] Emerson, *supra* note 95 (finding that individuals who have been franchisees in the past were about two to six percent less likely to respond, "No. I would always hire a lawyer" when asked if there is a minimum

shortcoming in judgment, common economic fallacies persist in the legal market.[195] Such fallacies include thinking in terms of percentages rather than actual time or money spent: respondents indicated threshold deal values and time values after which they would consider procuring legal counsel.[196] While it may seem intuitive to not spend $500 on legal services for a $1,000 venture, one must consider real dollar value and avoid thinking in terms of percentages. This is complicated by the difficulty in quantifying the value of the non-price items and the risks of various legal outcomes.[197]

Of the 960 respondents in the survey who provided a numerical answer to the minimum amount of money at stake in a deal that would be required before they sought legal representation, slightly over half provided an answer that was either equal to or less than $2,000.[198] The respondents' answers varied from $0.00 to $1,000,000.00,[199] and the most popular answers were $1,000 (212 responses), $5,000 (167 responses) and $10,000 (162 responses).[200] To put these numbers into perspective, traditional economic theory posits that humans are rational beings able to judge alternatives in

amount of money or time that would have to be at stake before hiring a lawyer).

[195] *See* Emerson, *supra* note 19, at 722 (noting that the type of legal representation in a franchise transaction may affect the persistence of such fallacies: franchise lawyers sought more favorable terms for the franchisee when the franchisor was in business for ten or more years and also negotiated more favorable terms for clients with franchise networks with under 500 units).

[196] Emerson, *supra* note 95. By the time the franchisee realizes that franchisor disclosure documents and contracts are more complicated than expected, the franchisee has already expended a significant amount of money. Hiring the attorney at this point will result in additional costs for a previously-confident franchisee. *See* Emerson, *supra* note 19, at 724.

[197] *Cf.* Steve A. Lauer, *Toward Fee Arrangements More Closely Calibrated to Value*, OF COUNS., Jan. 2012, at 1, 3 ("The benefit that a company derives from the legal service can flow from several sources."). Consider a situation in which legal fees would cost $500, but the provided legal services help avoid a future $2,000 liability.

[198] Emerson, *supra* note 95.

[199] *Id.* This excludes one outlier response of $4,320,000.00. *Id.*

[200] *Id.* Survey respondents chose their own figure rather than picking among several dollar-figure choices. *Id.*

terms of costs and benefits to maximize utility.[201] Similarly, many capitalist theories assume that individuals will try to maximize their own individual benefits.[202] The survey findings seem to contradict these assumptions of free-market economics.[203]

One reason for this that is applicable to franchise contracting is information asymmetry.[204] The available information limits one's ability to calculate a cost-benefit difference. This observation applies in more than one way. When an individual decides between two alternatives, that individual may not know the full extent to which one of the alternatives will yield more favorable outcomes. It may be that consumers focus on identifying and satisfying relatively certain short-term needs as opposed to less-certain, long-term ones. Or they may believe they are equipped to make a reasonable assessment of potential long-term effects and consequences based on prior knowledge or independent research. For example, potential franchisees may rely on insufficient information in evaluating their franchise agreements' negotiable terms, which tend to be hard-to-quantify, non-price items.[205]

When choosing among options from online legal services such as LegalZoom down to no legal consultation at all, the outcomes are uncertain. However, the dynamic is different here. While a traditional attorney may assist clients by directly negotiating on their behalf, online legal services may

[201] *Cf.* Prest & Turvey, *supra* note 188, at 683 (explaining the usefulness of cost-benefit analysis).

[202] *See* SOCIOLOGY: UNDERSTANDING AND CHANGING THE SOCIAL WORLD 479–80 (Univ. of Minn. Librs. Publ'g ed. 2016) (ebook).

[203] For a discussion of some ways in which franchisees depart from the free-market model, see Emerson & Benoliel, *supra* note 71, at 209–13.

[204] *See id.* at 210–12 (noting information acquisition and processing problems facing franchisees).

[205] *Cf.* Eric Rosenbaum, *The 7 Most Important Franchise Business Terms to Negotiate*, CNBC, https://www.cnbc.com/2016/05/11/the-7-most-important-franchise-business-terms-to-negotiate.html [https://perma.cc/NS7Z-DW3K] (last updated July 6, 2016, 1:14 PM) (identifying as the terms "that a franchise company is most likely to be flexible on" a list exclusively composed of non-price terms).

not provide actual legal representation.[206] LegalZoom offers a FDD review service for a flat fee of $8,499.00.[207] That review includes a summary report but only "2.5 hours of consultation with [an] attorney."[208]

After an individual has determined that legal consultation is necessary, but before deciding between traditional and online services, the cost-benefit analysis becomes more difficult. The services offered by the traditional law firm may differ from the services offered by commercial companies. The prices and pricing schemes may vary.[209] Some new online services only offer certain services to individuals who purchase memberships first.[210] So, while cost is a leading determinant of an individual's propensity to procure legal services,[211] one may further posit that information asymmetry and uncertain levels of risk prevent the reliable estimation of

[206] *See Legal Forms*, *supra* note 118 (denying that LegalZoom provides legal representation); *cf. also* Paul F. Kirgis, *The Knowledge Guild: The Legal Profession in an Age of Technological Change*, 11 NEV. L.J. 184, 192 (2010) (reviewing RICHARD SUSSKIND, THE END OF LAWYERS?: RETHINKING THE NATURE OF LEGAL SERVICES (2008)) (noting the dispute over whether online legal service providers avoid unauthorized practice of law by disclaiming any representation)..

[207] *Set Your New Franchise on the Right Track*, LEGALZOOM, https://www.legalzoom.com/attorneys/franchise-disclosure-documents-review.html [https://perma.cc/JG7P-RXR9] (last visited Nov. 20, 2020).

[208] *Id.*

[209] Compare the flat fee for FDD review with a variable billable hours scheme.

[210] *See, e.g.*, *Small Business Legal Services*, LEGALSHIELD, https://www.legalshield.com/business-plan/plan-summary [https://perma.cc/5Q7V-9X47] (last visited Mar. 4, 2021) (offering three different plans that include advice and consultations, document review, and contract review for small businesses).

[211] *See supra* Section V.B.2.i.

benefits and costs for a cost-benefit analysis.[212] This may make miscalculation more likely.[213]

[212] The problem of franchisee informational deficits relative to the franchisor long has dominated the legal environment and business culture for franchising.

> Information asymmetry is an inevitable consequence of franchis[ing] because every franchise involves the transfer of some intellectual property rights and knowledge together with a tested business pattern and the related expertise. A myriad of tools are ready to be exploited for ensuring uniformity, direct inspection, and audit rights, in addition to the advantages the franchisor has in the negotiation process. . . . [I]nformational disclosure could only partially counteract the asymmetric reality.

Tibor Tajti (Thaythy), *Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?*, 37 LOY. L.A. INT'L & COMPAR. L. REV. 245, 267 (2015) (footnote omitted); *see also* Jinye Li & Hongsheng Xia, *Franchise: A Literature Review and Directions of Future Research*, 7 OPEN J. BUS. & MGMT. 817, 821 (2019) ("[T]here is a serious information asymmetry between the franchisor and the franchisee. The franchisor may abuse its information in order to maximize its own interests."). Although a minority view, some commentators contend that information asymmetry is a significant risk to the franchisor. MARK ABELL, THE LAW AND REGULATION OF FRANCHISING IN THE EU 32 (2013) ("[I]nformation asymmetry and moral hazard are the main risks to franchisors."). However, franchisors can structure their networks to ameliorate many of their concerns about missing information. Mark Wilson & Greg Shailer, *Information Asymmetry and Dual Distribution in Franchise Networks*, 42 J. BUS. FIN. & ACCT. 1121, 1149 (2015) (concluding that networks with both franchisor-operated and franchisee-operated outlets reduce the franchisor's information asymmetry and increase their contract pricing efficiency).

[213] *See* PARLIAMENTARY JOINT COMM. ON CORPS. & FIN. SERVS., FAIRNESS IN FRANCHISING 59 (2019) (Austl.) ("[I]nformation asymmetry that favours franchisors can hamper franchisees in conducting due diligence and making informed decisions because of a lack of understanding about fees and other costs, contractual obligations and personal risks. This is particularly problematic where relevant information cannot be obtained independently of the franchisor. For example, in cases where a franchisor has an incentive not to provide negative information to a franchisee because it may result in a lost or diminished sale for the franchisor, it may also result in franchises being sold at inflated prices compared to the true value of the business." (footnote omitted)).

iv. Related Litigation

Two class actions showcase the costs and uncertainties everyday individuals face when using LegalZoom to meet their legal needs. In *Webster v. LegalZoom.com, Inc.*,[214] the lead plaintiff in a nationwide class action sued LegalZoom based on a "legally flawed living trust" she obtained from the website.[215] The lead plaintiff was the executor of an estate and the trustee of the living trust.[216] Allegedly as a result of misrepresentations about the quality of LegalZoom's documents compared to those prepared by an attorney, the estate spent more than $10,000 for an outside attorney to fix the documents' deficiencies.[217] The lawsuit ended in a settlement agreement, which resulted in a nearly $5 million payment to the plaintiffs.[218]

In an earlier class action consolidated with *Webster*, the named plaintiff "alleged problems using LegalZoom documents for his Bike Cafe business."[219] Specifically, he alleged that he paid LegalZoom $687 for documents to incorporate his business, but the company used a contract that failed to include provisions and disclosures that were statutorily required in California.[220] The *Webster* settlement also resolved this case, since the "settlement established a

[214] Webster v. LegalZoom.com, Inc., No. B240129, 2014 WL 4908639 (Cal. Ct. App. Oct. 1, 2014).

[215] Tom McNichol, *Is LegalZoom's Gain Your Loss?*, DAILY J. (Sept. 2, 2010), https://www.dailyjournal.com/articles/327304-is-legalzoom-s-gain-your-loss [https://perma.cc/37NW-NDK8].

[216] *Id.*

[217] *Id.*

[218] *Webster*, 2014 WL 4908639, at *2.

[219] *Id.* at *1.

[220] Elizabeth Banicki, *Class Questions LegalZoom's Business*, COURTHOUSE NEWS SERV. (Sept. 18, 2009), https://www.courthouse news.com/class-questions-legalzooms-business/ [https://perma.cc/G6B8-926J]. These missing provisions and disclosures included "specific language about the right to rescind, the availability of attorney's fees, how to report the unauthorized practice of law and other matters." *Id.* (internal quotation marks omitted).

consent decree governing LegalZoom's future conduct, and it created other class benefits as well."[221]

These cases are emblematic of problems that consumers of online legal services are still experiencing and about which they are still complaining. Routine complaints from unsatisfied consumers include that legal documents obtained through the use of online services may be invalid and that the services may not file documents correctly.[222] In both cases, consumers will have to spend money on an outside attorney to correct the mistakes. For example, a total of 481 complaints were filed against LegalZoom on the Better Business Bureau (BBB) website in the last three years.[223] Additionally, the legal community has expressed concern with Rocket Lawyer's process for drafting LLC operating agreements, fearing that the service's lack of transparency will lead business owners to use agreements that may be invalid, likely were not desired, and almost certainly were not products of bargaining.[224] Small business owners using these agreements are likely to agree to fiduciary duty waivers without appreciating their nature or the implications of doing so.[225] For these reasons, consumers

[221] *See Webster*, 2014 WL 4908639, at *2.

[222] Mitch Lipka, *Can You Trust Online Legal Services?*, CBS NEWS (July 20, 2015, 8:55 AM), https://www.cbsnews.com/news/can-you-trust-online-legal-services/ [https://perma.cc/W7VY-AC9H].

[223] *Complaints: LegalZoom.com*, BETTER BUS. BUREAU, https://www.bbb.org/us/ca/glendale/profile/legal-document-help/legalzoomcom-1216-13156151/complaints [https://perma.cc/PE43-J29V] (last visited Nov. 21, 2020). Some complaints made against LegalZoom by dissatisfied consumers to the BBB involve failure to file documents with the correct body and charging for nonexistent services. *See id.*

[224] *See* Derek Terry, Comment, *The Pitfalls of Fiduciary Duty Waivers in Do-It-Yourself LLC Formation*, 20 TRANSACTIONS 1001, 1004 (2019).

[225] *See id.* at 1003–04 (noting that the standard agreement contains a waiver but also that Tennessee courts are unlikely to enforce it).

> The consequences of the absence or presence of fiduciary duties imposed upon members and managers of LLCs are not readily apparent to unsophisticated individuals. In the case of an entrepreneur organizing a business association without the assistance of an attorney, the risk that the organizing owners are not properly

have more to gain (and less to lose) by engaging experienced counsel before executing a franchise agreement, rather than accepting, without adequate information, the risks of online legal services.

VI. SOME EFFECTS OF MARKET FORCES

"You can't escape the responsibility of tomorrow by evading it today." ~ Abraham Lincoln[226]

Even with all the horror stories, business franchises continue to exist, and prospective business franchisees often seem to be just as eager to jump into a relationship as the franchisor.[227] To ensure prosperity and conformity, big business franchisors impose stringent requirements for new franchisees.[228] These strict requirements need not inhibit the franchise's growth, as business franchisors may have many people interested in opening up a franchise. Moreover, the minimum requirements correlate with future success for both the franchisee and the franchisor.

As franchisors gain much of their revenue in the form of royalties from their franchisees' operations,[229] they have an

> informed about the risks and rewards associated with fiduciary duties, or waivers of them, is especially great.

Id. at 1005.

[226] *Thoughts on the Business of Life*, FORBESQUOTES, https://www.forbes.com/quotes/51 [https://perma.cc/MMN6-SD2V] (last visited Mar. 4, 2021).

[227] *Cf. supra* text accompanying notes 22–24 (discussing the popularity of franchising).

[228] *See* Robert W. Emerson, *Franchise Goodwill: Take A Sad Song and Make It Better*, 46 U. MICH. J.L. REFORM 349, 352 (2013). While franchise units may be independently owned and operated, the franchisor and franchisee are exposed to similar risks from the franchise operation. Because of the shared brand name, "an event that occurs at one franchised unit . . . can have a ripple effect throughout the entire system." *See* Morgan Ben-David, *Managing Catastrophic Risks in Franchise Systems*, 38 FRANCHISE L.J. 207, 208 (2018).

[229] *See* Joel Libava, *Franchise Fees: Why Do You Pay Them And How Much Are They?*, U.S. SMALL BUS. ADMIN. (Apr. 18, 2017), https://www.sba.gov/blog/franchise-fees-why-do-you-pay-them-how-much-

interest in seeing their franchisees succeed. While in certain situations franchisors may benefit from not renewing a successful franchise or taking ownership of franchisee building improvements themselves, franchisors largely should select franchisees who will be successful in the industry.

> [I]f a start-up franchisor does not have franchisees who are willing to work hard, do not have sufficient finances, and do not have a firm understanding that they are taking a bit of a gamble along with the franchisor in terms of building up the franchise system, the system will not be able to grow in a healthy manner.[230]

Thus, commentators recommend that franchisors seek franchisees "who are adequately financed, appropriately capitalized, possess some form of business savvy and experience, and present a stable and likable personality."[231] A fast food franchisor, for instance, may require that the franchisee have previous business experience and millions of dollars available in capital in order to ensure an ability to absorb future costs or even periodic losses.[232]

While a large consideration is the franchisee's ability to pay the initial investment, other considerations are important. A franchisee in a large franchised system is far

are-they [https://perma.cc/MEH6-R8S9] ("Monthly royalties are where the profits are for franchisors-not the upfront franchise fee, which is a one-time payment.").

[230] Elizabeth D. Sigety, *Lessons for Franchisors and Franchisees in Avoiding Conflicts and Running a Successful Franchise*, *in* MANAGING LEGAL ISSUES IN FRANCHISING *2 (2013), 2013 WL 3773407.

[231] Herbert A. Hedden, Judith L. Marsh & Clifford R. Ennico, *Avoidance of Litigation*, *in* 2 ADVISING SMALL BUSINESSES § 30:13, Westlaw (Steven C. Alberty ed., database updated July 2020). It is from the monthly royalties that franchisors are able to make a profit—not the up-front franchise fee. Generally, franchise royalty payments range from 4% of a franchisee's revenue all the way up to 12% or more. The amount varies based on industry. *See* Libava, *supra* note 229.

[232] *See* Dana Hatic, *Franchising a Restaurant, Explained*, EATER (May 8, 2017, 4:31 PM), https://www.eater.com/2017/5/8/14936008/how-to-franchise-restaurant-mcdonalds-arbys-subway [https://perma.cc/N3BK-SNEW] (noting some fast food franchisors' experience and capital criteria).

from solitary, and the risk that franchisees will tarnish the franchisor's goodwill through negligent operations or intentional wrongdoing may worry the franchisor more than initial capital.[233] A franchise's goodwill—the loyalty and reputation that it has earned from its customers—if injured can affect the franchise's success, growth, and operations.[234]

Anyone familiar with the commercial credit industry knows that underwriters of small business loans stress the "Five C's" of lending—standards which evaluate character, capacity, collateral, conditions, and capital.[235] A rational franchisor likewise should use the Five C's to evaluate prospective franchisees by consulting the following table:

[233] *See* 2 GARNER, *supra* note 68, § 10:28 (describing franchisee acts that are injurious to the franchisor's goodwill).

[234] *See* Emerson, *supra* note 228, at 353–55.

[235] *See Know What Lenders Look for*, WELLS FARGO, https://www.wellsfargo.com/financial-education/credit-management/five-c/ [https://perma.cc/7Y39-5KZP] (last visited Nov. 21, 2020) (giving a version of the Five C's); Ty Kiisel, *The Five 'C's of Small Business Lending*, FORBES (Nov. 5, 2013, 4:00 PM), http://www.forbes.com/sites/tykiisel/2013/11/05/the-five-cs-of-small-business-lending/ [https://perma.cc/Q4UC-DP9G] (same); Jean Murray, *The 4 C's of Credit for Business Loans*, THE BALANCE: SMALL BUS., https://www.thebalancesmb.com/the-4-c-s-of-credit-for-business-loans-398030 [https://perma.cc/L97R-NG2Y] (last updated Nov. 26, 2019) (giving four "C's").

Table 1[236]

Standard	Factors Considered
Character	Franchisee business history and intangibles, including character.
Capacity	Franchisee education, experience, management style, and past performance.
Collateral	Franchisee likelihood of maintaining physical assets and goodwill.
Conditions	Franchisee understanding of the franchise agreement.
Capital	The amount and source of franchisee resources.

In doing so, a franchisor looks at the situation like a debt manager looks at a portfolio of loans, asking which loans will be repaid. It may be better to focus on a few franchisees with the potential for success rather than a highly diversified portfolio of franchisees. The resulting risk reduction is one of the reasons why many franchisors prefer to sell additional franchises to existing franchisees rather than newcomers.[237] Many franchisors only offer franchises to existing franchisees, and some franchisors, such as Krispy Kreme, have even required new franchisees to commit to opening several stores.[238] Past success may predict future success, and a

[236] I distill the five concepts from general small business lending principles. *See supra* note 235.

[237] *See* Carol Tice, *5 Reasons Why Franchise Ownership Is No Longer the American Dream*, FORBES (May 23, 2012, 4:44 PM), http://www.forbes.com/sites/caroltice/2012/05/23/5-reasons-why-franchising-is-not-american-dream/ [https://perma.cc/9EWF-9H49] (discussing reasons why franchisors are likely to pick pre-existing franchisees).

[238] *See* Carlye Adler, *Would You Pay $2 Million for this Franchise?*, CNN MONEY (May 1, 2002), http://money.cnn.com/magazines/fsb/fsb_archive/2002/05/01/322792/index.htm [https://perma.cc/HEP9-UP6U] (reporting Krispy Kreme's experience and multiple-location requirements); *cf. also* Jason Daley, *Power in Numbers*, ENTREPRENEUR, June 2015, at 91,

franchisee who knows how to handle one franchise is likely to be familiar enough with the business to be more successful, all things being equal, than another prospective franchisee without this experience.

VII. PROFIT PROGNOSES, COLLECTIVE ACTION, AND PRIVATE RIGHTS

A. Regulatory Adjustments and Private Rights of Action

The power imbalance between franchisor and franchisee explains the lack of transparency in their relationship, and existing market forces may not be a sufficient answer. This problem is not unique to the franchisor-franchisee relationship; it occurs in many business entities (e.g., partnerships) and agency relationships to some degree.[239] In the franchising context, there are ways to reduce franchisee confusion and franchisor aggression. Among the possible solutions is increased government regulation at either the federal or state level.[240] New laws could reach—or existing

92 ("[M]ulti-unit franchisees . . . own 53 percent of the 450,000 franchise units in the U.S. . . . . [and] multi-units owners now control 76.5 percent of franchised restaurants.").

[239] *See, e.g.*, James Chen, *Agency Problem*, INVESTOPEDIA, https://www.investopedia.com/terms/a/agencyproblem.asp [https://perma.cc/352Z-ACJ2] (last updated May 24, 2020) (discussing agency problems); *cf. also* Jeffrey Steinberger, *Control in a General Partnership*, ENTREPRENEUR (Oct. 30, 2007), https://www.entrepreneur.com/article/186122 [https://perma.cc/T385-9R8E] (discussing conflicts within partnerships).

[240] *See, e.g.*, Boyd Allan Byers, Note, *Making a Case for Federal Regulation of Franchise Terminations—a Return-of-Equity Approach*, 19 J. CORP. L. 607, 608 (1994); *cf. also generally* Jessica Lynn Kruse, Comment, *The Proposed Revised Franchise Rule Will Not Clarify the Confusion as to the Extraterritorial Scope of the Rule*, 12 TULSA J. COMPAR. & INT'L L. 455 (2005) (discussing the extraterritoriality of the Franchise Rule). Existing regulations in the franchisor-franchisee relationship context include Business Opportunity Statutes, Securities Laws, Little FTC Acts, the Unlawful Trade Practices Act, and Antitrust Laws. *See* Byers, *supra*, at 627–31 (discussing several of these regulations); CAROLYN CARTER, NAT'L CONSUMER L. CTR., CONSUMER PROTECTION IN THE STATES: A 50-STATE EVALUATION OF UNFAIR AND DECEPTIVE PRACTICES LAWS 53 app. A (2018),

laws could more thoroughly cover—disclosure, contract terms, and franchisee termination or nonrenewal rights.[241] Presently, nineteen states, as well as Puerto Rico and the U.S. Virgin Islands, have statutes concerning franchise terminations.[242] Moreover, each state that requires certain

https://www.nclc.org/images/pdf/udap/udap-report.pdf [https://perma.cc/NMC2-XFWX] (comparing the strengths and weaknesses of all fifty states' unfair and deceptive acts and practices laws); *cf. also* 21 AM. JUR. *Trials* 453, §§ 9–16.7 (1974) (discussing causes of action under various statutes, including the Securities acts and the federal mail fraud statute). For example, franchisees may be able to win lawsuits alleging violations of the Uniform Commercial Code's implied obligation of good faith and fair dealing, U.C.C. § 1-203 (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2020), if the franchise contract deals with the sale of goods; if a franchise contract deals with both goods and services, then the UCC applies only if the "predominant purpose of the agreement is the sale of goods." Am. Casual Dining, L.P. v. Moe's Sw. Grill, L.L.C., 426 F. Supp. 2d 1356, 1369 (N.D. Ga. 2006) (first citing Crews v. Wahl, 520 S.E.2d 727 (Ga. Ct. App. 1999); and then citing Mail Concepts, Inc. v. Foote & Davies, Inc., 409 S.E.2d 567 (Ga. Ct. App. 1991)).

[241] *See* 62B AM. JUR. 2D *Private Franchise Contracts* § 225, Westlaw (database updated Nov. 2020) (discussing termination rights). Franchise relationship laws enacted by individual states govern the franchise relationship and many post-sale issues with the franchise agreement. *See* Honey V. Gandhi, *Franchising in the United States*, 20 LAW & BUS. REV. AMS. 3, 12 (2014) ("Several states and U.S. territories, such as Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, South Dakota, Virginia, Washington, Wisconsin, Puerto Rico and the Virgin Islands, have enacted relationship laws. These states have created better protection for franchisees against the abuse of the franchisor, who is usually the party represented by counsel that often drafts the franchise agreement. The relationship laws typically deal with various facets of issues arising during the term of a franchise agreement, such as termination and renewal provisions, assignment and transfer of a franchise, restriction of free association of franchisees, repurchase of the remaining inventory by the franchisor upon the termination of the franchise, encroachment by the franchisor, and termination only with good cause." (footnotes omitted)); Elsewhere, I have recommended an expansion of the "good faith and fair dealing" standard for franchise agreements. Emerson, *supra* note 16, at 685–86.

[242] Gandhi, *supra* note 241, at 22 (citing CHRISTINE E. CONNELLY, ROBERT LICHTENSTEIN & ELIZABETH MOORE, INT'L FRANCHISE ASS'N, FRANCHISE DEFAULT AND TERMINATION—BEST PRACTICES TO ENFORCE THE CONTRACT AND PROTECT THE SYSTEM 11 (2012)).

disclosures to potential franchisees also creates a private right of action for any violations of those requirements.[243]

Increased regulation may allow future franchisees to obtain a clearer understanding of their prospects. Regulation could come in the form of required earnings claims, increased protections beyond those obtained by signing a contract, or the active involvement of franchisee associations in negotiating and forming the franchise relationship. These protections could arise naturally from franchisee membership in franchisee associations.[244]

[243] *See* Thomas J. Collin & Matthew D. Ridings, *Sources of Claims—The FTC Franchise Rule and State Franchise Disclosure Statutes* (noting also that state law may penalize infringements of the FTC Franchise Rule), *in* 12 BUS. & COM. LITIG. IN FED. CTS. § 129:13, Westlaw (Robert L. Haig & Section of Litig., Am. Bar Ass'n eds., database updated Dec. 2020).

[244] Often born out of discontent with a franchisor or a franchisor-dominated franchisee advisory council (sometimes likened to a company-owned or management-controlled "union"), franchisee associations may naturally have an adversarial relationship with franchisors, who in turn frequently view these associations as hostile entities. *See* ROGER SCHMIDT & HARRIS J. CHERNOW, MANAGING THE ORGANIZATION OF A FRANCHISE ASSOCIATION 3 (2009), https://www.americanbar.org/content/dam/aba/events/franchising/2009/w13.pdf [https://perma.cc/8UFL-77XT]; Joseph Schumacher, William Darrin & Lawrence Cohen, Effective Relationships with Franchisee Associations—Legal and Practical Aspects (May 2001), https://www.wiggin.com/wp-content/uploads/2019/09/effective-relationships-with-franchisee-associations.pdf [https://perma.cc/FR6D-G434].

Presumably franchisees are far less likely than franchisors to have such extensive information or lobbying campaigns. Moreover,

> the lack of franchisee protective legislation stems from the lack of an effective organized voice of franchisees to lobby for such laws. In other words, franchisee associations are not a substitute for legislation, rather they are essential if there is any hope for passing legislation into law.

Robert L. Purvin, Jr., *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?*, AM. ASS'N OF FRANCHISEES & DEALERS (Dec. 11, 2013), https://www.aafd.org/can-franchisee-associations-serve-as-a-substitute-for-franchisee-protection-laws/ [https://perma.cc/8UF3-BJ8G] (reviewing Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?*, 118 PENN ST. L. REV. 99 (2013)).

Furthermore, a new private right of action based solely on the Franchise Rule could allow individuals to take to court alleged violations left unaddressed by the FTC. Reforms favoring better disclosure during the pre-contractual phase, for example, do not carry much weight unless there is a private cause of action. However, as some have maintained, the expense of a private right of action could outweigh its benefits.[245] Many issues surface after, and may not be strongly related to, the early required disclosure stage of franchising. These issues go beyond inadequate pre-contractual information to relational abuses that sometimes follow contracting.

B. Financial Performance Representations

Franchisors or their representatives may choose to furnish statements—known as FPRs—about past profits and the prognoses for future franchisee earnings.[246] While in 2008 only about twenty-five percent of all franchisors provided FPRs in their FDDs,[247] the percentage has risen[248]—

[245] *Cf. generally* David L. Belt, *Should the FTC's Current Criteria for Determining "Unfair Acts or Practices" Be Applied to State "Little FTC Acts"?*, ANTITRUST SOURCE, Feb. 2010 (describing some of the difficulties entailed by private actions).

[246] *See supra* text accompanying note 57.

[247] Stuart Hershman & Joyce Mazero, *Foreword* to FINANCIAL PERFORMANCE REPRESENTATIONS: THE NEW AND UPDATED EARNINGS CLAIMS, at xxi, xxi (Stuart Hershman & Joyce Mazero eds., 2008).

[248] Uri Benoliel, *Are Disclosures Really Standardized? An Empirical Analysis*, 62 VILL. L. REV. 1, 11–15 (2017) (studying the 2015 FDDs of 109 quick-service restaurant franchisors that started franchising before 2010 and finding that ninety (82.5%) of them provided some financial performance representations (of variable quality) while the remaining nineteen (17.5%) gave no such information). *But see* Andrew A. Caffey, *The Importance of Item 19 in the Franchise Disclosure Document*, ALLBUSINESS, https://www.allbusiness.com/the-importance-of-item-19-in-the-franchise-disclosure-document-13425632-1.html [https://perma.cc/WG5M-F8RP] (last visited Jan. 7, 2021) ("Studies of FDDs conclude that between 25 percent and 30 percent of all franchisors include some form of financial performance representation in Item 19[.]").

apparently dramatically[249]—with the assumption that a successful franchisor should include an FPR in its FDD.[250] The evidence supports that assumption. Professors Farhad Sadeh and Manish Kacker "find strong support for the quality signaling rationale for making an FPR."[251]

Often having entered into the franchise relationship without consulting an attorney[252] and after signing an agreement that may be overwhelmingly one-sided, franchisees are susceptible to fraud and other abuses, thus

[249] *See* Anya Nowakowski, *FRANdata Supports IFA Position on FTC Franchise Rule*, FRANDATA (Apr. 18, 2019), https://www.frandata.com/ifa-ftc-franchise-rule/ [https://perma.cc/HNG6-DFX5] ("Market forces have driven franchisors to provide increasing transparency into their systems' financial performance disclosures, with 66% of franchisors disclosing revenue information in their Item 19 in 2017 compared to only 52% in 2014. . . . Forty-seven percent (47%) of franchisors with an Item 19 disclose operating expenses, and 34% provide some measure of profitability, including operating income, net income, or earnings before income, taxes, depreciation, and amortization[.]").

[250] *See* Ritchie Taylor, *Should I Include an Item 19 in my FDD?*, MANNING FULTON ATT'YS (July 1, 2020), https://www.franchisefeed.net/2020/07/should-i-include-an-item-19-in-my-fdd/ [https://perma.cc/Y9CY-PLMA] ("Generally, it's advisable to include an Item 19 in your FDD. In short, if your business' numbers are strong, you have every incentive to do so: Including an Item 19 will only help you onboard the best prospective franchisees possible and give you a competitive edge."). Taylor further declared that the FPR would "instill trust"—inspiring "confidence" in prospective franchisees via transparency—while failure to provide an FPR, especially if competitors do, may leave potential franchisees wondering what the franchisor is "hiding." *Id.* The FPR may give franchisors with a strong record of earnings both a "competitive edge" and "instant credibility" that is "a powerful sales tool." *Id.* The disclosing franchisor (1) "control[s] the narrative," (2) "reduce[s] risk" (an Item 19 may offset franchisor sales personnel misstatements about the franchise network's performance), and (3) "provides a concrete profile of [its] business," helping expedite franchisee due diligence. *See id.* (emphasis omitted).

[251] Farhad Sadeh & Manesh Kacker, *Quality Signaling Through Ex-Ante Voluntary Information Disclosure in Entrepreneurial Networks: Evidence from Franchising*, 50 SMALL BUS. ECON. 729, 743 (2018).

[252] *See supra* text accompanying notes 191–93.

placing a higher importance on the pre-contract phase.[253] Therefore, would-be franchisees may put more weight on earnings claims than they deserve: the prosperity of one franchisee (or even a group of franchisees) cannot be a direct characterization of how another franchisee will succeed in the franchise system.[254] While earnings are certainly one of the most important aspects of any business, requiring an earnings claim might put an unnecessary emphasis on the earnings themselves,[255] which should not be the franchisee's only reason for starting a franchise.[256] Also, as most earnings claims are based on the most recent full year,[257] the data likely

[253] *See* Caroline B. Fichter, Andrew M. Malzahn & Adam Matheson, *Don't Tread on Me: A Defense of State Franchise Regulation*, 38 FRANCHISE L.J. 23, 32–33 (2018).

[254] Inexperienced franchisees may view successful franchises as business models that will consistently and predictably provide at least "a reasonable return on their investment of capital, time, and energy." *See How Franchise Candidates Define Value*, FRANCHISE PERFORMANCE GRP. (May 17, 2018), https://franchiseperformancegroup.com/how-franchise-candidates-define-value/ [https://perma.cc/4LYJ-BBVG].

[255] Franchisees might overlook other considerations like the strengths, weaknesses, opportunities, and risks of a particular franchise or franchise industry. To combat this error, responsible franchisors should "[p]rovid[e] good initial support and business assistance to current franchisees . . . to promote the chain and to recruit [more] prospective franchisees, who, because they are often inexperienced in running the business, need to acquire the appropriate knowledge." Laura Lucia-Palacios et al., *Franchising and Value Signaling*, 28 J. SERVS. MKTG. 105, 107 (2014).

[256] A recent study conducted across thirty-five different franchise networks and 1,570 Australian franchises indicates that "franchisee optimism, proactivity, family support and *perceived* organizational support [are] all positively associated with financial performance." Stacey L. Parker et al., *Understanding Franchisee Performance: The Role of Personal and Contextual* Resources, 34 J. BUS. & PSYCH. 603, 616 (2019)

[257] *See Item 19 of an FDD and Researching Potential Franchise Profitability*, FRANCHISE DIRECT (Mar. 10, 2017), https://www.franchisedirect.com/information/item19ofanfddandresearchingpotentialfranchiseprofitability/ [https://perma.cc/75HW-JQM5]. Or, these earnings claims are based on "a subset of outlets that share [similar] characteristics like location" but may not be useful for all franchisees. *See id.*

do not accurately portray a twenty-year franchise agreement.[258]

A requirement of an earnings claim may be flawed, or at least unnecessary, for other reasons as well. It would put additional pressure on franchisors to market their franchises based on earnings claims as opposed to other factors that may be selling points, such as reputation or product quality. This pressure might, in fact, increase the level of misrepresentation in franchising by creating an incentive to give the illusion of higher earnings.[259] Moreover, to make the FPR mandatory not only "undermines its signaling value[, but

[258] This can also be explained by the risk of the franchisor engaging in some form of data manipulation as it relates to the figures reported on the earnings disclosure, since "franchisors can say anything as long as they can substantiate it. . . . [S]ome franchisors try to manipulate their numbers to present them in the best light." Julie Bennett, *Right Way, Wrong Way To Present Item 19*, FRANCHISE TIMES, https://www.franchisetimes.com/September-2015/Right-way-wrong-way-to-present-Item-19/ [https://perma.cc/LHR9-5QHY] (last updated Nov. 5, 2020) (internal quotation marks omitted). For example, to make a franchise look more appealing, a franchisor could manipulate the reporting of gross financial revenue (which is used to calculate the franchisor's royalty assessments) by presenting it "separated into thirds or quartiles, with average gross revenue calculated from the top, middle and lowest earning franchisees" but without "also including franchisees' average expenses." *Id.* "[H]and[ing] [a franchisee] an Item 19 that includes average gross sales of $1.6 million a year" will get them "excited" because they are not learning "what it costs to run that franchise." *Id.* (internal quotation marks omitted).

[259] Mark Dayman, *What You Need to Know About Franchise Value*, CAPVAL-ABA (Nov. 21, 2015), http://www.capval-llc.com/blog/need-know-franchise-value/ [https://perma.cc/DK8B-RUL8] (observing, as would prospective franchisees reviewing an FPR, that "[i]f the [franchise is] not making money, or not sufficiently to provide a return on the capital invested, the brand will likely fail"). *But see* Lucia-Palacios et al., *supra* note 255, at 112 (finding that an FPR does "not offer a point of differentiation for prospective franchisees" and that franchisees "do not regard [FPR] disclosures as a signal of business quality"). Lucia-Palacios et al.'s study found that "important signals of quality are related to the number of franchised units, followed by experience and the number of company-owned units." *Id.* However, the researchers admitted that "disclosure of information, might generate different results and implications if the sample were to be divided by sectors" and that "value is a personal perception and may vary from one customer to another as well as over the life cycle of the relationship between the firm and the customer." *Id.* at 113.

also] imposes the cost of enforcement of mandatory FPRs on the taxpaying public."[260] Given that the optional nature of the FPR is already serving a purpose and that the need for other regulatory measures is pressing, those reforms should have first call on the energies of federal and state regulators and of the franchising community.

C. Recommendations

One alternative is increased regulation beyond the signing of the contract. Some have lambasted as inadequate the purely disclosure-based federal franchise law structure.[261] However, substantive regulation of franchise agreements could be politically impractical and costly to the point of infeasibility for a governmental regulatory agency with limited resources such as the FTC.[262] The prospect of dissatisfied franchisees filing petitions for FTC review of their franchise relationships could, as a practical matter, justify FTC support of actions by private litigants that are independent of the FTC's Franchise Rule enforcement.[263]

[260] Farhad Sadeh & Manish Kacker, *Performance Implications of Using Signaling and Screening for Expanding Interfirm Business Networks: Evidence from Franchising*, 88 INDUS. MKTG. MGMT. 47, 56 (2020).

[261] *See* Steinberg & Lescatre, *supra* note 145, at 107 ("This paper sets forth a wide range of abusive practices found . . . across franchise systems. . . . [and] [v]irtually all . . . deal[ing] with abuse occurring after signing of the franchise contract.").

[262] *See* Rupert M. Barkoff, *Is It Time to Rebuild the U.S. Franchise Regulatory System?*, N.Y.L.J. (Mar. 17, 2015), https://www.law.com/newyorklawjournal/almID/1202720692170/is-it-time-to-rebuild-the-us-franchise-regulatory-system/ (on file with the Columbia Business Law Review) (mentioning that the federal government's historical failure to fund enforcement holds true in the franchise context).

[263] *Cf.* Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, 72 Fed. Reg. 15,444, 15,478 n.350 (Mar. 30, 2007) (to be codified at 16 C.F.R. pts. 436–37) (noting, in expanding disclosure requirements under the Franchise Rule "that there is no private right of action to enforce the Franchise Rule" (first citing Holloway v. Bristol-Myers Corp., 485 F.2d 986 (D.C. Cir. 1973); and then citing Days Inn of Am. Franchising, Inc. v. Windham, 699 F. Supp. 1581 (N.D. Ga. 1988))).

When the FTC amended the Rule, though, it chose to retain a private cause of action free zone.[264]

Despite the FTC's balking at the creation of more rights, a private right of action for violations of the Franchise Rule would be the easiest reform to implement. While franchisee-plaintiffs already can bring common-law proceedings against a franchisor for claims such as misrepresentation or breach of contract,[265] this reform would open a wide gamut of franchising-specific actions based on the Franchise Rule. Obviously, the creation of a private right of action—a heightened ability for franchisees to sue—may make franchisors more careful, not just because of potential liability but because a suit itself could seriously harm a franchisor's reputation and lead to an increase in opportunity costs.[266]

Litigation may also lead to more litigation, fostering challenges in a number of areas, such as disputes about the purpose and effect of network-wide uniform contract terms. In one case, for example, franchisees attempted to certify a class, alleging that the franchisees should not be bound by arbitration clauses in their franchise contracts that they had not seen.[267] The court ultimately found that the class should be bound by the arbitration clauses, but the franchisor's attempts to get around employment laws by having its workers sign franchise contracts did result in a significant damages award for the plaintiffs.[268] Similarly, the addition of

The suit would be in addition to or in lieu of regulatory oversight. *Cf.* Collin & Ridings, *supra* note 243, § 129:13 ("Courts have ruled that there is no federal private right of action for violation of the FTC Franchise Rule . . . even though the FTC has taken a position in favor of private enforcement.").

[264] Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, 72 Fed. Reg. at 15,478 n.350.

[265] *See* Thomas J. Collin & Matthew D. Ridings, *Sources of Claims—Common Law Claims* (discussing common-law theories and their limits), *in* 12 BUS. & COM. LITIG. IN FED. CTS., *supra* note 243, § 129:17.

[266] Presumably reputational effects explain why the Franchise Rule itself requires franchisors to provide information about all lawsuits to potential franchisees. 16 C.F.R. § 436.5(c) (2020).

[267] *See* Awuah v. Coverall N. Am., Inc., 740 F. Supp. 2d 240, 245 (D. Mass. 2010).

[268] *See Awuah*, 740 F. Supp. 2d at 243–45.

the private right of action angle for franchisees—even though it could fail in individual cases—helps to even the playing fields of franchisee litigation and public relations far beyond the outcome of any particular count in one specific court case.

In franchising, a right of action based on the Franchise Rule, combined with the power of franchisee numbers, could serve as a counterweight to franchisors' power and influence. Collective dispute resolution may attract financial support and have a greater impact than individual franchisee actions. However, the law may not favor franchisee class actions[269] or suits by franchisee associations,[270] and a franchisee's direct challenge—while procedurally more likely to be tenable than the other collective actions—may be substantively difficult.[271] After all, the franchisor or its representatives very likely drafted the contract terms.[272] Ironically, the one genuinely powerful nationwide association for franchising interests, the International Franchise Association (IFA), originated as a *franchisor* trade association.[273] While franchisees now also join the IFA, which can advocate for the collective rights of

[269] *See* 3 GARNER, *supra* note 68, § 17:32 ("On the whole, class actions have not widely been used in actions involving franchises and distributorships.").

[270] *Id.* § 17:31 ("The [franchisee] association is the most efficient and convenient vehicle for vindicating the interests of many franchisees . . . . [but] the question of the association's standing is often raised by the franchisor. . . . [Sometimes] the association is not technically a proper party to vindicate the contract rights of the franchisees.").

[271] *See* Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1556–57 (1990) (arguing that protections for individual franchisees are inadequate). I have proposed strong, uniform standards protecting franchisees' rights to form and join independent franchisee associations, as well as an antitrust exemption for a number of franchisee organizational activities. *See id.* at 1555–60.

[272] 1 GARNER, *supra* note 68, § 3:2 ("[F]ranchise agreements are generally drafted by the franchisor."); *see also supra* Part IV (discussing troubling contract terms like integration and arbitration clauses).

[273] It was not until 1993 that the IFA broke with tradition and invited franchisees to become members. *See* Janet Sparks, *Franchisees Must Control Destiny with Stealth Leadership*, FORBES (Oct. 29, 2018, 11:29 AM), https://www.forbes.com/sites/janetsparks/2018/10/29/franchisees-must-control-destiny-with-stealth-leadership/?sh=4db286af1ea9 [https://perma.cc/83MW-5BE2].

franchisors *and* franchisees on issues where their interests may align, the IFA is certainly not the same as a franchisee association.[274] The Franchise Rule already covers the case of unilateral material modification to the franchise agreement by the franchisor.[275] While individual franchisees ordinarily are not as financially equipped to litigate a Franchise Rule violation lawsuit as is the FTC,[276] collective suits, or at least actions facilitated by franchisee associations, could compensate for that relative disadvantage. In effect, a lack of FTC action would not mean that the franchisee is left to simply give up on its claim or to "go it alone."

Some people would contend that a private right of action is no godsend for franchisees if common-law actions based on the same factual premises would end in dismissal; for example, failure to perform due diligence before entering into an agreement could leave a franchisee, as a matter of law and public policy, bound to the contract clauses, disclaimers, or other information that the franchisee should have read and understood.[277] However, there are strong reasons, drawn from both cognitive science and the fact patterns common to many franchisor-franchisee disputes, to conclude that poor

[274] The IFA established a Franchise Action Network that has "set high standards, implemented strong programs, and created sound strategies to drive change." *See Franchise Advocacy*, INT'L FRANCHISE ASS'N, https://www.franchise.org/advocacy [https://perma.cc/B7MQ-NWYT] (last visited Nov. 20, 2020).

[275] Commonly, however, franchisors draft agreements that "grant the franchisor wide discretionary latitude, reserving the right to exercise its 'absolute,' 'exclusive' or 'sole' discretion, or to exercise its 'business judgment.'" *See Change in Franchise Business Model*, DADY & GARDNER, P.A. (May 4, 2015), https://www.dadygardner.com/blog/2015/05/business-model-franchise-agreements/ [https://perma.cc/G392-PMQP].

[276] *Cf.* Jeff Elgin, *Franchising ROI: What's Reasonable?*, ENTREPRENEUR (May 6, 2010), https://www.entrepreneur.com/article/206466 [https://perma.cc/QF9F-TN68] (suggesting that new franchises tend to lose money for several years).

[277] *Cf. supra* Part IV (discussing integration and arbitration clauses). The argument assumes that many of the issues giving rise to litigation could have been avoided by the franchisee acting more cautiously and seeking legal advice in the first place, which should deprive the franchisee of any private right of action.

decisionmaking by prospective franchisees is predictable and may be a built-in feature of franchising.[278]

The survey demonstrates that many businesspersons' central need—the need for control—arises in a world where cost matters.[279] Survey respondents evidently calculate, *inter alia*, how to get control and how to obtain the legal information they need, while accounting for the costs of getting this control and information. The cost of an attorney is a principal deterrent for franchisees who might have otherwise utilized an attorney in activities like explaining contract terms and engaging in negotiations that are often crucial to franchisees' success.[280] Online legal services can address these issues by advertising the cost up-front and allowing franchisees to pick and choose services.[281] Traditional law firms may adopt similar approaches in order to benefit their firms financially and to keep up with the ethical obligations of attorneys.[282]

Additional regulation of online legal services may be useful. Some seekers of legal assistance do not have any idea of what to expect from an attorney, or they do not see the value in having an attorney. This creates a danger when those same individuals have access to online webpages that promise a solution but then provide a disclaimer—perhaps "hidden" at the bottom of the webpage—that no legal advice will be provided.[283] A regulation might require online legal service providers to have conspicuous disclaimers outlining the problems of failing to seek legal counsel and the advantages of hiring a traditional law firm. This would allow the franchisee to better understand that fact-dependent law

[278] *See* Emerson & Hollis, *supra* note 66, at 16–21.

[279] *See supra* Sections V.E.1.ii, .2.iii.

[280] *See supra* Sections V.E.1.i, .2.iii.

[281] *See supra* text accompanying notes 206–09.

[282] *See* MODEL RULES OF PRO. CONDUCT r. 1.1 cmt. 8 (AM. BAR ASS'N 2020) ("[A] lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology[.]").

[283] *See* LegalZoom Main Page, *supra* note 114 (displaying a similar disclaimer).

belies an online one-stop shop's claim that it can offer standardized legal help.

So, where does this leave us? A mandatory FPR should not be a priority, and federal registration and substantive regulation appear to be—for the time being—unworkable. The FTC *should* engage in more active oversight of franchising. Still, increased administrative enforcement is far from the only solution, nor is it, perhaps, the optimal solution when compared to other avenues of relief. Regulation cannot substitute for a prospective franchisee's due diligence and prudent research. To some degree, the answer to the transparency problem lies internally with the contracting parties, both franchisees and franchisors. Increased regulation and private as well as public enforcement can foster transparency and improve franchise relationships. Certainly, on their own or in combination with other franchisees and their own investors—possibly as members of franchisee associations[284] or as multi-unit owners[285]—franchisees may become more sophisticated and maybe even formidable.

VIII. CONCLUSION

Novice franchisees often enter into franchise relationships without fully anticipating their consequences. It is a natural result, in part, of parties' acting on inadequate information. There is no simple solution to this problem, but there are ways to deal with it in both business and law.

[284] *Cf.* Emerson & Benoliel, *supra* note 71, at 211–13, 215 (observing the need for greater franchisee sophistication and experience).

[285] *See* Don Daszkowski, *Single vs. Multi-Unit Franchise Owner*, THE BALANCE: SMALL BUS., https://www.thebalancesmb.com/single-versus-multi-unit-franchise-owner-1350420 [https://perma.cc/XZ8X-LQUM] (last updated Oct. 31, 2019) ("[I]t is not uncommon for a Multi-Unit Franchisee to be a bigger and more experienced company than the franchisor[.]"). Moreover, "a franchisor can penetrate markets at a faster pace while curtailing the number of franchise relationships" in a multi-unit franchise. David B. Ramsey & Michelle Murray-Bertrand, *Issues in Growth by Multi-Unit Franchising*, FRANCHISE L.J. 359, 361 (2019).

This Article has examined many of the inherent disadvantages to franchisees in franchise relationships. Given these considerations, one might ask why people still sign up to become franchisees. Answering that question is the final step toward evaluating whether additional franchise regulation is necessary. No loopholes seriously hinder the prospective franchisee's ability to objectively evaluate the franchise.[286] Nor do circumvention or evasion of the franchising regulations explain the informational problem. More relevant are the law's intentional weaknesses and the vulnerabilities of parties—particularly would-be franchisees —to errors in judgment.[287]

The FTC's role in franchise regulation is to provide transparency in franchise relationships to prospective franchisees and—assuming that it has the power to regulate franchising "substance"—to the franchise relationship itself. In practice, however, the FTC has played no such significant role. Instead, the FTC has left the regulation of franchising substance to state law and been "nothing more than a paper tiger" as an administrative enforcer.[288] Still in dispute, over decades, is the efficacy of franchising's legal patchwork: the federal disclosure rule and, in some states, a varying set of registration statutes and substantive laws.[289]

[286] *Cf.* Sharon Collins Casey, Note, *Franchisors and the FTC: State Regulation and Federal Preemption*, 3 HARV. J.L. & PUB. POL'Y 155, 187 (1980) (noting that States have regulated franchising disclosure when the FTC has not addressed problems).

[287] *See* 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, 144 (2010) (emphasizing the significance of inadequate franchisee sophistication).

[288] Stanley M. Dub, *In Support of a New Uniform Franchise Disclosure Act; If Not Now, When?*, 39 FRANCHISE L.J. 387, 389 (2020).

[289] *See* Robert W. Emerson & Michala Meiselles, *U.S. Franchise Regulation as a Paradigm for the European Union*, 20 WASH. U. GLOB. STUD. L. REV. (forthcoming 2021) (manuscript at 16) (citing Rochelle Spandorf, *Can Federal Preemption Solve What's Wrong with Franchise Sales Laws?*, 39 FRANCHISE L.J. 477, 487 (2020), and arguing that "a federal preemption system need not remove the states from an important regulatory role" while still providing franchisees with some uniform remedies); Peter C. Lagarias, *Franchise Sales Laws Need Revisions to Further Their Objectives, but*

While regulations concerning disclosure increase the amount of information available to the prospective franchisee, they do not guarantee a complete understanding or synthesis of that information by the franchisee. The easiest solution to this problem is for franchisees to seek the services of experienced legal counsel. While general practitioners may provide a bevy of benefits to a franchisee over the course of the franchisee's business venture, a lawyer who specializes in franchising matters typically is necessary for someone who seeks to understand thoroughly the implications of any prospective franchise relationship. An experienced franchisee counsel knows what to look for when evaluating disclosure documents and should have the resources to educate a client on what to expect from the franchisor. Thus, retaining experienced counsel can level, or at least reduce, the inequalities between a franchisor and its franchisees. Highly skilled, knowledgeable franchise lawyers, as opposed to online legal services, have the ability to fully analyze the fact-dependent circumstances underlying a franchisee's business venture. This traditional legal counsel is in the best position to help franchisees understand the costs, benefits, potential issues, and rewards associated with their business endeavors.

Federal Preemption Is Not the Solution, 40 FRANCHISE L.J. 201, 219 (2020) (arguing the need for stronger federal disclosure requirements and for new, federal franchise relationship laws providing franchisees with "basic rights and remedies" while not undermining the state protections already afforded to franchisees).