

BOUND BY BIAS? FRANCHISEES' COGNITIVE BIASES

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Cognitive biases play a fundamental part in franchisor-franchisee deal making. Ordinarily, franchisors have more power and information than do franchisees. The disparity between these parties is often exacerbated by the franchisees' psychological dispositions. Are franchisees biased or uninformed to the extent that they cannot evaluate the information franchisors present to them? The franchisees' sound judgment may be undermined by well-recognized cognitive biases such as anchoring, confirmation bias, the bandwagon effect, and escalation of commitment.

To gather data specifically about potential cognitive biases in the franchising context, this article incorporates a survey of franchisees; it provides empirical evidence of the limited perspective and flawed decision-making of most persons who buy a franchise. The article concludes by exploring potential reforms intended to enhance the franchise bargaining process. Certain legal frameworks as well as business practices, both domestic and international, offer promising means to combat franchisees' cognitive biases. Those legal and business structures, in turn, should lead to more even-handed contracts and to better long-term franchise relationships.

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I. INTRODUCTION

Cognitive biases are “systematic pattern[s] of deviation from norm or rationality in judgment, whereby inferences about other people and situations may be drawn in an illogical fashion.”¹ In some fields, cognitive biases may take on a more specific meaning, such as – in discrimination law – “the use of categories that are themselves shaped or contaminated by confining stereotypes and habitual ways of thinking about nondominant groups in our society.”² When applied in the context of franchising, cognitive biases are better understood by the more general definition. Franchising harbors these biases via a

¹ See Martie G. Haselton, Daniel Nettle & Damian R. Murray, *The Evolution of Cognitive Bias*, in THE HANDBOOK OF EVOLUTIONARY PSYCHOLOGY 724 (David M. Buss ed., 2005). Cognitive biases systematically distort objective reality. Martie G. Haselton, Daniel Nettle & Damian R. Murray, *The Evolution of Cognitive Bias*, in THE HANDBOOK OF EVOLUTIONARY PSYCHOLOGY 968 (David M. Buss ed., 2nd ed. 2016).

² Martha Chamallas, *The Architecture of Bias: Deep Structures in Tort Law*, 146 U. PA. L. REV. 463, 467 (1998).

business arrangement³ whereby a franchisor grants a franchisee the right or license⁴ to market goods, services, or both under the franchisor's trademark⁵ or trade name.⁶ It has long been an attractive option for people looking to own and run a business in the United States without actually starting out alone and on the ground floor; instead, the franchisee is able to operate within a network of franchised businesses sharing a community of interests and ensconced in what is supposed to be an extensive, long-term system of support (e.g., training and advertising) overseen by a capable, experienced franchisor. A franchisor and its franchisees are part of a business organization not altogether different from vertical integration.⁷

The franchise sector of the United States economy grew from 697,943 franchise establishments in 2013 to 759,236 establishments at the start of 2018, an annual growth rate of about 1.7%.⁸ Although franchised businesses only make up about 3% of the businesses in the United States,⁹ the franchising sector as a whole is an economic

³ See *Franchising*, WEBFINANCING, INC., BUSINESS DICTIONARY (2013), <http://www.businessdictionary.com/definition/franchising.html>.

⁴ See *Franchise*, MERRIAM-WEBSTER ONLINE DICTIONARY, <https://www.merriam-webster.com/dictionary/franchise> (last visited Dec. 20, 2018).

⁵ Caron Beesley, *The Difference Between a Trade Name and a Trademark-And Why You Can't Overlook Either*, U.S. SMALL BUS. ADMIN. BLOG (Sep. 19, 2016), <https://www.sba.gov/blogs/difference-between-trade-name-and-trademark-and-why-you-cant-overlook-either> (“A trademark is used to protect your brand name and can also be associated with your trade name . . . Registering a trademark guarantees exclusive use, establishes legally that your mark is not already being used, and provides government protection from any liability or infringement issues that may arise.”).

⁶ *Id.* (stating a trade name is the official name under which a company does business – a “doing business as” (DBA) name. Sole proprietors, partnerships, existing corporations or LLCs need a DBA designation).

⁷ See G. Frank Mathewson & Ralph A. Winter, *The Economics of Franchise Contracts*, 28 J.L. & ECON. 503 (1985).

⁸ IHS MARKIT ECON., FRANCHISE BUSINESS ECONOMIC OUTLOOK FOR 2018 2 (2018),

https://www.franchise.org/sites/default/files/Franchise_Business_Outlook_Jan_2018.pdf (referring to 2018 figure of the “Franchise Business Economic Outlook: January 2018 Forecast” table); IHS MARKIT ECON., FRANCHISE BUSINESS ECONOMIC OUTLOOK FOR 2017 2 (2017),

<http://www.franchise.org/sites/default/files/Franchise%20Business%20Economic%20Outlook%20January%202017.pdf> (referring to 2013 figures of the “Franchise Business Economic Outlook: January 2017” table).

⁹ OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., FREQUENTLY ASKED QUESTIONS ABOUT SMALL BUSINESS 3 (Aug. 2017), <https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2017-WEB.pdf> (2.9% of all firms are franchises, with 2.3% of nonemployer firms being franchises, as are

powerhouse—totaling \$2.3 trillion dollars in revenues.¹⁰ Prospective franchisees must learn a substantial amount of information regarding costs, franchisor controls, and contractual obligations.¹¹ Furthermore, decisions such as how initially to staff and finance the business, as well as whether to hire a franchise attorney, and – if so – what attorney to hire, are equally important considerations for the future franchisee to make before completing the purchase of a franchise.¹² However, many franchise candidates fail to perform due diligence before buying that franchise.¹³ Instead, aspiring franchisees often erroneously assume that an opportunity must be profitable if a franchisor has more than one unit and a good product.¹⁴

In the United States, most states simply depend on the Federal Trade Commission (FTC), through its Franchise Rule, to define franchising and to require a disclosure from franchisor to franchisee, with no mandatory public filing let alone any franchising-specific

5.3% of small employers and 9.6% of large employers – those having more than 500 employees, *id.* at 1–2). The survival rate between independent businesses and franchises is similar, with each prospective business owner having an assortment of factors—managerial talent, sales abilities—to think about when deciding between an independent business or franchise arrangement. OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., FREQUENTLY ASKED QUESTIONS ABOUT SMALL BUSINESS 2 (Sept. 2012), https://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf.

¹⁰ Matt Haller, *CNBC's Behind the Counter: What They Left "Untold" About Franchising*, INT'L FRANCHISE ASS'N (last visited Dec. 20, 2018), <http://www.franchise.org/cnbc%E2%80%99s-behind-the-counter-what-they-left-%E2%80%9Cuntold%E2%80%9D-about-franchising-0> (noting that, according to CNBC's "Behind the Counter" documentary, U.S. franchising comprises \$2.3 trillion and, despite some recent economic downturns, the "franchise industry" is growing).

¹¹ FED. TRADE COMM'N, A CONSUMER'S GUIDE TO BUYING A FRANCHISE 1 (June 2015), <https://www.ftc.gov/tips-advice/business-center/guidance/consumers-guide-buying-franchise> (last edited June 2015).

¹² See Charles Internicola, *5 Factors to Consider Before Buying a Franchise*, INTERNICOLA LAW FIRM (Jan. 24, 2014), <http://www.franchiselawsolutions.com/blog/5-factors-to-consider-before-buying-a-franchise/> (Internicola describes the FDD as an important "life line" that should be reviewed with an experienced franchise lawyer. An evaluation of expectations, and whether or not the legal rights set forth in the FDD accurately match expectations are at the core of the review, according to Internicola).

¹³ *Id.* (discussing the pre-signing research that franchisees typically fail to perform). See Justin Kruger & David Dunning, *Unskilled and Unaware of it: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments*, 77 J. PERSONALITY & SOC. PSYCHOL. 1121, 1121 (1999) (reviewing the longstanding evidence that people frequently do not know that they fail to know what they need to know).

¹⁴ Internicola, *supra* note 12.

substantive regulation.¹⁵ About a third of the states do define franchises in the same way, while a handful of others adopt their own definition.¹⁶ In twelve states (California, Illinois, Indiana, Iowa, Maryland, Michigan, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin), a franchise must adhere to three elements: a marketing plan, an association with trademark, and a required fee.¹⁷ However, in the states of Hawaii, Minnesota, Mississippi, Nebraska, and South Dakota, the law defines a franchise by the following three elements: Trademark license, community of interest, and a required fee.¹⁸ Two of the three elements – the trademark and the mandatory fee – thus appear in all state law definitions¹⁹ as well as the FTC definition.²⁰ Even the somewhat

¹⁵ See Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 661–62 (2013).

¹⁶ See *U.S Franchise Law Basics*, VINSON FRANCHISE LAW FIRM, <http://franchiselaw.net/startups/usfranchiselawbasics.html> (last visited Dec. 20, 2018); Emerson, *supra* note 15, at 661–62. See also 16 C.F.R. § 436.1(h) (2018) (codifying the definition of “franchise”).

¹⁷ *Id.* If all three elements are present, then the relationship is considered a “franchise” for purposes of the FTC Franchise Rule. State law mandates various restrictions and requirements on franchise relationships. These include: Encroachment, Free Association, Good Faith/Reasonableness, Management, Marketing Fees, Non-Compete Agreements, Non-Discrimination, Non-Waiver, and Required Purchases. *Id.*

¹⁸ *Id.*

¹⁹ See 62B Am. Jur. 2d *Private Franchise Contracts* § 17 (2018) (“A minimum purchase requirement can be a franchise fee if the distributors were required to purchase amounts or items that they would not purchase otherwise...[a] charge for a literature package and a ‘bookkeeping entry’ fee have been held to constitute a franchise fee.”).

²⁰ The FTC Rule defines a franchise using the typical three elements of trademark, control or assistance, and a mandatory fee:

Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

varying third element is not that different from one legal definition to another. As outlined in the franchise definition of the twelve states, above, the “marketing plan” is a system prescribed by the franchisor that provides franchisees with the rights and methods to offer, sell, or distribute goods or services under the franchisor’s trademark or trade name.²¹ This actually differs only slightly from the “trademark license”²² element adopted by the other five states, above, in which franchisees have the right to offer, sell, or distribute the franchisor’s goods or services through use of the franchisor’s trademark or trade name. So, the problem for new franchisees is not so much the legal definition of their arrangement with the franchisor, but rather, what these franchisees know, expect, and thus depend upon with respect to that incipient, long-term franchise relationship.

Upon signing a franchising agreement, are franchisees acting on distorted representations of reality and are they, therefore, cognitively “biased”?²³ More specifically, are prospective franchisees unable to evaluate objectively the information that franchisors present to them because of certain internal or external variables? These internal variables include shame or lack of self-control,²⁴ while the external variables include the uncertainty and discomfort surrounding the ever-changing business environment.²⁵ Cognitive biases such as anchoring,²⁶

16 C.F.R. § 436.1(h) (2018) (emphasis in original).

²¹ 62B Am. Jur. 2d *Private Franchise Contracts* § 17 (2018).

²² *Id.*

²³ See Chamallas, *supra* note 2, at 467.

²⁴ Govind Persad, *When, and How, Should Cognitive Bias Matter to Law*, 32 LAW & INEQ. 31, 42 (2014).

²⁵ See Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 722 (2004).

²⁶ Persad, *supra* note 24; Shana Lebowitz & Drake Baer, *20 Cognitive Biases That Screw Up Your Decisions*, BUSINESS INSIDER (Aug. 6, 2015, 11:44 AM), <http://www.businessinsider.com/cognitive-biases-affect-decisions-2015-8/#zero-risk-bias-220> (Anchoring occurs when one is over-reliant on the first piece of information one receives; consequently, any information received later is viewed in light of the initial information and adjusted accordingly.). For an example of anchoring, see Joe Lau & Jonathan Chan, *Cognitive Biases*, CRITICAL THINKING WEB (2015), <http://philosophy.hku.hk/think/fallacy/biases.php> (University of Hong Kong). Prior to describing examples of cognitive biases, namely those relating to probability, the authors ask the question of how big the country of Namibia’s population is—whether it is above or below 100 million. *Id.* The answer is revealed to be around 2.3 million as of 2013, and the answer’s explanation further states that many people would probably give an estimate that is much higher because of the way that the question was phrased—offering a set parameter of above or below 100 million within the question leads people to make decisions based on “anchoring,” where a piece of information acts as an anchor from which people making

the bandwagon effect,²⁷ confirmation bias,²⁸ and escalation of commitment²⁹ are all used as mental shortcuts in the decision-making process.³⁰

Through the use of these mental shortcuts, franchisees are likely to be less objective and more likely to succumb to errors in reasoning. For example, we can easily imagine how three common cognitive biases – overconfidence, the illusion of control, and the belief in the law of small numbers – can be applied to our own understanding of the purchase and ownership of franchises. Overconfidence, the failure to know the limits of one’s knowledge,³¹ can be a potent factor in the thought process of a franchisee. For example, the franchisee may believe that he or she understands an entire Franchise Disclosure Document³² and therefore does not need to hire a franchise attorney. Secondly, the illusion of control occurs when an individual overemphasizes the extent to which her skill strengthens her performance in situations when, in actuality, chance plays a heavy role and skill is not necessarily the decisive factor.³³ In our situation, franchisees may rely (to their detriment) on their business acumen or their previously successful negotiating style. In fact, their current playing field – the competition, along with the business conditions – differs from what the franchisees previously encountered.

decisions use to make minor adjustments from their assessment of the information.
Id.

²⁷ See Lebowitz & Baer, *supra* note 26 (noting that the bandwagon effect occurs because the probability of one person adopting a belief increases based on the number of other people who hold that belief).

²⁸ *Id.* (stating that confirmation bias is the tendency to listen only to information that confirms preconceived notions).

²⁹ *Escalation of Commitment*, WEBFINANCING, INC., BUSINESS DICTIONARY (2013), <http://www.businessdictionary.com/definition/escalation-of-commitment.html> (noting that escalation of commitment is the “[t]endency to invest additional resources in an apparently losing proposition, influenced by effort, money, and time already invested.”).

³⁰ See Mark Simon, Susan M. Houghton & Karl Aquino, *Cognitive Biases, Risk Perception, and Venture Formation: How Individuals Decide to Start Companies*, 15 J. BUS. VENTURING 113 (1999) (studying the effects of cognitive biases including overconfidence, illusion of control, and the belief in the law of small numbers).

³¹ *Id.* at 113. See Kruger & Dunning, *supra* note 13.

³² FEDERAL TRADE COMMISSION, FRANCHISE RULE 16 C.F.R. PART 436 COMPLIANCE GUIDE (May 2008),

<https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf> [hereinafter *Franchise Rule Compliance Guide*].

³³ See Simon, Houghton & Aquino, *supra* note 30, at 113.

Overconfidence and the illusion of control thus may each bolster the other's faulty reasoning to produce, for the franchisee, a rash conclusion.

The last of the three common biases mentioned immediately above, the belief in the law of small numbers, occurs when an individual uses a small sample of information to draw firm and broad conclusions.³⁴ When subject to this particular bias, prospective franchisees cling only to those details that appear favorable at first glance, such as the franchisor allowing the franchisee an opportunity to purchase more than one franchise at a time, although the franchisee may not be receiving a great deal. Thus, a franchisee may “anchor,” or heavily depend upon, the *first* bit of information received in negotiations.³⁵ For example, an alluring sales pitch may lead franchisees to make a quick judgment or act on information without placing equal reliance on subsequent information that could be just as valuable.³⁶

We can deduce the ways in which franchisees may fool themselves or otherwise fall prey to poor reasoning processes, but it is best to ground public policy on empirical evidence when possible. Therefore, a short survey was developed and sent to franchisees across the United States. The survey's purpose was to determine whether and how franchisees fall victim to cognitive biases when entering into franchise agreements. Over 200 franchisees responded to the survey,³⁷ and the questions as well as the response data are recorded in the Appendix to this article.

³⁴ *Id.* at 114.

³⁵ See Lebowitz & Baer, *supra* note 26. We thus see how two cognitive biases – here, anchoring and the belief in the law of small numbers, may reinforce one another.

³⁶ See Brian P. Kane, *Are Cognitive Biases Impeding Your Legal Advice under Rule 2.1*, 58 *ADVOCATE* 23, 23 (Oct. 2015) (providing another example of anchoring in *Harry Potter*).

³⁷ At a 95% confidence level, with a sample size (N) of 203 franchisees, a population (p) of approximately 744,437 franchisees in the United States, and a percentage of 50% as a “worst case percentage” used to determine a general level of accuracy (see <https://www.surveysystem.com/sscalc.htm>), our survey's confidence interval is approximately 6.88. Our margin of error is approximately +/- 6.88% for our given sample size. According to SurveyStar, a leading provider of survey management, data entry, survey coding, data processing, and tabulation services to researchers worldwide, an “acceptable” margin of error used by survey researchers falls between 4% and 8% at the 95% confidence level. Thus, our survey's results are reliable to within +/- 6.88% at the 95% confidence level. See *What Every Researcher Should Know about Statistical Significance*, DATASTAR (Oct. 2008)), <http://www.surveystar.com/startips/significance.pdf>.

II. THE ROLE OF LAWYERS IN FRANCHISING

The lawyer's advice is a key component in franchising, both for franchisors and, although often "honored" by omission, for franchisees.³⁸ For would-be franchisees, there are numerous pre-contractual disclosures indispensable to analyzing a franchise's business prospects, many legal concepts and business customs that inform everyone about franchise standards and practice, and a short timeframe for undertaking all preparatory work and – when applicable – successfully dealing with the franchisor.

A. Preliminary Information for the Franchisee to Consider

Prior to signing an agreement with the franchisor, the franchisee has a plethora of information to consider.³⁹ Under the rules that the FTC promulgated in 1979 and amended in 2007, the franchisor must provide a Franchise Disclosure Document (FDD) to the franchise candidate at least 14 calendar days before a binding agreement is signed.⁴⁰ The FDD includes items such as franchise litigation history, bankruptcy, initial fees and financing, intellectual property information⁴¹ and numerous other items pertinent to an aspiring

³⁸ 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 (2014).

³⁹ See Haller, *supra* note 10.

⁴⁰ *Franchise Rule Compliance Guide*, *supra* note 32. According to the Compliance Guide, since July 1, 2007, franchisors could comply with the FTC's disclosure requirements by using any one of the following formats: (1) the original Franchise Rule; (2) the Uniform Franchise Offering Circular "UFOC"; or (3) the amended Franchise Rule. However, as of July 1, 2008, all franchisors must use only the amended Franchise Rule. *Id.* Additionally, the Compliance Guide states that a commercial business arrangement is a "franchise" if it satisfies three definitional elements: the franchisor must (1) promise to provide a trademark or other commercial symbol; (2) promise to exercise significant control or provide significant assistance in the operation of the business; and (3) require a minimum payment of at least \$500 during the first six months of operations.

⁴¹ See Joel Libava, *Franchise Lawyers: When to Use One*, U.S. SMALL BUS. ADMIN. BLOG (June 5, 2012), <https://www.sba.gov/blogs/franchise-lawyers-when-use-one>. The Guest Blogger for this particular post, "Franchise King" Joel Libava, makes the very important, albeit obvious, point that the franchise agreement is "not that easy to read," since a majority of the wording is in legalese. *Id.* According to Libava, the FDD "can easily be 200-300 pages long" and franchisees "probably won't be able to digest all of it in one sitting." *Id.* Libava also states that the

franchisee's decision to "buy in."⁴² It is important to note that franchise agreements can last 10 to 20 years and command an investment of \$250,000 or more.⁴³

Between 2014 and 2016, FRANdata, a research and consulting firm that specializes in performance analysis and benchmarks for franchising,⁴⁴ examined the quality of the FPR (financial performance representations) disclosures (Item 19 of the FDD) from a representative sample of 259 brands.⁴⁵ Through the use of surveys, FRANdata gained important insight into how prospective franchisees use the FPR and ultimately decide to make their investment decisions.⁴⁶ These practices may be especially meaningful inasmuch as the FTC places few limits on how or what specific information the franchisor discloses.⁴⁷ According to 16 C.F.R. § 436 (Disclosure Requirements and Prohibitions Concerning Franchising – also known as the FTC Franchise Rule), the FTC expressly permits the electronic dissemination of a FDD both by email and by permitting a prospective franchisee access to the FDD on the franchisor's website.⁴⁸ The franchise candidate could even show that he or she received the FDD by clicking on a "submit" button on the FDD's receipt page (even

franchisors are just trying to "protect themselves" and the franchisee can do the same thing by "hiring a qualified franchise attorney." *Id.*

⁴² 16 C.F.R. § 436.5(a) (2018). For a discussion on the items, see Uri Benoliel, *Are Disclosures Really Standardized?*, 62 VILL. L. REV. 1 (2017).

⁴³ See Cindy Skrzycki, Opinion, *FTC's Proposed Changes in Franchise Rules Elicit Chain Reactions*, WASH. POST (Apr. 19, 2005),

[http://www.washingtonpost.com/wp-](http://www.washingtonpost.com/wp-dyn/content/article/2005/04/18/AR2005041801774.html)

[dyn/content/article/2005/04/18/AR2005041801774.html](http://www.washingtonpost.com/wp-dyn/content/article/2005/04/18/AR2005041801774.html); see also *Sioux Falls Pizza Co., Inc. v. Little Caesar Enterprises, Inc.*, 858 F. Supp. 2d 1053, 1055 (D.S.D.

2012) (evaluating franchisor's termination of an automatically renewing ten-year franchise agreement).

⁴⁴ *What We Do*, FRANdata, <http://www.frandata.com/about-us/> (last visited Dec. 20, 2018).

⁴⁵ FRANdata, *Market Demand Pushing Higher Levels of Transparency, Financial Performance Representation*, INT'L FRANCHISING ASSOC. FRANCHISE EDUC. & RES. FOUND. (Apr. 2017)

[http://franchise.org/sites/default/files/2017-](http://franchise.org/sites/default/files/2017-Financial_Performance_Representations_final.pdf)

[Financial_Performance_Representations_final.pdf](http://franchise.org/sites/default/files/2017-Financial_Performance_Representations_final.pdf) (The FPR is intended to be a more nuanced, updated term for that which the UFOC called "earnings claims.").

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ 16 C.F.R. § 436.2(c), § 436.6 (2018). See also Michael K. Lindsey, *Technology: The New Frontier in Intellectual Property*, in THE INTELLECTUAL PROPERTY HANDBOOK: A PRACTICAL GUIDE FOR FRANCHISE, BUSINESS, AND IP COUNSEL 279, 286–87 (Christopher P. Bussert & James R. Sims III eds., 2d ed. 2016) (discussing the FTC Rule, the FDD, and franchisor websites).

though the FTC Rule prohibits external hyperlinks).⁴⁹ While potential franchisees owe themselves a large measure of due diligence before buying a franchise, the FDD should reinforce that duty to self: absent such a disclosure of pertinent information, prospective franchisees are not led toward, or otherwise assisted in acquiring, more realistic expectations of the return from a franchise.⁵⁰ They are, in a sense, simply left on their own.

After its study, FRANdata concluded that the better brands—that is, the better franchises—disclose optional information in FDD Item 19 more often than brands that do not.⁵¹ However, not every FPR “revelation” is in fact accurate; it could even be purposeful misrepresentation. Since the 1970s, the FTC has filed over 200 lawsuits against violators of the FTC Franchise Rule, many for false earning claims,⁵² including franchisor behavior which may be so informal that commentators and franchisees have labeled it “cocktail napkin disclosure.”⁵³ Similarly, lawsuits based on state law have arisen as a result of other fraudulent information included in disclosure documents.⁵⁴ Furthermore, franchisors themselves also frequently bring lawsuits against franchisees to enforce franchise agreements or terminate those agreements based on franchisee conduct.⁵⁵

⁴⁹ *Id.* See also Amended Franchise Rule FAQ’s, <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs> (2014) (section 436.6(d) of the amended Franchise Rule prohibits franchisors from including in any electronic (franchise) disclosure document external links to materials outside of the disclosure document itself).

⁵⁰ See FRANdata, *supra* note 45, at 2.

⁵¹ See *Id.*, at 3.

⁵² See Skrzycki, *supra* note 43.

⁵³ *Id.*; See also HAROLD BROWN ET AL., FRANCHISING REALITIES AND REMEDIES 51 (Law Journal Press rev. ed. 2003).

⁵⁴ See *Motor City Bagels, LLC v. Amer. Bagel Co.*, 50 F.Supp.2d 460 (D. Md. June 7, 1999) (regarding alleged misrepresentations as to franchise start-up costs); *JMF, Inc. v. Med. Shoppe Int’l, Inc.*, 2011 WL 4369475 at 3 (D.N.D. Sep. 19, 2011) (challenging a franchisor’s failure to follow a “Most Favored Nations Clause”). However, false earning claims are not always successful, especially if the franchisor includes disclaimers in its disclosures. See, e.g., *Ayu’s Global Tire, LLC v. Big O Tires, LLC*, 2013 WL 2298585 (Cal. Ct. App. 2d May 24, 2013) (ruling in favor of franchisor on a number of claims of fraudulent information in disclosure documents); *Steak n Shake Enterprises, Inc. v. Globex Co., LLC*, 110 F.Supp.3d 1057, 1084 (D. Col. June 23, 2015) (holding that projected earnings statements were not fraudulent because of disclaimer and clarifications that the earnings were simply estimates), *aff’d* 659 F. App’x. 506 (10th Cir. 2016).

⁵⁵ See, e.g., *Barry Cook Ford, Inc. v. Ford Motor Co.*, 616 So. 2d 512, 513 (Fla. Dist. Ct. App. 1993) (regarding termination of franchise agreement because franchisee engaged in “conduct . . . unbecoming a reputable businessman”); see

B. *Hard Law and Soft Law*

Commentators and academics define the term, “regulation,” with many different meanings.⁵⁶ Similarly, the terms “hard law” and “soft law” can be defined in countless ways.⁵⁷ The term “hard law” describes the traditional process of regulation and the way that laws are enforced by the courts. “Soft law” describes regulations outside of the traditional process.⁵⁸ The recent trend in scholarship is to “view regulation broadly.”⁵⁹ While the aforementioned FDD disclosure rules may be viewed as “hard law,” the ambiguity, breadth of coverage, and confusion that franchisees face with respect to disclosure rules suggest that these requirements should have a broader interpretation, beyond just literal wording, to be characterized as “soft law,” something in line with “aspirational guidelines and statements of best practices.”⁶⁰ In other words, some disclosures must be made under explicit rules (hard law), and other disclosures *should be* made in order to meet implied expectations (soft law). Instead, when franchisees sign their franchise agreements without fully understanding the overly broad terms in the agreements, the franchisor effectively acquires a broad right to end its business relationship with the franchisee for any number of potential franchisee breaches furnishing the franchisor with “good cause” to terminate.⁶¹ Under hard law that is inflexible, a franchise agreement would normally be binding, but, with overly broad terms within franchising agreements, a franchisor grants itself the opportunity to treat the agreement as flexible soft law, invoked at the franchisor’s discretion.⁶²

also Robert W. Emerson, *Franchising Hard Law and Soft Law*, in HANDBOOK OF RESEARCH ON FRANCHISING 137–168 (Francis Hoy, Rozenn Perrigot & Andrew Terry, eds., 2017) (discussing franchise contract standards and grounds for termination based on various concepts ranging from iron-clad, or close thereto, laws to “mere” notions of good or fair behavior).

⁵⁶ See ELIZABETH CRAWFORD SPENCER, *THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY* 1–15 (Edward Elgar Pub. 2010).

⁵⁷ See Emerson, *supra* note 55.

⁵⁸ *Id.*

⁵⁹ Vincent R. Johnson, *Nanotechnology, Environmental Risks, and Regulatory Options*, 121 PENN ST. L. REV. 471, 497–98 (2016).

⁶⁰ *Id.*; see also Emerson, *supra* note 55, at 137.

⁶¹ See generally Robert W. Emerson, *Franchise Terminations: “Good Cause” Decoded*, 51 WAKE FOREST L. REV. 103 (2016) (discussing various judicial and legislative approaches to good cause terminations).

⁶² Emerson, *supra* note 55, at 137.

Ordinarily, a would-be franchisee needs representation and advice from a lawyer learned in franchise law and experienced in franchising business practices. Otherwise, that prospective franchisee may fail to recognize the subtleties of franchise law and business – the hard law *and* the soft law. Along a continuum of behavior, what the franchisee or franchisor must do, should do, can do, should refrain from doing, or absolutely must not do are all matters of knowledge, judgment, and reason for which professional guidance, especially including that of lawyers, is essential.

C. *The Fourteen-Day Window*

The FTC requires franchisors to distribute a complete FDD, with exhibits, to prospective franchisees. The franchisor, affiliates, predecessors, and parents must disclose to the franchisor any pending legal actions, past convictions or judgments, as well as material civil actions involving the franchise, and must do so in a manner complying with the FTC's fourteen-day rule.⁶³ These disclosures provide the franchisee with an overview as to the viability of the franchise itself. Moreover, during the fourteen-day FDD window, an aspiring franchisee may decide to employ the services of an accomplished, knowledgeable franchise attorney.⁶⁴

The fourteen-day rule poses an interesting problem. While this two-week period is a static timeline, with the proposed franchise agreement only available for signing on or beyond the fourteenth day after the franchisee received the FDD from the franchisor, the question remains: Does the fourteen-day rule in practice sometimes place franchisees in an even weaker state for evaluating and perhaps negotiating over a franchise opportunity? This is due to the hurdles that a franchise candidate must overcome to honor the duty to oneself of due diligence: evaluating *everything* disclosed, following up on all issues raised therefrom, and hiring needed experts, such as a franchise attorney. If there is implicit pressure on a franchise applicant either to accept a franchise offer shortly after the 14-day period has lapsed, or to decline the offer without delay, then that rapidly expiring two-week interlude may place enormous pressure – a real “nudge” – on the applicant.⁶⁵ On its face, the FTC Rule requires the franchisor to

⁶³ *Franchise Rule Compliance Guide*, *supra* note 32, at 37.

⁶⁴ See Internicola, *supra* note 12.

⁶⁵ See *infra* notes 246–257 and accompanying text (on nudging).

provide a FDD as soon as it reasonably can.⁶⁶ With a practical deadline on the franchisee not much beyond that 14-day timeframe, franchisees are disproportionately affected (lacking any significant bargaining power). Therefore, franchisees are often compelled to contend with a complex document and insufficient opportunity to comprehensively and effectively evaluate the proposed franchise investment.

Franchise attorneys know what to focus on in FDDs and in the contractual agreement.⁶⁷ However, with franchise attorneys commanding a \$2,000-\$5,000 upfront retainer, along with hourly rates of \$350 to \$800,⁶⁸ it is unsurprising that many franchisees ultimately do not hire a franchise attorney to review FDDs.⁶⁹ While this high cost may merely be a heightened burden for some franchise applicants, it proves to slow or outright preclude the franchise process for others who cannot afford to spend that much money before their business commences. Past studies have shown that franchisees visit their family lawyer or a friend for counsel instead of obtaining advice from an attorney skilled in franchise matters.⁷⁰ In addition to cost, the largest deterrent to hiring an attorney is the franchisee's desire to maintain control over his or her process.⁷¹

⁶⁶ *Franchise Rule Compliance Guide*, *supra* note 32, at 124. Literally, it is merely a time period, which the franchisor must provide the FDD and not a hard and fast rule for signing the agreement; thus, it again unduly burdens franchisees, as it disproportionately affects one's negotiating position.

⁶⁷ See VINSON FRANCHISE LAW FIRM, *supra* note 16.

⁶⁸ Kevin B. Murphy, *Cost to Review Franchise Disclosure Documents (FDD)*, HG.ORG. (2014) (July 27, 2018), <https://www.hg.org/legal-articles/cost-to-review-franchise-disclosure-documents-fdd-5388>. Murphy describes the "very dry and technical" Franchise Disclosure Document as something you would "read if you're having trouble getting to sleep at night." *Id.* He also states that there is a disturbing trend of newly established franchises are bound to extraordinarily unfair contract provisions that they ignored during the contract formation process (gathering information, negotiation, and closing the deal). It is the role and function of a franchise attorney "to see the flashing red lights that [a prospective franchisee] does not even notice." *Id.*

⁶⁹ Ronald K. Gardner, Jr. & Julianne Lusthaus, *Representing Franchisees*, in FUNDAMENTALS OF FRANCHISING 329 (Rupert M. Barkoff et al. eds., 4th ed. 2015) (stating that most franchisees fail to hire an attorney).

⁷⁰ See Emerson, *supra* note 38, at 719 (2014) (including comments from franchise attorneys and a survey of franchise lawyers).

⁷¹ See Nika Kabiri, *Why People Don't Hire Lawyers – And No, It's Not Because They Hate You (part 3 of 5)*, LAWYERNOMICS BY AVVVO (Dec. 3, 2015), <http://lawyernomics.avvo.com/legal-marketing/why-people-dont-hire-lawyers-and-no-its-not-because-they-hate-you-part-3-of-5.html>.

If a prospective franchisee decides not to hire a franchise attorney, then the franchisee remains solely responsible for comprehending the language of the FDD. This requires the franchisee to extract, on his or her own, important information from the FDD, a proactive, precautionary measure which, in effect, could serve to deter or detect fraudulent conduct. However, to undertake a thorough inquiry of the FDD and the franchise's prospects requires much hard work and often is counter to predispositions or inclinations when under the spell of a cognitive bias. Regulators and others well versed in franchised businesses and the law thereof strongly discourage the "going it alone" approach to evaluating a franchise offer, which is a foolish attitude (not even a tactic) that leaves would-be franchisees vulnerable to their own mistakes and to others' avarice and fraud.⁷² So, at this point in the negotiations, has the soon-to-be franchisee involved friends or family in the decision-making process?⁷³ Has he or she "anchored" on a particular piece of information that has guided his or her thinking when considering the deal,⁷⁴ or does the prospective franchisee have alternatives to the franchise under consideration?⁷⁵ In addition, do franchisees turn to the Internet to look for answers to their questions?⁷⁶ If so, confirmation bias may be at play, with the franchisees seeking specific information to confirm their already-established beliefs or theories.⁷⁷ The answers to all of these questions about friends, family, information sets, alternative investments, and the Internet reveal just a

⁷² See New York State Office of the Attorney General, Eric T. Schneiderman, Investor Protection Bureau, Franchise Section, *What to Consider Before Buying a Franchise*, https://ag.ny.gov/sites/default/files/franchise_booklet.pdf. ("[one] should not attempt to extract important FDD information... unless [one has] considerable background regarding franchise documents or if one is already involved in the type of business [being considered] . . . Relying on the FDD without consulting a professional and hoping that the franchisor has told the truth is setting [oneself] up for potential fraud.")

⁷³ *Infra* App., Survey on Franchise Agreements, Question 6 (comments on file with authors).

⁷⁴ *Infra* App., Survey on Franchise Agreements, Question 2 (comments on file with authors).

⁷⁵ *Infra* App., Survey on Franchise Agreements, Question 3 (comments on file with authors).

⁷⁶ Various websites offer legal information or services for a flat fee. *Franchise Disclosure Document Review*, LEGALZOOM, <https://www.legalzoom.com/attorneys/franchise-disclosure-documents-review.html> (last visited Dec. 20, 2018).

⁷⁷ See Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 REVIEW OF GEN. PSYCHOL. 175, 178 (1998).

few of the many factors that cognitively influence, for better or for worse, the decision to reach a binding contract with the franchisor.

III. VARIABLES TESTED, AND HYPOTHESES

Over forty years ago, Amos Tversky and Daniel Kahneman comprehensively studied human judgment and decision-making from a cognitive bias perspective.⁷⁸ Cognitive biases are “mental shortcuts”—cognitive limitations and heuristics—⁷⁹ constituting mental tools that people use to reduce the amount of information they must consider when coming to a decision.⁸⁰ To investigate whether franchisees suffered from cognitive biases when entering franchise agreements, several common biases were tested via survey questions to the respondents. These biases include, but are not limited to, anchoring,⁸¹ the bandwagon effect,⁸² confirmation bias,⁸³ and escalation of commitment.⁸⁴

A. Anchoring Bias

⁷⁸ See generally Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCI. 1124, 1124 (1974) (describing heuristics and biases in judgment). Tversky and Kahneman further explain the anchoring bias as occurring not only when the starting point—the particular number to hedge on—is given to the subject, but also when the subject bases his estimate on the result of some “incomplete computation.” *Id.* at 1128. The authors explain the meaning of the term “incomplete computation” by giving a mathematics example of an ascending and descending order of multiplying the first eight real whole numbers. *Id.* The median estimate for the ascending sequence was 512, while the median estimate for the descending sequence was 2,250. *Id.* The correct answer is 40,320. *Id.* So there is plausible evidence that making estimates by starting from an initial value that is adjusted to yield the final answer, as was shown by Tversky and Kahneman’s experiment, can have an effect as to what you would predict numerically.

⁷⁹ *Heuristic*, MERRIAM-WEBSTER DICTIONARY (2018), <https://www.merriam-webster.com/dictionary/heuristic> (“involving or serving as an aid to learning, discovery, or problem-solving by experimental and especially trial-and-error methods”).

⁸⁰ See Charles R. Schwenk, *Information, Cognitive Biases, and Commitment to a Course of Action*, 11 ACAD. MGMT. REV. 298–310 (1986).

⁸¹ See Lebowitz & Baer, *supra* note 26.

⁸² See Lebowitz & Baer, *supra* note 26.

⁸³ See Nickerson, *supra* note 77, at 175.

⁸⁴ See WEBFINANCING, INC., *supra* note 29; see also Schwenk, *supra* note 80, at 304.

Before the survey was distributed to the randomly populated sample, the authors hypothesized that a majority of franchisees would answer “Yes” to relying on a particular piece of information and that, when asked to explain what this information was, the franchisees would respond that it was *numerical* information. For example, we, as authors of this article and draftsmen of the franchisee survey in the appendix, expected most franchisee respondents to rely on their review of the financial figures listed in the Franchise Disclosure Document (FDD), previously known as the Uniform Franchise Offering Circular (UFOC). The FDD contains twenty-three sections⁸⁵ that contain valuable information for the prospective franchisee, such as franchise bankruptcy history as well as start-up and initial investment costs.⁸⁶ These are among the first pieces of information that a franchise applicant will review when making his or her decision, and this initial exposure is precisely why franchisees may be susceptible to the anchoring bias. That bias affects a person’s ability to assess rationally an “initial starting value”;⁸⁷ in other words, this person may expect his or her initial return on investment as a new franchisee to be higher than anticipated. A potential franchisee could also expect minimal start-up costs because this aspiring franchisee anchors his or her assessment to a previously owned franchise. This could lead that person to become a

⁸⁵ See John Buzza & Joseph B. Mosca, *Create the Plan, Work the Plan: A Look at Why the Independent Business Owner Has Trouble Calling a Franchisee a True Entrepreneur*, AMER. J. OF BUS. EDUC. 113 (2009). Buzza and Mosca detail the differences between an individual independently starting his or her own enterprise and a business model in which one can purchase an “already detailed and complete business plan.” They relate the popular belief that buying a franchise—the latter—is an easier route to becoming an entrepreneur than if a person were to create a business from scratch (i.e., on his or her own).

⁸⁶ 16 C.F.R. § 436.5 (2007).

⁸⁷ See generally Markku Kaustia, Eeva Alho & Vesa Puttonen, *How Much Does Expertise Reduce Behavioral Biases? The Case of Anchoring Effects in Stock Return Estimates*, 37 FIN. MGMT. 391 (2008). The Tversky and Kahneman research study in 1974 (Tversky & Kahneman, *supra* note 78, at 1130) paved the way for numerous additional studies on the effects of anchoring in the valuation of real estate and the purchasing decisions of the consumer. The authors of this particular study explain that even experts can succumb to the anchoring bias. When put into the context of interpreting franchising agreements, it goes without saying that the franchisee, if he or she is burdened with anchoring bias, would most probably want an experienced franchise attorney to possess the knowledge and know-how in order to not fall into the cognitive bias traps that plague the franchisee. Because they are educated attorneys who specialize in a particular subset of business law, these lawyers should be able to navigate through and interpret the legalese on behalf of their clients; that additional expertise should serve to fend off any possible anchoring bias upon which the attorney, or expert, might rely.

multi-unit franchisee, thereby part of an organizational arrangement in which franchisees are permitted to own and operate multiple units within the same franchise system.⁸⁸

In addition, a would-be franchisee may anchor on the first bit of information and insufficiently adjust as the franchisor reveals less appealing information.⁸⁹ We can look to the FTC's used-car rule (requiring the dealer to disclose all warranties in a buyer's guide placed on the vehicle) or to the Truth in Lending Act (requiring that finance charges and interest rates be disclosed before credit is extended) as examples that ensure disclosure upfront in an effort to minimize the threat of anchoring bias.⁹⁰ In the alternative, a potential franchisee could anchor "down" and make the unfortunate calculation not to buy a franchise when in reality the purchase would have been profitable. This would be the case if the initial anchor was to an arbitrary or irrational number, hence skewing the initial value, causing the prospective franchisee to anchor to a fatal misconception, and concluding in a lost investment opportunity.⁹¹

B. *Reactance Bias*

The authors hypothesized that a majority of franchisees would answer, "Yes," to their having had friends or family members weigh in on the decision-making process and offer these—then prospective franchisees—before they committed to buying a franchise, an opposing view about whether to enter into the proposed franchise agreement. The cognitive bias studied through this particular question—reactance—is characterized by people reacting against attempts to control their own behavior and thus to eliminate freedom of choice.⁹²

⁸⁸ See generally Marco Grunhagen & Robert A. Mittelstaedt, *Entrepreneurs or Investors: Do Multi-Unit Franchisees Have Different Philosophical Orientations?*, 43 J. SMALL BUS. MGMT. 207, 209 (2005). According to the article, multi-unit franchise ownership has "become the dominant form of franchising in the United States[.]" Similarly to our research, Grunhagen and Mittelstaedt's article focuses on the franchisee's viewpoint

⁸⁹ Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 WAKE FOREST L. REV. 295, 325 (2005).

⁹⁰ *Id.*

⁹¹ See Paul Bennett Marrow, *Behavioral Decision Theory Can Offer New Dimension to Legal Analysis of Motivations*, 74 N.Y. ST. B.J., Jul.–Aug. 2002, at 46, 48.

⁹² See Mona A. Clee & Robert A. Wicklund, *Consumer Behavior and Psychological Reactance*, 6 J. CONSUMER RES. 389 (1980). Similar to how the article uses a recent college graduate as an example of someone with job offers to

Potential franchisees consult many outside sources before arriving at the decision to own a franchise.⁹³ These sources may include, but are not limited to, family, friends, attorneys, former business partners, and the Internet. Perhaps these friends or family members would strongly encourage a franchisee to play it safe and choose a powerful brand such as Subway or McDonald's. They could support that decision by adding that those are established franchises with a well-known name and good reputation, and thus are more likely to draw customers than a relatively new or unknown franchise.⁹⁴ Indeed, many people become franchisees because they want to buy into a brand, something already known and trusted by a large and growing customer base.⁹⁵ Through a franchise, the hopeful franchisee believes that he or she will reap the benefits of brand recognition, without having to develop his or her own recognition through substantial effort and expense. It is this perceived value that gives the franchisor an upper hand in dictating the terms of the franchise.⁹⁶ These different influences could cause a

ponder, a prospective franchisee may have numerous offers to balance in a given time from multiple franchisors in many jurisdictions. Just as a recent college graduate might find one job offer to be enticing and ready to accept it, a franchisee may select one offer in preference over the others, but then realize the loss of freedom that comes with making a definitive selection. This sense of a loss of freedom creates a delay in the selection process, and also makes otherwise turned-down choices "suddenly more attractive," in the words of the author. *Id.* This delay may also give the franchisee more time to implicitly succumb to multiple cognitive biases, as the selection process continues. With regard to the study of the "reactance theory," Jack Brehm in 1966 and 1972 studied the theory (JACK W. BREHM, A THEORY OF PSYCHOLOGICAL REACTANCE (1966); JACK W. BREHM, RESPONSES TO LOSS OF FREEDOM: A THEORY OF PSYCHOLOGICAL REACTANCE (1972)) as well as Gisla Gniech and Hans-Joachim Grabitz in 1978 (Gisla Gniech & Hans-Joachim Grabitz, *Freiheitseinengung und psychologische Reaktanz*, in KOGNITIVE THEORIEN DER SOZIALPSYCHOLOGIE 48-74 (Dieter Frey ed., 1978)) and Robert A. Wicklund in 1974 (ROBERT A. WICKLUND, FREEDOM AND REACTANCE (1974)) from both the laboratory and out in the field.

⁹³ See, e.g., *Franchisee Resources on the Web*, AM. ASS'N OF FRANCHISEES & DEALERS, (Aug. 5, 2018), <https://www.aafd.org/buying-a-franchise/selecting-a-franchise/franchise-resources/> (featuring list of outside sources relevant and available to franchisees).

⁹⁴ FED. TRADE COMM'N, *supra* note 11.

⁹⁵ See Thomas J. Power, *Fast Food Sweatshops: Franchisors as Employers under the Fair Labor Standards Act*, 19 CUNY L. REV. 337, 354 (2016).

⁹⁶ *Instructional Sys., Inc. v. Comput. Curriculum Corp.*, 614 A.2d 124, 151 (N.J. 1992) (D'Annunzio, J.A.D., dissenting) (holding that the contractual relationship between a producer and its distributor was a "franchise" under the New Jersey Franchise Practices Act, and a community of interest existed under that Act to establish a franchise).

budding franchisee to react to the viewpoints from family and friends and make the incorrect decision. For instance, if the aspiring franchisee received from confidantes negative or opposing viewpoints about his or her probable decision to purchase a particular franchise, he or she might respond with hostility and prove even more likely to pursue the ownership of that franchise; this reaction would allow the future franchisee to maintain his or her autonomy.⁹⁷

Certainly, autonomy is something the franchisee usually desires in the franchise relationship. Franchisee autonomy is described as the “degree of freedom fostered in the system with regards to franchisee entrepreneurial activity.”⁹⁸ Prior research has shown that allowing franchisees to have flexibility and individualism in order to meet their local market needs may be beneficial to the franchise system.⁹⁹ However, franchisors may still seek to limit franchisee liberty by directing brand imaging and other quality controls.¹⁰⁰ Therefore, managing a franchisee’s autonomy is a true balancing act for the franchisor.

C. *Confirmation Bias*

The survey questions for this article also tested for confirmation bias. The authors hypothesized that a majority of the franchisees queried would believe that they had no better alternatives to the franchise that they currently operate. Thus, before buying their franchises, most franchisees would have been so cognitively biased that they would not have considered other options or alternatives.

People fail to consider alternatives because they simply do not think to do so.¹⁰¹ In effect, they just look to confirm what they already believe to be true.¹⁰² For example, as the franchise applicants have some time to evaluate FDDs, they may fall victim to a reaffirmation of confirmation bias through the “mere-exposure effect,” a psychological phenomenon where people prefer things with which they are more

⁹⁷ See *infra* Appendix, Survey on Franchise Agreements, Question 6.

⁹⁸ See Anna Watson, Olufunmilola (Lola) Dada, Marko Grunhagen & Melody L. Wollan, *When Do Franchisors Select Entrepreneurial Franchisees? An Organizational Identity Perspective*, 69 J. BUS. RES. 5934, 5936 (2016).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ See Nickerson, *supra* note 77, at 200.

¹⁰² See Bill Kanasky, Jr., *Juror Confirmation Bias*, 33 NO.2 TRIAL ADVOC. Q. 35 (2014) (“People tend to interpret new information in a way that confirms their existing beliefs.”).

familiar.¹⁰³ Studies show that exposure to a stimuli increases one's mindset towards the stimuli.¹⁰⁴ A franchisee who has more time to review a disclosure document will have more exposure to that document. Thus, that potential franchisee, if already leaning toward, or even anxious to enter, a franchise relationship, perhaps due to cognitive biases such as confirmation bias or reactance bias,¹⁰⁵ would tend to have an even more positive attitude toward purchasing the franchise.

D. *Information Bias*

Lastly, the authors theorized that a majority of franchisees actually seek more information than necessary about their franchise agreement before deciding to acquire a franchise. The cognitive bias being tested in this case is “information bias,” the tendency to seek information regardless of how ineffective such additional information is likely to be.¹⁰⁶ “Additional information may be irrelevant or unnecessary.”¹⁰⁷ Nonetheless, a person may be reluctant to make a decision if he or she thinks that some small piece of undiscoverable information is missing.¹⁰⁸

When a leader or organization is faced with a difficult decision, that leader or organization typically does not want an information gap and will seek any information that *may* be missing.¹⁰⁹ Even though a poorly performing franchise owner may be dismayed over his or her business situation, there is likely little help that additional information can offer at that point (after the franchise relationship commenced) because of the binding franchise agreement that this franchisee signed.¹¹⁰ The reason to understand and counter the information bias must be to prevent serious mistakes in judgment *before* it is too late, while a potential franchisee is still deciding for or against investment in and operation of a franchise.

¹⁰³ Gillian Fournier, *Mere Exposure Effect*, PSYCHCENTRAL (July 17, 2016), <https://psychcentral.com/encyclopedia/mere-exposure-effect/>.

¹⁰⁴ Robert B. Zajonc, *Attitudinal Effects of Mere Exposure*, 9 J. PERSONALITY & SOC. PSYCHOL. 1, 23 (1968).

¹⁰⁵ *Supra* notes 97, 101–104 and accompanying text.

¹⁰⁶ MICHAEL VAUGHAN, *THE THINKING EFFECT: RETHINKING THINKING TO CREATE GREAT LEADERS AND THE NEW VALUE WORKER* 25 (2013).

¹⁰⁷ *See* Kane, *supra* note 36, at 24.

¹⁰⁸ *Id.* at 24–25.

¹⁰⁹ *Id.* at 24.

¹¹⁰ In effect, the information at that point in time may be viewed as irrelevant. The franchisee would remain bound to the franchise agreement.

IV. COLLECTION OF SURVEY DATA

The authors developed a short survey to test whether or not franchisees experienced certain cognitive biases before they reached an agreement with their franchisor.¹¹¹ The authors obtained a randomly populated sample of business franchisees, with over 200 franchisees responding to and completing the survey. Once consent was given, Question 1 asked respondents if they had ever hired a franchise expert/attorney to assist them with their decision to operate a franchise. Nearly three-fourths of the respondents (70%) answered “No,” with 30% indicating that they had hired an expert/attorney.¹¹²

Question 2 asked respondents if they relied on a particular piece of information before entering into the franchise agreement, and, if so, to specify it.¹¹³ The percentage difference between the answers for this question was less pronounced, with 52% (105/201) of respondents indicating “No” and 48% (96/201) of respondents answering “Yes.”¹¹⁴ Moreover, ninety-three respondents described the “particular piece of information” that they relied on when making their decision. Out of those respondents who described their influencing information, roughly 35% (33/93) of these respondents indicated that they relied upon the FDD or UFOC,¹¹⁵ while the other 65% (60/93) indicated that they had “previous experience” or “had already worked in a franchise” in their general comments.¹¹⁶

The third question asked: “Before acquiring your present franchise, did you own and/or operate one or more franchises?”¹¹⁷ This question turned out to be a proper follow-up from the previous question, as only 7% of respondents owned and/or operated one or more franchises before taking on their current one.¹¹⁸ It can be

¹¹¹ See generally *infra* Appendix, Survey on Franchise Agreements.

¹¹² *Infra* Appendix, Survey on Franchise Agreements, Question 1.

¹¹³ *Infra* Appendix, Survey on Franchise Agreements, Question 2.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Infra* Appendix, Survey on Franchise Agreements (comments on file with the authors); The Uniform Franchise Offering Circular (UFOC) is a document that describes franchise opportunities, something akin to the Franchise Disclosure Document (FDD) that tended to replace it under the amended FTC Rule of 2007. Patricia Schaefer, *Layman's Guide to the Uniform Franchise Offering Circular*, FRANCHISE KNOW HOW, <http://www.franchiseknowhow.com/articles/ufoc.htm> (last visited Dec. 20, 2018).

¹¹⁷ *Infra* Appendix, Survey on Franchise Agreements, Question 3.

¹¹⁸ *Id.*

concluded from this question's responses that franchisees rarely have prior experience with operating a franchise, and that their current franchise was the first one that they had owned and operated.¹¹⁹

The next two questions asked: "If you answered 'Yes' to the previous question - that, before acquiring your present franchise you owned and/or operated one or more franchises . . . was the previous franchise in the same field as your current franchise [Question 4] and would you consider that previous franchise successful? [Question 5]"¹²⁰ With only 28 respondents, the results are not statistically significant.¹²¹ However, over 70% of these respondents answered "No," that their previous franchises were not in the same field as their current franchise, which could indicate that franchisees tend to diversify their portfolio when it comes to owning and operating franchises. This result goes against our initial hypothesis, as we originally hypothesized that franchisees would be so cognitively biased as to not consider (or buy into) franchises in alternative markets. However, more respondents would have to participate in answering this specific question in order to assess the gravity of owning and operating multiple franchises. Finally, note that there may be a reduced number of "repeat" franchisees (those in the same field) because of non-competition or non-solicitation agreements restricting persons who left the employment of, or franchise relationship with, a franchise company in the same industry as the new franchised business; the prospective franchisee may be bound to such non-compete or non-solicitation covenants with the former franchisor and thus impeded from signing a new contract that exposes the franchisee, and even its new franchisor, to potential liability.¹²²

Over 78% of respondents to Question 5 believed that their previous franchise was successful.¹²³ A "successful" franchise may be considered one that is well established, has "integrity," and has

¹¹⁹ Clearly, only a very small portion of the respondents who indicated that they had "previous experience" or "had already worked in a franchise," *infra* Appendix, Survey on Franchise Agreements, Question 2, actually had owned or operated a franchise. *Infra* Appendix, Survey on Franchise Agreements, Question 3.

¹²⁰ *Infra* Appendix, Survey on Franchise Agreements, Question 4.

¹²¹ *Id.* (Note that with only 28 respondents—the results for this question are not enough to be statistically significant).

¹²² Henry C. Su & Michael J. Lockerby, *Trade Secrets*, in THE INTELLECTUAL PROPERTY HANDBOOK: A PRACTICAL GUIDE FOR FRANCHISE, BUSINESS, AND IP COUNSEL, *supra* note 48, at 213, 242–44.

¹²³ *Infra* Appendix, Survey on Franchise Agreements, Question 5. Again, as for Survey Question 4, the numbers are too small to be statistically significant.

franchisees happy with the overall setup.¹²⁴ In franchising, past results are an excellent indicator of future performance.¹²⁵ Decisions such as picking a product one cares about, making sure to adequately research the business, and thinking twice before determining a location for a franchise¹²⁶ are all notable actions leading to franchise success. Those respondents who deemed their first franchise a success may also be predisposed to think that their next venture will also, almost automatically, triumph. Such conviction may be the result of psychological mechanisms where individuals employ the overconfidence effect, a form of cognitive bias fostered by a personal

¹²⁴ See Michael Garlick, *The Franchise Relationship: Counseling Potential Franchisors and Franchisees*, in THE FLA. BAR: FRANCHISE LAW AND PRACTICE 3-1 (THE FLA. BAR, 1996).

¹²⁵ See Grant Amos, *Gleaning Psychometric-Based Insights for Franchise Success*, FRANCHISE CHAT (last visited Dec. 20, 2018), http://www.franchise-chat.com/resources/gleaning_psychometric-based_insights_for_franchise_success.htm.

¹²⁶ *How to Succeed as a Franchisee*, WALL ST. J. (Sept. 11, 2008, 5:33 PM), <http://guides.wsj.com/small-business/franchising/how-to-succeed-as-a-franchisee/>. (in addition to the franchises that do succeed, there also those that inevitably fail every year from causes including but not limited to: lack of funding, poor relationships with others and management, and a mismatch between the business operation and the franchisee. Not only is the decision to hire a franchise attorney a decision that the franchisee must make early on in the decision-making process, but also hiring a consultant who can give advice to the franchisee about whether the product that he or she will be selling is a “good fit” opportunity is also a hiring decision that the franchisee should and must make. From reading this article, there is a noticeable plethora of mistakes that a franchisee can make from the get-go. If the franchisees do not have adequate managerial experience themselves, they may employ poor managers, which may lead to the other causes of why certain franchises fail, as stated above. The anchoring bias, mentioned above, can take hold if the franchisee possesses insufficient funds to keep the business afloat. For instance, as stated in this article, the initial up-front fee to own and operate a franchise must be paid to the franchisor and is “clearly stated.” However, beginner franchisees may place too much weight on the initial fee without equally considering the impact of high operating costs. Alternatively, unanticipated events can also bring the franchise into financial ruin. By relying on the initial fee amount as a barometer for assessing whether or not a good deal is being offered by the franchisor, the franchisee can lead him or herself down a dangerous path of not keeping cognizant the additional costs of overhead that come with running a business. The article also brings up the importance of realizing the detriment that “unrealistic optimism” can bring. Optimism bias is a cognitive bias that can plague franchisees. For instance, if a franchisee is not adequately prepared financially to withstand a financial crisis because the franchisee did not decide to save during a period of economic boom and thought that the favorable business conditions were bound to last a long time, then the franchisee falls into the pit of the optimism bias).

history absent of any negative stimuli.¹²⁷ That is, during his or her past franchisee establishment, the individual may not have experienced negative consequences; however, the individual may also be unaware of the potential for a good franchise opportunity and thus have a negative impression of the franchise system if the one that he or she chose first performs poorly. Without negative stimuli or awareness regarding the true meaning, if any, of positive stimuli, an individual may develop a false sense that he or she is able to produce an optimal outcome sans the assistance of legal counsel.

Question 6 asked, “Before entering into a single franchise agreement, did you have friends or family that offered an opposing view as to whether you should enter into the agreement?”¹²⁸ Over 71% of the respondents answered “No,” with the rest receiving an opposing view from friends or family about their impending franchise purchase.¹²⁹ The authors designed this question to test whether or not the use of advice or suggestions swayed franchisees to go against the mass, general opinion of family members or friends. Thus, this question tested the aforementioned reactance bias.¹³⁰ Receiving advice about “real world problems”¹³¹ is processed differently than answers to “textbook problems,” and the decision whether to become a franchisee is surely not a singular textbook problem. People expect advice to help them. However, there is evidence throughout decision-making studies to show that individuals may draw different conclusions when presented with the same information.¹³² This phenomenon is called the “framing effect.”¹³³

For question 7, over 53% of respondents answered that they had held alternatives besides the franchise that they currently operated—the answers are examined in detail in the “Analysis” section below.¹³⁴ Many of the franchisees who responded owned businesses in fields

¹²⁷ See Joyce Ehrlinger, Ainsley L. Mitchum & Carol S. Dweck, *Understanding Overconfidence: Theories of Intelligence, Preferential Attention, and Distorted Self-Assessment*, 63 J. OF EXPERIMENTAL SOC. PSYCHOL. 94, 97–99 (2016).

¹²⁸ *Infra* Appendix, Survey on Franchise Agreements, Question 6.

¹²⁹ *Id.*

¹³⁰ See Clee & Wicklund, *supra* note 92, at 389–90 and accompanying text.

¹³¹ Ilan Yaniv, *Receiving Other People's Advice: Influence and Benefit*. 93 ORG. BEHAV. & HUM. DECISION PROCESSES 1, 1 (2004).

¹³² Shlomi Sher & Craig R.M. McKenzie, *Framing Effects*, UC SAN DIEGO-DEPARTMENT OF PSYCHOLOGY, <http://psy2.ucsd.edu/~mckenzie/SHERMCKENZIEFRAMINGEFFECTSFINAL1.pdf> (last visited Nov. 18, 2018).

¹³³ *Id.*

¹³⁴ *Infra* Appendix, Survey on Franchise Agreements, Question 7.

such as early childhood education, landscaping, and food service,¹³⁵ an eclectic group, to say the least.

Three distinct stages exist in the consumer decision-making process.¹³⁶ The first two stages are retrieval of information and the formation of a consideration set, respectively.¹³⁷ The third and final stage of this process, most important to our discussion, involves the evaluation of an assortment of products, or, in this special case of franchising, a selection from a set of different franchises¹³⁸. The would-be franchisee is the consumer in this case, and he or she must come to a decision about what franchise to buy. The question here is: Do prospective franchisees consider alternatives before they sign their single-franchise agreement? Or, by contrast, do franchisees simply pinpoint a selection and the process is complete?

Research shows that having too many choices can lead people to take “less positive risks.”¹³⁹ These findings can have a profound effect on the application of cognitive psychology to business agreements and eventual ownership. In *Doing Better but Feeling Worse: The Paradox of Choice*, Barry Schwartz and Andrew Ward describe choice as

¹³⁵ *Id.* (comments on file with authors).

¹³⁶ Rajdeep Grewal, Thomas W. Cline & Anthony Davies, *Early-Entrant Advantage, Word-of-Mouth Communication, Brand Similarity, and the Consumer Decision-Making Process*, 13 J. CONSUMER PSYCHOL. 187, 188 (2003). According to the authors, word-of-mouth “significantly influences product evaluations and purchase decisions.” *Id.* Many of our collected free responses for the survey included the answer “word of mouth” when the franchisees were asked to further explain any answer choices to the previous seven questions or to write a comment to be left. The franchisee may also rely upon word-of-mouth if he or she elected to receive advice from family members or friends about whether or not to take on the ownership of a franchise. Regardless, word-of-mouth communication is described by Grewal, Cline, and Davies as a “personal, unpaid means of communication” which enhances credibility. *Id.* at 196. Considering the role of a prospective franchisee, the franchisee may give more cognitive recall effort towards word of mouth conversations between him or herself and the franchisor, rather than through more modern forms of communication such as text messaging and email).

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ Tori DeAngelis, *Too Many Choices?*, MONITOR ON PSYCHOL., June 2004, at 56, (noting that having so many choices to choose from in a given selection situation can overwhelm us and our typical thinking process, sometimes to the point where we “choose nothing at all.”). In our survey, question 7, asked the franchisees whether or not they had alternatives to the franchise that they ultimately chose to own and operate, and slight majority (53%) stated that they had to decide from multiple choices. Some of their brief explanations as to why they chose to make the agreement with their franchisor give insight into the thought process and whether or not it may have been influenced by cognitively biases).

something that can lead to “misery-inducing tyranny.”¹⁴⁰ For instance, one respondent offered his opinion as to whether he had alternatives besides the franchise he currently operates; he wrote that there were “too many to list” when offered by a franchise broker,¹⁴¹ and presumably the resulting information overload was a detriment. The recurring theme of having to choose between alternatives is often at the heart of “buyer’s remorse.” The sense of regret that one feels when one has made a purchase or ownership decision, but then has “second thoughts” about the transaction, is apparent in the behavior of those making commonplace purchasing decisions,¹⁴² and it is found to occur in franchisees’ choice to buy a franchise.¹⁴³

Many franchisees, however, commented only positively about their selection of the franchise they currently owned and operated. In contrast to the aforementioned “choices” paradox, a number of franchisees seemed to thrive from, and therefore enjoy the decision-making process of choosing a particular franchise. One franchisee mentioned “values” matching his own as a reason why he chose his franchise, with another believing that it “best fit [his] goals and skill base.”¹⁴⁴ The effect of any significant cognitive biases on these apparently contented franchisees appears to be negligible based on the percentage of respondents who had alternatives as well as their recorded opinions. The final “Yes/No” question of the survey asked: “After entering into your franchise agreement, did you find yourself seeking out more information about your agreement?” Over one-third (35%) of respondents answered that they did seek out more information, while 65% of respondents indicated “No.”¹⁴⁵

V. ANALYSIS

A. *Economic and Demographic Considerations*

¹⁴⁰ Barry Schwartz & Andrew Ward, *Doing Better but Feeling Worse: The Paradox of Choice*, in POSITIVE PSYCHOLOGY IN PRACTICE 86 (P.A. Linley and S. Joseph eds., 2004).

¹⁴¹ *Infra* Appendix, Survey on Franchise Agreements, Question 7.

¹⁴² Schwartz & Ward, *supra* note 140, at 86–87.

¹⁴³ A fair number of respondent franchisees, from around the United States – nearly 10% of the total respondents – took the additional time in answering the survey to discuss their second thoughts in the comments section of the survey. *Infra* Appendix, Survey on Franchise Agreements, Question 9.

¹⁴⁴ *Id.*

¹⁴⁵ *Infra* Appendix, Survey on Franchise Agreements, Question 8.

The survey results reveal some important data. Most franchisees (almost three-fourths) chose not to hire a franchise expert or attorney to assist them in their decision-making about owning a franchise.¹⁴⁶ Cost, among other deterring factors, must have had a significant impact on a franchisee's thinking.¹⁴⁷ With additional setup expenses, the cost of hiring a franchise expert or attorney may prove to be too large a financial outlay for the prospective franchisee.¹⁴⁸ Additionally, most members of the public perceive franchise agreements as non-negotiable, so many aspiring franchisees think help from an attorney would be futile.¹⁴⁹ It is reasonable to assume that franchisees, in an effort to cut costs, would turn to the Internet to answer their legal and business questions rather than hiring an expert or attorney.¹⁵⁰ Furthermore, as the percentage of franchisees who are minorities has risen, so has the possible increase in unrepresented franchisees. Generally, minorities (Hispanics, African-Americans, Asians, and Pacific Islanders) are more likely to be wary of hiring attorneys or experts outside of family or those directly recommended by a family member.¹⁵¹

Indeed, franchising has long featured a growing number of minorities and women; the days of franchisees being almost exclusively white males is long gone.¹⁵² Franchisees that identify as

¹⁴⁶ *Id.* at Question 1.

¹⁴⁷ See Internicola, *supra* note 12; Murphy, *supra* note 68.

¹⁴⁸ Jeff Elgin, *Is the Price Right?*, ENTREPRENEUR (Aug. 14, 2006), <https://www.entrepreneur.com/article/164820> (describing various initial costs in a franchise setup); Murphy, *supra* note 68 (describing the average costs of a franchise attorney).

¹⁴⁹ Emerson, *supra* note 38, at 720–21.

¹⁵⁰ The Internet is erupting with websites that provide “immediate legal advice.” Companies such as LegalZoom, Just Answer Legal, and Public Legal all provide services to individuals interested in getting answers without consulting a lawyer in person. This is also not including the legal information blogs that law firms provide on their own websites. The results speak for themselves. Robert Ambrogi, *Latest Legal Victory has LegalZoom Poised for Growth*, AM. B.J. (Aug. 2014), http://www.abajournal.com/magazine/article/latest_legal_victory_has_legalzoom_poised_for_growth/ (noting that Legal Zoom earned \$156 million in 2011).

¹⁵¹ There is data in another field of law indicating the tendency to not hire lawyers. A study of 2,438 bankruptcy filings in 2007 indicated that the odds of non-Hispanic African American debtors using lawyers were about 43 percent less than the odds for white debtors. Angela Littwin, *The Do-It-Yourself Mirage: Complexity in the Bankruptcy System*, in BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS (Katherine Porter ed., 2012).

¹⁵² PRICEWATERHOUSECOOPERS, FRANCHISED BUSINESS OWNERSHIP : BY MINORITY AND GENDER GROUPS: AN UPDATE FOR THE IFA FOUNDATION 2 (2018), <https://www.franchise.org/sites/default/files/Franchise%20Business%20Ownership>

minorities operate franchises in greater rates compared to those that do not.¹⁵³ Although the number of franchisees from underrepresented groups is far from a majority, the rapid increase in minority ownership rate coupled with almost three out of every four franchisees not hiring an attorney to assist them with their legal needs is a startling correlation.¹⁵⁴

To start, financing is the main problem that minority franchise owners face.¹⁵⁵ Often, minority franchisees do not know how to

%202018_0.pdf (“Overall, the minority ownership rate for franchised businesses increased by 10.3 percentage points from 20.5 percent in 2007 to 30.8 percent in 2012, an increase in the ownership rate of 50 percent,” while for non-franchised, non-franchised businesses the figures were, in order, much lower - an increase of 4.6 percentage points, from 14.2% to 18.8%, for a 32 percent rise in the ownership rate); *Id.* (“female ownership among franchises increased by 10.1 percentage points from 20.5 percent in 2007 to 30.6 percent in 2012, an increase of 49 percent”); *Id.* (the overall percentages for minority-owned franchised businesses and for female owned franchised businesses also rose from 2002 to 2007).

¹⁵³ PRICEWATERHOUSECOOPERS, *FRANCHISED BUSINESS OWNERSHIP: BY MINORITY AND GENDER GROUPS* 7 (2007),

http://www.franchise.org/sites/default/files/ek-pdfs/featured_news/women-and-minorities-in-franchising-rept.final_0.pdf; In that same year, almost twenty percent of all franchised businesses were owned by minorities. *Id.* at 4; That percentage has continued to rise since. Littwin, *supra* note 151.

¹⁵⁴ Our research did not test the impact that race or gender may have had in whether or not franchisees were found to have been susceptible to certain cognitive biases. That remains a topic for future studies. However, while causation is unclear, there does seem to be a positive correlation between minority status and proceeding to a franchise closing *sans* counsel.

¹⁵⁵ Rachel McCormick-Jennings, *Fast Food Franchise Track: Minority Entrepreneurs Find Opportunity in Brand Names*, MILWAUKEE BUS. J. (Jan. 29, 2006),

<https://www.bizjournals.com/milwaukee/stories/2006/01/30/story7.html?sprint>. Most restaurant chains mandate that potential owners have a “minimum net worth and liquid assets.” *Id.* This factor alone can lead to the purging of many would-be franchisees from the competition pool of potential owners, especially minorities without extensive business connections. As a result, many prospective franchisees may find themselves focusing in on just one factor upon many when deciding whether or not to make the purchase—the startup cost, rather than the softer but also important factors such as management style, technology available, and location. This can implicitly lead to the franchisee seeking confirmation for what he or she may already know the answer—that the price of owning a franchise may be too high and the future cost of having to obtain a loan may in itself be unfeasible. The article cites Henry James, a business counselor at the Small Business Development Center at the University of Wisconsin-Milwaukee as saying that “the owner usually has to come up with 35 to 40 percent of the money.” Once the owner comes up with the money, there may be an escalation of commitment on the part of the franchisee to continue making either investments into the franchise

obtain the financial resources necessary to start a business. Additionally, lack of social and business connections¹⁵⁶ puts minority franchisees at an even further disadvantage. In order to help alleviate the disparities that exist between privileged and underprivileged franchisees, many of America's most well-known franchises, such as Burger King, Six Continents Hotels, and Subway, have collaborated to create "minority outreach programs"¹⁵⁷ in franchising. For example, Subway started a "Minority Ownership Financial Assistance Program" that allows minority franchisees to receive financing of up to 90% of the franchise fee, with the first six months interest free.¹⁵⁸ Choice Hotels also developed a free seminar targeting minority entrepreneurs in order to attract more minorities to its franchising base.¹⁵⁹ Through these minority outreach programs, franchisees may be less inclined to desire the services of a franchise attorney, especially when the franchisors offer free seminars.¹⁶⁰ With topics such as evaluating hotel opportunities, capital and operating costs, and sources of capital and funding,¹⁶¹ franchisees may be deluded into thinking that the specified topics are the only information they need in order to begin their new venture as a franchise owner.

Although franchisors have implemented minority outreach programs,¹⁶² what they have accomplished sometimes remains unclear. The previously listed franchises with minority outreach programs are some of the world's most profitable franchises with the resources necessary to establish an active presence in poorer communities. Most franchises are not as costly to join, nor as lucrative, and some are owned by franchisors who "[get] greedy," according to

opportunity or to continue running the operation past the point where the venture may even be profitable, perhaps even going against the advice of seasoned professionals or possibly family members who offer a different outlook.

¹⁵⁶ See Carla Wong McMillian & Kelly J Baker, *Discrimination Claims and Diversity Initiatives: What's a Franchisor to Do?*, 28 FRANCHISE L.J. 71, 71–72 (2008).

¹⁵⁷ RICHARD WILLARD, INT'L FRANCHISING ASS'N EDUC. FOUND., MINORITY OUTREACH PROGRAMS IN FRANCHISING: RESEARCH REPORT AND CASE STUDIES (2001), https://www.franchisefoundation.org/sites/default/files/research/files/minoritybook_1.pdf.

¹⁵⁸ *Id.* at 14.

¹⁵⁹ *Id.* at 7.

¹⁶⁰ Press Release, *Choice Hotels Int'l Inc.*, Choice Hotels Expands Franchise Ownership Among Minorities, <http://media.choicehotels.com/2006-04-03-Choice-Hotels-Expands-Franchise-Ownership-Among-Minorities>.

¹⁶¹ WILLARD, *supra* note 157, at 7.

¹⁶² *Id.*

one anonymous respondent from the survey.¹⁶³ For these owners, expanding outreach is a futile concept where money can be allocated elsewhere.

Additionally, sometimes it is the franchisees themselves who wish to expand into different markets. In *Home Repair, Inc. v. Paul W. Davis Systems, Inc.*,¹⁶⁴ an African-American franchisee sued his franchisor over restricting minority opportunities in select communities.¹⁶⁵ This particular franchisee had been in good-standing and wanted to expand his business into “white areas” in metropolitan Chicago.¹⁶⁶ The franchisor ended up denying the African-American franchisee’s proposal and encouraged him to expand only in minority-populated inner-cities.¹⁶⁷ The District Court upheld the franchisee’s pursuit of a claim of racial discrimination, and—while the case eventually settled before the start of the trial—the result demonstrates possible ramifications for franchisors that actively avoid outreach or limit it to urban areas and poorer markets.¹⁶⁸

In *Home Repair*, the franchisee was able to obtain access to an attorney who successfully advocated on the franchisee’s behalf.¹⁶⁹ But timing is often crucial, and would-be franchisees that do seek legal assistance often do not solicit lawyers until well after the beginning of the franchising process.¹⁷⁰ This can be seen in many of the

¹⁶³ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁶⁴ *Home Repair, Inc. v. Paul W. Davis Systems, Inc.*, 98 C 4074, 1998 U.S. DIST. LEXIS 16223, at *1 (N.D. Ill. Oct. 8, 1998) (mentioning the plaintiff’s counsel in introduction).

¹⁶⁵ See Carmen Caruso, *Racial Discrimination in Franchising*, FRANCHISE TIMES, June 2001, *edited version available at* <https://cdcaruso.com/articles/racial-discrimination-in-franchising>.

¹⁶⁶ *Home Repair, Inc.*, 98 C 4074, 1998 U.S. DIST. LEXIS 16223, at 2.

¹⁶⁷ *Id.*

¹⁶⁸ See Robert W. Emerson, *Franchise Selection and Retention: Discrimination Claims and Affirmative Action Programs*, 40 ARIZ. L. REV. 511 (1998) (discussing numerous claims of racial discrimination brought by franchisees or franchise candidates against a franchisor).

¹⁶⁹ *Home Repair, Inc.*, 98 C 4074, 1998 U.S. DIST. LEXIS 16223, at 1.

¹⁷⁰ Lawyers, though, can play a crucial role on behalf of their clients later in the franchising process. Throughout the business life of a franchisee, attorneys may be sought and retained, and—even later—their representation may be crucial to a franchisee’s success. This was demonstrated in *Home Repair*, 1998 U.S. DIST. LEXIS 162323. It clearly is a necessity in contests over the end stage of a franchise, termination. See Emerson, *supra* note 61.

franchisees' survey responses.¹⁷¹ While seven out of ten franchisees failed to hire a franchise attorney, the work handled on behalf of the thirty percent that did retain an attorney was significant. One franchisee weighed in on his attorney's role as ensuring that the franchisee "was covered and didn't get screwed if [the franchisee] defaulted or the franchisor didn't live up to the contract."¹⁷² Another franchisee had an attorney who "raised concerns about the level of support stated in the preliminary packet and what was actually listed in the contract."¹⁷³ By ensuring that their clients are protected, and by raising concerns about the various contractual terms in the agreement, franchise lawyers can provide a competitive advantage in decision-making to their clients that unrepresented franchisees are unable to accomplish on their own.

B. *Biases Reflected in the Survey Results*

Almost half (48%) of franchisees relied upon a distinct piece of information when arriving at their decision to become a franchisee.¹⁷⁴ When asked to describe the "particular piece of information" upon which they relied, 35% stated that they relied upon the FDD or the UFOC.¹⁷⁵ Past experiences (whether the franchisee had already dealt with the franchisor before, relied on the franchisor's past experience of success, or had some prior relationship with the franchisor before arriving at an agreement) played a significant role in how respondents answered, as well as word-of-mouth and financial figures.¹⁷⁶

The last question of the survey encouraged franchisees to write freely about their current experience as a franchisee.¹⁷⁷ Although some respondents volunteered that they "haven't had any reasons to re-visit the agreement,"¹⁷⁸ others felt quite differently. For example, a number of franchisees believed that some terms in the agreement were

¹⁷¹ *Infra* Appendix, Survey on Franchise Agreements (comments on file with authors).

¹⁷² *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁷³ *Id.*

¹⁷⁴ *Infra* Appendix, Survey on Franchise Agreements, Question 2 (FDD/UFOC stat table).

¹⁷⁵ *Id.*

¹⁷⁶ *Infra* Appendix, Survey on Franchise Agreements, Question 2 (FDD/UFOC stat table) (comments on file with authors).

¹⁷⁷ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁷⁸ *Id.*

“confusing” and “weren’t explained as clear [sic] as they now needed to be.”¹⁷⁹ A survey respondent from Kansas detailed his experience as a franchisee in interesting terms. When the respondent first entered into his franchise agreement, he was – the respondent admitted – “very uninformed.”¹⁸⁰ In the very next sentence, the Kansas franchisee stated that he “wishes [he] had done more research prior to entering into the agreement.”¹⁸¹ Perhaps this manifests the psychological phenomenon known as “hindsight bias,” defined as “the tendency for people considering a past event to overestimate [his or her] likelihood of having predicted its occurrence.”¹⁸² In this case, the respondent believed that conducting more research on the franchise agreement would have meant that he avoided feeling “uninformed” about becoming a franchisee. This franchisee admitted to “not seeking out” alternatives because the franchise that he chose “really appealed to [him] initially” (and, obviously, not as much in retrospect).¹⁸³

The respondent fell victim to confirmation bias by succumbing to useless information¹⁸⁴ and by failing to pursue alternatives that could have improved his fortunes as a franchisee. Confirmation bias was also evident for another franchisee, who believed her agreement to be “extensive . . . too hard to absorb all at once,” and therefore something she “used . . . as a reference at times.”¹⁸⁵ This franchisee likely referenced her franchise agreement to see whether it actually contained what she already thought was there,¹⁸⁶ thus demonstrating the

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² See Hal R. Arkes, et al., *Eliminating the Hindsight Bias*, 73 J. APPLIED PSYCHOL. 305, 305 (1988). With regard to hindsight bias being tested within our research study, there was a small total of 27 collected responses, and even though 21 of those franchisees answered affirmatively to the question of whether they had thought of their previous franchise as “successful,” a lack of evidence exists as to whether the franchise truly was a success and thus merited the franchisee believing it to be a success, or whether the franchise was not successful and the franchisee fell victim to a hindsight/recall bias; see *infra* Appendix, Survey on Franchise Agreements, Question 5.

¹⁸³ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁸⁴ See Nickerson, *supra* note 77, at 175.

¹⁸⁵ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁸⁶ See Ben Yagoda, *Your Lying Mind: The Cognitive Biases Tricking Your Brain*, THE ATLANTIC MONTHLY, Sept. 2018, <https://www.theatlantic.com/magazine/archive/2018/09/cognitive-bias/565775/>

confirmation bias. Those who do seek information to “confirm” preexisting beliefs or to reaffirm a position as a franchisee are subject to information bias, such as the case of one franchisee who even after owning [his] own business, chose to “[seek] out more information regarding his agreement” after the fact.¹⁸⁷ His reasoning would be that he intended “[t]o understand how conflicts [he saw] in the Franchisee and Franchisor relationship might be addressed.”¹⁸⁸ Information bias affects other business affairs as well. For instance, research shows that providing information about a public or private good “can be viewed as a persuasive communication likely to change . . . attitudes and intentions” towards that good.¹⁸⁹

C. Buyer’s Remorse

Even if a franchisee were to seek out additional information, as was the case for the 35% of respondents who admitted to doing so after signing their franchise agreements,¹⁹⁰ would the franchisee be able to use effectively the mostly innocuous or redundant information? “Keep in mind almost 100% of franchise agreements favor the franchisor,” wrote one West Coast franchisee.¹⁹¹ Recall that nearly three-fourths of respondents did not hire a franchise attorney¹⁹² to review the often-complex language of a long legal document that includes clauses and statements referring to territories, royalties, arbitration, and disclaimers.¹⁹³ This presence of legal jargon, combined with the absence of representation, only deepens the pitfall into which some

(stating that confirmation bias—probably the most pervasive and damaging bias of them all—leads us to look for evidence that confirms what we already think).

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ See Icek Ajzen, Thomas C. Brown & Lori H. Rosenthal, *Information Bias in Contingent Valuation: Effects of Personal Relevance, Quality of Information, and Motivational Orientation*, 30.1 J. ENVTL. ECON. & MGMT. 43, 44 (1996).

¹⁹⁰ *Infra* Appendix, Survey on Franchise Agreements, Question 8.

¹⁹¹ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁹² *Infra* Appendix, Survey on Franchise Agreements, Question 1.

¹⁹³ Emerson, *supra* note 15, at 674.

franchisees fall.¹⁹⁴ In one case, a franchisee even felt that she “signed the agreement under duress.”¹⁹⁵

Rather than associate her complaint with a specific cognitive bias, clearly the respondent felt that she could not thoroughly assess the information in a comprehensive manner, even mentioning that she took it on “blind faith . . . that nothing would change, when in fact everything did change.”¹⁹⁶ This is a classic example of franchisees believing that the franchise agreement is non-negotiable, and therefore they choose to sign, believing that they have no say in the matter and must simply hope for the best.¹⁹⁷ This case demonstrates the franchisor’s disproportionately greater bargaining power.¹⁹⁸ This example also epitomizes a franchisee who was so cognitively biased (simply taking on faith rather than using reasoning and seeking effective counsel) to the point that she was unable to evaluate accurately what was needed to understand her franchise agreement, as she remained in thrall to “buyer’s remorse” or regrets of action.¹⁹⁹

Buyer’s remorse abounds. One respondent from Illinois states, “in 2007 when [he] first purchased, [he] was very happy with the agreement” but now the respondent feels that “the franchise owner has lost touch with his smaller franchises and has gotten greedy.”²⁰⁰ In another instance, a franchisee from Missouri declares, in a stark denouncement of both its franchisor’s motives and its actions: “[S]ince opening, [we] now question the business practices [of this particular franchise]” and “cannot recommend any of [the franchisor’s] concepts.”²⁰¹ From “undisclosed fees,”²⁰² to the “many unanticipated unintended consequences [that] occurred after the franchise

¹⁹⁴ Uri Benoliel & Xu Zheng, *Are Disclosures Readable? An Empirical Test*, 70 ALA. L. REV. (forthcoming 2018) (an empirical study of 523 franchise disclosures indicating that, on average, a prospective franchisee needs over 20 years of education in order to understand, on the first reading, a FDD).

¹⁹⁵ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

¹⁹⁶ *Id.*

¹⁹⁷ Emerson, *supra* note 38, at 720–21 (discussing how this misconception helps to reinforce many franchisees’ predisposition to not hire a franchise attorney).

¹⁹⁸ *Id.* at 717 n.38.

¹⁹⁹ See Emily Rosenzweig & Thomas Gilovich, *Buyer’s Remorse or Missed Opportunity? Differential Regrets for Material and Experiential Purchases*, 102 J. PERSONALITY & SOC. PSYCHOL. 215, 216 (2012).

²⁰⁰ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

²⁰¹ *Id.*

²⁰² *Id.*

purchase,”²⁰³ it is clear that buyer’s remorse affects many franchisees’ level of contentment with and commitment to their current business.

VI. POLICY RESPONSES

Evidence, including the surveys below, shows that numerous franchisees fall victim to many different cognitive biases. This raises the question: What can be done to mitigate the biases in franchising? How can governments act to reform the way in which franchisors and franchisees conduct business, yet still manage to leave both sides content? From a political standpoint, it is bound to be difficult. Franchisors increasingly have become involved in national political controversies, and franchisees in return have demanded some form of franchisor accountability.²⁰⁴ Without franchisor accountability, prospective franchisees may be discouraged from investing in such a highly-charged setting,²⁰⁵ and will also thus forego the opportunity to be part of an entrepreneurial experience. Inasmuch as franchising creates a relationship of mutual dependence between the two parties, any proposed regulation that is “one-sided”²⁰⁶ and ignores that interdependence ultimately fails to advance the needs of the individual businesses (franchisor or franchisee) or the franchise network overall.²⁰⁷

In the survey, we asked over 200 franchisees if they relied especially on a particular piece of information. Many stated that the FDD or UFOC was their primary piece of information.²⁰⁸ Listed later in the FDD/UFOC are the financials, and, also on point, where political contributions would be listed if the FTC Franchise Rule were to expand disclosure transparency for political spending on the

²⁰³ *Id.*

²⁰⁴ See Daniel J. Oates, *Franchisor Political Speech: The Disclosure Question*, 34 *FRANCHISE L.J.* 555, 562 (2015).

²⁰⁵ Robert W. Emerson & Jason R. Parnell, *Franchise Hostages: Fast Food, God, and Politics*, 29 *J. L. & POL.* 353, 384 (2014).

²⁰⁶ See Eric A. Zacks, *Contract Review: Cognitive Bias, Moral Hazard, and Situational Pressure*, 9 *OHIO ST. ENTREPRENEURIAL BUS. L.J.* 379, 413 (2015) (explaining that when an attorney has knowledge of her client’s superior bargaining power with respect to the desire to consummate the transaction, the drafting attorney can prepare a more one-sided contract than what might be possible or preferred if the parties were situated differently).

²⁰⁷ Byron E. Fox & Henry C. Su, *Franchise Regulation - Solutions in Search of Problems?*, 20 *OKLA. CITY U. L. REV.* 241, 302–3 (1995).

²⁰⁸ *Infra* Appendix, Survey on Franchise Agreements, Question 2 (comments on file with authors).

franchisor's part.²⁰⁹ This would undoubtedly also lead to the imposition of requirements on franchisees and their associations if they, too, desire to lobby the government for more franchisee-friendly laws. If these laws are to help protect potential and existing franchisees – forcing more extensive and meaningful disclosures and creating substantive franchise law reforms (e.g., required franchise contract provisions and prohibited franchisor practices) – then these parties must recognize their inextricable link to the other side. For instance, a franchisee's life ahead as possible agent of the franchisor may call for some upgraded franchise laws, but in this area any increased transparency requirements for the franchisor very likely must extend as well to the franchisees, their associations, and any other franchisee advocacy groups. That would be a fair exchange to get fairer, more meaningful disclosures.

Transparency and measures to confront, directly, the would-be franchisee's cognitive biases are necessary. Besides both mandated disclosures prior to a franchise agreement and legislative or regulatory intervention governing franchise contracts as a substantive matter, other reforms may be implemented. We can use the thinking of the franchisee (his or her cognitive biases) to push him or her in the right direction, through anchoring and nudging. American business and policymakers also can adopt a number of approaches from other nations, such as rescission, psychometric tests, and franchisor pilot units.

A. *State Franchisee Protection Laws*

While new franchise legislation has been relatively rare, hope springs eternal for franchisee activists. Reform proposals themselves are common, and, of course, their enactment is always possible.²¹⁰

²⁰⁹ Oates, *supra* note 204, at 562.

²¹⁰ There are many hurdles to clear before a bill gets to the governor's desk, and still the bill may, unexpectedly, be waylaid. In California, for example, the legislature pushed through an amendment to the state's Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20020–20021 (Deering 2007), with the legal standard for an acceptable franchise termination going from “good cause” to “substantial and material breach” of the franchise contract. Governor Edmund G. (Jerry) Brown, Jr. vetoed the bill on September 29, 2014. Finally, in late October 2015, Brown signed a bill providing a different standard for termination: limiting good cause to instances when the franchisee failed to “substantially comply” with the franchise agreement even after being given 60 days' notice and a period to cure his or her alleged breach. Emerson, *supra* note 61, at 143–44 & nn.156–61. Indicative of how difficult it is to pass even a focused, limited franchise bill is that

This is doubtless spurred on by an aversion toward, and need to surmount, the states' inability to create, let alone adhere to, a uniform model of interpreting franchise law and regulating franchise practices.²¹¹

As an example of recent state legislation, consider Wisconsin's law. During the 2015-2016 Wisconsin Legislative Session, the Senate passed Senate Bill 422, the Franchise Protection Act.²¹² Governor Scott Walker signed the Act on March 2, 2016, affirming that franchisors and franchisees were "separate entities."²¹³ Though this act was meant to halt "government overreach" over the lives of small-business owners in response to recent changes the National Labor Relations Board (NLRB) implemented and not so much to help the franchisee become a less cognitively-biased businessperson, it did show that franchisees were an area of concern for a state government.²¹⁴ Similarly, Ohio's 2013 business opportunity statute is an example of significant reform in how franchisees are treated.²¹⁵ According to the Ohio State Bar Association website, the Business Opportunity Plan Law prohibits "misrepresentations," requires "presale disclosures to the franchisee," and, unlike the FTC Rule, allows for the franchisee to "sue for damages, attorney's fees and other relief."²¹⁶ With some franchisees reporting inadequate explanations by franchisors or their agents,²¹⁷ and, more significantly, with several franchisees volunteering their belief that they had signed the franchise

party politics played no significant part in the drafting, slowing down, vetoing, or revamping of the reform; both at the legislative and executive level, the California state government is overwhelmingly Democratic. With all key players from one party, the drafting of the bill and then – after the veto – the re-drafting and ultimate signing still proved to be long and arduous.

²¹¹ See Emerson, *supra* note 15, at 644 & 659-663 (examining the federal and state legal environment surrounding franchises and how the current legal standards employed for the franchising relationship are inadequate).

²¹² S.B. 422, 2015 Leg., Reg. Sess. (Wis. 2016).

²¹³ FRANCHISE UPDATE MEDIA, MULTI-UNIT FRANCHISEE, *Wisconsin Passes Pro Franchise Bill* (2015),

http://www.franchising.com/articles/wisconsin_passes_pro_franchisee_bill.html.

²¹⁴ *Testimony on Senate Bill 422* (statement of Wis. State Senator Chris Kapenga), https://docs.legis.wisconsin.gov/misc/lc/hearing_testimony_and_materials/2015/sb422/sb0422_2016_01_14.pdf.

²¹⁵ OHIO REV. CODE § 1334.02 (2012).

²¹⁶ G. Jack Donson, Jr. & Margaret A. Lawson, *Franchise Laws Protect Investors*, OHIO ST. BAR ASSOC. (March 2, 2016).

²¹⁷ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

agreement “under duress,”²¹⁸ it is clear that these reforms, on a national scale, would benefit the franchisee and offer a more level-playing field.

Iowa and Michigan, like Wisconsin, pose two other examples of franchise relationship regulation.²¹⁹ Few other states directly regulate a relationship²²⁰ that often skews strongly in favor of the franchisor.²²¹ This reticence to regulate comes despite the fact that the franchise relationship is of enormous economic importance – one of mutual benefits and obligations between the two contractual parties. Accordingly, the Michigan Franchise Investment Law (MFIL)²²² has been described as “an act to regulate the offer, sale, and purchase of franchises; to prohibit fraudulent practices in relation thereto; to prohibit pyramid and chain promotions; to impose regulatory duties upon certain state departments and agencies; and to provide penalties.”²²³ Michigan thereby replaces the “old laissez faire regime” with a “pre-contract disclosure regime.”²²⁴

Under the MFIL definition,²²⁵ the franchisee is the “sole employer of the workers paid by the franchisee.”²²⁶ This has given more power and independence to the franchisee. For instance, unless “the franchisee and franchisor share in the determination of or codetermine the matters governing the essential terms and conditions of the

²¹⁸ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

²¹⁹ IOWA CODE § 523H (2007). The Iowa legislature enacted the strongest legislation ever to protect franchisees. Paul Steinberg & Gerald Lecastre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 259 (2004).

²²⁰ Steinberg & Lecastre, *supra* note 219, at 294–95; Emerson, *supra* note 15, at 671.

²²¹ Robert W. Emerson, *Franchise Savoir-Faire*, 90 TUL. L. REV. 589, 603–04 (2016); Robert W. Emerson, *Franchising Constructive Termination: Quirk, Quagmire or a French Solution?* 18 U. PA. J. BUS. L. 163, 202 (2015).

²²² MICH. COMP. LAWS ANN. §445.1501 (2017).

²²³ Michigan Legislature, *Michigan Compiled Laws Complete Through PA 197 of 2016*, Act 269 of 1974.

[http://www.legislature.mi.gov/\(S\(usj4o1sdeaandr4gqduccioq\)\)/mileg.aspx?page=getobject&objectname=mcl-act-269-of-1974](http://www.legislature.mi.gov/(S(usj4o1sdeaandr4gqduccioq))/mileg.aspx?page=getobject&objectname=mcl-act-269-of-1974).

²²⁴ Howard Yale Lederman, *Franchising and Franchise Law: An Introduction*, 92 MICH. B.J. 34, 37 (Jan. 2013).

²²⁵ MICH. COMP. LAWS ANN. §445.1504(b) (2017).

²²⁶ Paul R. Fransway, *Change to Michigan Law Provides Some Protection for Franchisors*, NAT’L L. REV. (Apr. 14, 2016).

employee's employment”²²⁷ during the franchise agreement negotiations, the franchisee and franchisor under the MFIL are excluded as being “joint employers.”²²⁸ Before the FTC and state legislatures began addressing legal issues regarding franchisors and franchisees, such as through the FTC Rule²²⁹ and any state equivalents, there were fewer legal standards for evaluating the franchising concepts. The franchisee's recourse against a franchisor – any avenues toward franchisor liability – were even more dominated by antitrust law and common law misrepresentation principles.²³⁰

B. *Can the Level of Disclosure Rise to the Level Mandated by the SEC?*

The first states that enacted franchise regulation laws modeled their legislation on federal securities law.²³¹ However, courts have been reluctant to assess important factors in securities law, such as *scienter*, when deciding securities disclosure requirement cases.²³² Instead, courts have focused on materiality without drawing a bright-line

²²⁷ BILL ANALYSIS, APPLICATION OF EMPLOYMENT RULES TO FRANCHISEES, HOUSE FISCAL AGENCY, <http://www.legislature.mi.gov/documents/2015-2016/billanalysis/house/archive/2015-HLA-5070-18F6DC69.htm> (last visited Dec. 20, 2018).

²²⁸ David L. Steinberg, Derek D. McLeod & Emily M. Mayer, *Uncertainty Abounds: The Joint Employer Doctrine and the Franchise Business Model*, MICH. B.J., 26, 27 (May 2017).

²²⁹ See 16 C.F.R. § 436 (2018); *Franchise Rule Compliance Guide*, supra note 32.

²³⁰ See ROBERT L. PURVIN, THE FRANCHISE FRAUD: HOW TO PROTECT YOURSELF BEFORE AND AFTER YOU INVEST 36-51 (1994) (discussing franchise fraud and the history of franchising as a business arrangement); Mario L. Herman, A BRIEF HISTORY OF FRANCHISING, <http://www.franchise-law.com/franchise-law-overview/a-brief-history-of-franchising.shtml> (last visited Dec. 20, 2018), at “III. Franchising's Collision with Antitrust Law – 1949 to 1980” (noting how the regulatory approach and key court cases until 1980 focused on antitrust claims).

²³¹ Peter C. Lagarias & Bruce J. Napell, *Lessons from Thucydides on Distinguishing Statutory from Common Law Fraud in Franchise Disclosure Actions*, 35 FRANCHISE L.J. 601, 613 (2016).

²³² See 17 C.F.R. § 240.10b-5 (2018). In order to make out a Rule 10b-5 claim, a plaintiff must show that there was (1) a misrepresentation or actionable omission of fact, (2) that is material, (3) made with *scienter*, (4) in connection with the purchase or sale of security, (5) that was justifiably relied upon by the plaintiff, and (6) that proximately caused the plaintiff's loss. *Id.*

rule.²³³ This is particularly important for franchising cases concerning allegedly fraudulent representations made under a sale of business agreement; there, state supreme courts have decided that federal and state franchise disclosure requirements do not apply and thus have limited the parties to reliance upon the common law of contracts.²³⁴ The FTC Franchise Rule is distinctly narrow in that it does not regulate the ongoing franchisor-franchisee relationship, nor does it require the franchisor to register or file the FDD with the FTC.²³⁵ Because the FTC Franchise Rule preempts state franchise law only if the state law “fail[s] to provide equal or greater protection than the [Rule],” it is up to state legislators and regulators whether to bolster protections beyond the “minimum federal standard.”²³⁶ This should be a cause of concern for prospective franchisees in states without additional disclosure protections, especially those who are trying to “make sure they [don’t] get screwed”²³⁷ or to avoid “fees charged that were not disclosed.”²³⁸

Contrary to the FTC Franchise Rule, the Securities Exchange Act was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing.²³⁹ As a public policy response to an aspiring franchisee’s cognitive biases, perhaps future federal legislation should mirror the Securities Exchange Act or other laws requiring extensive company registration, especially any heightened disclosure requirements for financial statements, in order to protect the investor-franchisee from a franchisor’s possible deception or the franchisee’s own mistakes in interpretation. Case law verifies that the “boundary between mere

²³³ Stefan J. Padfield, *Immaterial Lies, Condoning Deceit in the Name of Securities Regulation*, 61 CASE W. RES. L. REV. 143, 154 (2010) (discussing motions to dismiss allegedly frivolous suits brought by litigants claiming fraud).

²³⁴ See *Stewart v. Lucero*, 918 P.2d 1, 7 (N. M. 1996) (holding that federal franchise disclosure requirement did not apply; state franchise law did not require sellers to make disclosures to prospective purchasers; and evidence supported conclusion that sellers made no material misrepresentations for purposes of inducing buyers to enter sales agreement).

²³⁵ See Craig J. Knobbe, *Hidden Franchises*, 45 COLO. L. 25, 25 (Jan. 2016).

²³⁶ *Id.*

²³⁷ *Infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

²³⁸ *Id.*

²³⁹ See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 185 (1976) (holding that private action for damages will not lie under § 10(b) of the Securities Exchange Act of 1934 in the absence of an allegation of intent to deceive, manipulate, or defraud).

‘puffing’ and negligent misrepresentation may become blurry.”²⁴⁰ Franchisees have been unsuccessful in their actions against franchisors where representations concerning the future profitability of an owned business were at issue, because “an action for fraud may not be predicated upon the expression of an opinion or salesmen’s talk in promoting a sale, referred to as puffing.”²⁴¹ To clarify the line between franchise disclosure puffery and negligent misrepresentation, and to prevent cognitive biases (such as optimism bias) from overshadowing the decision-making process, federal and state legislatures or regulators should propose statutes or rules to combat the imbalance of both bargaining power and information that exists between franchisees and franchisors.²⁴²

C. *Anchoring and Nudging*

In *Franchising: Trap for the Trusting*, longtime, leading franchise lawyer Harold Brown described how potential franchisees react to a notably attractive advertisement and are convinced to sign a franchise agreement without receiving any legal or financial advice from a franchise attorney.²⁴³ This “anchoring” to unrelated information could cognitively bias a prospective franchisee so that he or she falls victim to a number of appeals made by the franchisor, such as dissatisfaction with existing employment and popularity of a well-known personality.²⁴⁴ Another example would be budding franchisees believing, as an unsophisticated consumer often would, that the

²⁴⁰ ELIZABETH CARPENTIER & NATALMA M. MCKNEW, 29 S.C. JUR. PRIVATE BUSINESS FRANCHISES § 86 Negligent Misrepresentation (updated Dec. 2017). See also Padfield, *supra* note 233, at 161 (discussing the contractual law doctrine of puffery and citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (holding that court must consider competing inferences in determining whether securities fraud complaint gave rise to a “strong inference” of *scienter* and that the plaintiff alleging fraud in § 10(b) action must plead facts rendering inference of *scienter* at least as likely as any plausible opposing inference)).

²⁴¹ *Van Tassel v. McDonald Corp.*, 407 N.W.2d 6, 8 (Mich. App. 1987); citing *Windham v. Morris*, 121 N.W.2d 479 (1963); see also *Hi-Way Motor Co. v. Intl. Harvester Co.*, 247 N.W.2d 813, 816 (Mich. 1976).

²⁴² See David J. Meretta, Eric H. Karp, *Regulation FD: Roadmap to Better Relations Between Franchisors and Franchisees*, 26 FRANCHISE L.J. 117, 118 (2007).

²⁴³ Michael I. Swygert, *Harold Brown, Franchising: Trap for the Trusting*, 4 VAL. U. L. REV. 224, 227 (1969), available at <https://scholar.valpo.edu/cgi/viewcontent.cgi?article=1795&context=vulr> (reviewing Brown’s book).

²⁴⁴ *Id.* at 227–8.

reputational brand of a franchise carries over to the consumer's perception of the franchise as a whole.²⁴⁵ Anchoring could very likely be considered enough of a predictable cognitive bias that it leads to decision-making which franchisors see as beneficial.²⁴⁶ Any attempt to foster such presumably better behavior may be called nudging.²⁴⁷

A nudge is when one party encourages another by subliminal or like conduct to promote a particular result. In *The Ethics of Nudging*, Cass Sunstein analyzed and explored how governments have used nudging to promote the general welfare.²⁴⁸ But, if nudging is used to undermine the general welfare, it can, arguably, give rise to conduct that would violate consumer protection laws. For example, in the United Kingdom, a "Nudge Unit" was established to use nudge theory to better government programs²⁴⁹ and change the behaviors of its people.²⁵⁰ What resulted were 100,000 additional registered organ donors a year and a doubling of the number of Army Reserve applicants after a large number of people initially expressed interest and then later dropped out.²⁵¹ This Nudge Unit used tactics such as reciprocity-based messaging on registration websites and appeals to personal experiences.²⁵²

In franchise relationships, the franchisor nudges the franchise candidate to focus on particular elements of the disclosure documents to increase the likelihood of the franchisee signing the agreement. From a legal point of view, while nudging's ethical grounding is problematic, mounting legal challenges to the nudging would normally be a steep hill to climb. A key component of nudging is the fact that

²⁴⁵ See Steinberg and Lecastre, *supra* note 219, at 155.

²⁴⁶ See Emerson, *supra* note 55, at 147. A "nudging" franchise has even been satirized. *The Simpsons: The Twisted World of Marge Simpson* (Fox television broadcast Jan. 19, 1997) (featuring the franchisor sales pitch – "The Exciting World of Frame Nudging!" at <https://www.youtube.com/watch?v=gYKSnYDyk0>).

²⁴⁷ *Id.*

²⁴⁸ Cass Sunstein, *The Ethics of Nudging*, 32 YALE J. ON REG. 413 (2015).

²⁴⁹ *Id.* at 415 ("Suppose, for example, that we believe that the goal of social ordering (including those forms for which government is responsible) is to promote social welfare. If so, we will favor welfare-promoting nudges."). Sunstein lists disclosure requirements for credit card companies and efforts to prompt people to make their own choices about what kind of retirement plan they could want, as examples. We thus see that social engineering and nudges are related, but not necessarily synonymous.

²⁵⁰ April Lea Pope, *To Behave or Not to Behave: How Behavioral Science Can Inform Policy and the Law*, 59-APR Advocate (Id.) 41 (Mar./Apr. 2016).

²⁵¹ *Id.*

²⁵² *Id.*

the final decision lies with the individual, that is, in our case, with a would-be franchisee.²⁵³ The encouraged (“nudged”) behavior is for a potential franchisee to continue anchoring onto extraneous information which would eventually give the franchisor’s business a boost in advertising and other franchising fields. In the franchise business model, a franchisor earns royalties while a franchisee hopes to succeed under the franchisor’s brand.²⁵⁴ Thus, it appears highly likely that prospective franchisees would take on even more business opportunities as long as there were sufficiently numerous and enticing incentives created by the franchisor, with the franchisee given the ultimate decision.²⁵⁵

Advocates for franchisee rights may question certain types of nudging conduct, such as franchisor encouragement or manipulation of potential franchisees into latching onto irrelevant data in hopes of having them sign the franchise agreement. Arguably, this conduct is patently exploitative and undermines the FTC’s purchaser-rights mission: prevention of anticompetitive business practices and the promotion of consumer protection.²⁵⁶ Still, unless combined with other, typically overt misconduct (manifest falsehoods, not merely diversions or hyperbole), it is difficult to see how the nudge connotes, let alone denotes, all the elements necessary to prove fraud in the inducement.²⁵⁷ So, to challenge nudging would likely require either imaginative theories of the common law or, more likely, new legislation or regulation directed at the specific behavior that nudging entails.

D. *Rules from an International Perspective*

²⁵³ See Emerson, *supra* note 55, at 147.

²⁵⁴ See Libava, *supra* note 41.

²⁵⁵ *Id.*

²⁵⁶ *About the FTC*, FED. TRADE COMM’N, <https://www.ftc.gov/about-ftc> (last visited Dec. 20, 2018).

²⁵⁷ Certainly, in a world where some government agencies may use nudges as regulatory tools, the public policy arguments against nudging, even by private businesses (e.g., franchisors), is perhaps undermined. In addition, “fraud” or “fraud in the inducement” would require proof of an intentional, material misrepresentation of fact knowingly or recklessly made in order to induce the recipient’s reliance, with the recipient reasonably relying on the misrepresentation and thereby suffering harm (e.g., by entering into a contract to which the recipient would not otherwise have agreed). *Fraud*, BLACK’S LAW DICTIONARY (10th ed. 2014); *Fraud in the Inducement*, BLACK’S LAW DICTIONARY (10th ed. 2014).

Franchising constitutes a possible entry mode into foreign markets.²⁵⁸ Many nations have their own, distinct rules for when someone is looking to buy a franchise. For example, Malaysia requires franchisors to provide disclosure documents only ten days before the franchisee can sign a franchise agreement.²⁵⁹ Additionally, a franchisor in Malaysia is required to disclose some information not required in the United States, such as the organizations in which it is a member, its management structure, and a list of its suppliers and all franchisees.²⁶⁰ In comparison, Mexico mandates a longer review period, with prospective franchisees having at least thirty business days to review a disclosure document before a franchise agreement can be signed.²⁶¹ Some view this as a challenge to franchising in Mexico because it creates a mandatory lag time in the franchising process.²⁶² However, when prospective franchisees must make an important decision, such as whether to invest in a franchise, perhaps the thirty-days-to-review rule in Mexico is a good place to start when it comes to reforming some of the franchising laws in the United States. With only fourteen days required to review a FDD in the United States,²⁶³ franchise applicants could be pinched for time when it comes to finding and consulting an attorney, or – in order to gain better insight – discussing their arrangement with family and friends. With more time on their hands before signing an agreement, prospective franchisees should be more likely to make smart decisions and less prone to post-signing regrets stemming from something they later learn—in effect, this mitigates the harm from cognitive biases.

1. *Rescission and Disclosure*

With regard to rescission and disclosure, *Raibex Canada Ltd. v. ASWR Franchising Corp.*, a rescission action in Canada, provides an

²⁵⁸ Veronica Baena, *Insights on International Franchising: Entry Mode Decision*, 14 *LATIN AM. BUS. REV.*, Jan.–Mar. 2013, at 2.

²⁵⁹ See Adhuna Kamarul Ariffin et al., *Franchising in Malaysia*, WILEY REIN, LLP (Apr. 7, 2015), <https://www.wileyrein.com/newsroom-newsletters-item-5275.html>.

²⁶⁰ *Id.*

²⁶¹ William Edwards, *Mexico*, *FRANCHISE TIMES* (Jan. 31, 2014), <http://www.franchisetimes.com/February-2014/Mexicos-proximity-is-just-one-selling-point/>.

²⁶² *Id.*

²⁶³ Federal Trade Commission, *Amended Franchise Rule 16 C.F.R. Part 436 FAQ's* (July 2, 2014), <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs#22>; see *supra* Section II.C.

interesting analysis.²⁶⁴ In this case, the franchisees brought a rescission claim under the “Fair Dealing” and “Damages for Misrepresentation, Failure to Disclose” sections of Ontario’s Arthur Wishart Act.²⁶⁵ The plaintiff franchisee’s claim was based on a number of alleged deficiencies, namely the failure to disclose a copy of the head lease and cost estimates for location development in the provided FDD.²⁶⁶ The Ontario Superior Court of Justice found that the franchisor was “not yet ready to deliver the statutorily required disclosure document” and that the franchisor “must wait” and “does not get excused from its statutory obligations.”²⁶⁷ Both parties to this case appealed.²⁶⁸

2. *Psychometric Tests*

In order to determine whether a candidate would be a suitable franchisee, a franchisor may look to the results of the prospective franchisee’s E-Test.²⁶⁹ The E-Test is a psychometric test that is a key predictor of potential franchisee success.²⁷⁰ After rating a series of statements that pertain to the applicant, including organizational and leadership competencies, the franchisor assesses the report and determines whether the aspiring franchisee is a good fit for the

²⁶⁴ Raibex Canada Ltd. v. ASWR Franchising Corp., 2016 CanLII 5575 (Can. Ont. S.C.); *see also* CORBY ANDERSON & CLAY TILLACK, ANNUAL FRANCHISE AND DISTRIBUTION LAW DEVELOPMENTS 290 (2017).

²⁶⁵ *See* ANDERSON & TILLACK, *supra* note 264, at 290. *See also* Arthur Wishart Act, S.O. 2000, c 3 (Can.) (“For the purpose of this section [§3], the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards and §7 Damages for Misrepresentation, Failure to Disclose”; further holding that when a franchisee suffers a loss from a misrepresentation contained in the disclosure document or in a statement of a material change or due to the franchisor’s failure to comply with §5, the franchisee has a right of action for damages against the franchisor and every person who signed the disclosure document or statement of material change).

²⁶⁶ *See* ANDERSON & TILLACK, *supra* note 264, at 290; *but see* 2212886 Ontario v. Obsidian Group, 2017 CanLII 1643 (Can. Ont. S.C.), *cited in* ANDERSON & TILLACK, *supra* note 264, at 291 (holding that the franchisor’s failure to provide a copy of a head lease did not constitute grounds for rescission; the franchisee’s motion for partial summary judgment was nonetheless granted because the defendant failed to properly disclose earnings projections outside of the FDD).

²⁶⁷ Raibex Canada Ltd. v. ASWR Franchising Corp., 2016 CanLII 5575 at 78 (Can. Ont. S.C.); *see also* ANDERSON & TILLACK, *supra* note 264.

²⁶⁸ ANDERSON & TILLACK, *supra* note 264.

²⁶⁹ FranchisingPlus, *Interviewing for Success* (Feb. 28, 2017), <http://www.franchisingplus.co.za/news-articles/243-interviewing-for-success>.

²⁷⁰ *Id.*

operation.²⁷¹ Grant Amos from *Franchise Chat* compares administering psychometric tests to understanding the manner in which a person's abilities, personal style, and ideal working environment can predict how that person will perform a given task, such as driving.²⁷²

Psychometric tests were the subject of a Quebec court case, *Quebec Inc. v. Franchises Cora*, in which Quebec Inc. applied to be a franchisee of Franchises Cora, Inc.²⁷³ The franchisor administered a psychometric test to evaluate Quebec Inc.'s principal operator-owner, but the franchisor failed to send the test score results to that person, despite her requests.²⁷⁴ Nevertheless, Quebec Inc. agreed to operate a restaurant location subject to the approval of the franchisor.²⁷⁵ The restaurant only lasted a year before being forced to close, and the franchisee, Quebec Inc., sued Franchises Cora to have the franchise agreement terminated.²⁷⁶ The franchisee's principal argued that the franchisee would not have entered into the agreement if she had known, *inter alia*, the results of her psychometric test, and therefore the agreement should be considered fraudulent and in error.²⁷⁷

The franchisee's suit was dismissed at the trial level. However, upon review, the Quebec Court of Appeals found that the respondent did not fulfill its duty to inform under the Quebec Civil Code.²⁷⁸ It held that a franchisor must provide a franchisee or prospective franchisee with all the information which could "significantly influence" its consent to contract.²⁷⁹ The Quebec Court of Appeals still dismissed the appeal because the trial judge had found the franchisee would have entered into the agreement with Franchises Cora (the franchisor) *even if* the results of the psychometric test had

²⁷¹ *Id.*

²⁷² Amos, *supra* note 125, at 16.

²⁷³ See Bruno Floriani, *Courts Rule on the Duty to Inform* (July 16, 2013), *citing* 9150-0595 *Quebec Inc. v. Franchises Cora Inc.*, 2013 CanLII 531 (Can. Que. C.A.),

<http://www.internationallawoffice.com/Newsletters/Franchising/Canada/Lapointe-Rosenstein-Marchand-Melanon-LLP/Courts-rule-on-the-duty-to-inform>.

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ *Id.*

²⁷⁸ See Civil Code of Québec, S.Q. 1991, c 64, art 1375 (Can.) ("The parties shall conduct themselves in good faith both at the time the obligation arises and at the time it is performed or extinguished.").

²⁷⁹ Floriani, *supra* note 273.

been presented to the franchisee.²⁸⁰ The case highlights the importance of the franchisor's duty to inform during the pre-contractual stage of the franchisee-franchisor negotiation process abroad, and the need to strengthen legislation at the national level to incorporate franchise-specific disclosure protections, as seen in some U.S. states and in other Canadian provinces.²⁸¹

3. *Increasing Pre-Agreement Franchisee Protections*

A good place to start for many jurisdictions with little to no franchisee protections would be to examine the United States' Franchise Rule requiring franchisors to disclose all required information clearly, legibly and in plain English for comprehensibility to both parties, but especially to prospective franchisees.²⁸² As noted in a 2015 federal case in Illinois, *Sanchez v. CleanNet USA*,²⁸³ many persons signing a franchise agreement do not read or speak the English language and may, to fully understand the agreement, need a translation to their native tongue.²⁸⁴ However, the court held that a franchisor's failure to translate the entire franchise agreement into Spanish (the franchisee's native tongue), or at least to take every material provision of the agreement and explain it in Spanish, did not render unenforceable a challenged provision in that agreement.²⁸⁵

In the *Sanchez* case, the court commented upon the differences between the facts present before it and in a 2012 federal district court case from California, *Cisneros v. Am. Gen. Fin. Servs.*, in which the terms of a franchise agreement were found to be procedurally unconscionable. In *Cisneros*, the plaintiff could not write, read, or speak English at the time of the transaction, and was unable to locate a translator.²⁸⁶ The *Cisneros* court also analyzed the fact that because the franchisee knew of no other way to make the sales representative

²⁸⁰ *Id.*

²⁸¹ See Andraya Frith, Eric Prefontaine & Gillian Scott, *La Belle Province: A Practical Business Guide to Key Legal Issues When Franchising in Quebec*, 36 FRAN. L.J. 303, 314–15 (Fall 2016).

²⁸² See The Franchise Rule, 16 C.F.R. § 436.6(b) (2007).

²⁸³ *Sanchez v. CleanNet USA*, 78 F. Supp. 3d 747 (N.D. Ill. 2015).

²⁸⁴ *Id.* at 754.

²⁸⁵ *Id.* (In extreme cases, the franchisee's limited language skills, with little education and little to no fluency in English, may be a basis for court intervention in the face of onerous, franchisor-imposed contract terms); see also Awuah v. Coverall N. Am., Inc., 554 F.3d 7, 9 (1st Cir. 2009).

²⁸⁶ *Id.* at 755, citing *Cisneros v. Am. Gen. Fin. Servs.*, 2012 WL 3025913 (N.D. Cal. 2012).

on her premises leave her home, the agreement that was signed was procedurally unconscionable.²⁸⁷

Because the *Sanchez* facts were noticeably different from *Cisneros*, the *Sanchez* court was unpersuaded, and it rejected the franchisee's argument.²⁸⁸ However, legal practitioners should still be on notice that, by voluntarily providing franchisees some additional pre-agreement protections, franchisors actually may increase not just the likelihood of the franchisee's success in business, but perhaps also heighten the franchisor's potential liability if the disclosure remains inadequate in terms of true informational value (the *Cisneros* approach). As a California state court of appeals remarked, to consider a franchise agreement procedurally or substantively unconscionable, courts must weigh factors such as (1) whether the franchise agreement is "difficult to read," (2) whether the franchisees "lacked sophistication"²⁸⁹ such that they did not understand the terms of the franchise agreement, and (3) especially, whether the franchisees lacked comparable, alternative business opportunities.²⁹⁰

²⁸⁷ *Cisneros*, 2012 WL 3025913 at 2.

²⁸⁸ *Sanchez*, 78 F. Supp. 3d at 755.

²⁸⁹ For a discussion on sophistication, see Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 519 (2010). In the franchising context, see Emerson, *supra* note 38, at 733-37, 738 n.172 (discussing both court decisions and state legislation to protect unsophisticated franchisees from the unfair practices of their franchisor); Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1511, 1555 (1990) (noting that state franchise legislation reflects the lawmakers' recognition "that franchisors possess most of the bargaining power and may abuse this power," and concluding that most franchisors "have a significant advantage in resources – money, information, political influence, business experience, and access to professional advice"); Robert W. Emerson, *Franchising and the Parol Evidence Rule*, 50 AM. BUS. L.J. 659, 698-725 (2013) (discussing various relational contract issues related to franchising, including the sophistication *vel non* of franchisees as well as the differences between franchising and other commercial contracts); 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, 140, 143 (2010) (referring to opportunistic franchisor behavior through territorial encroachment, enforcement of contract clauses, and franchise nonrenewal or termination).

²⁹⁰ See *Indep. Ass'n of Mailbox Ctr. Owners, Inc. v. Superior Court*, 133 Cal. App. 4th 396, 410 (2005). For discussion of an extreme set of circumstances, involving recent immigrants with limited business knowledge, meager English language skills, and little if any outside advice before the signing of their "franchise" agreements, and a series of court holdings labeling these extremely naïve, disadvantaged "franchisees" to be, in fact, simply the franchisor's employees, see

In fact, taking these unconscionability factors into consideration, a parallel may exist between prospective franchising and signature loan borrowing. The Supreme Court of New Mexico in 2014 held that the practices of subprime lenders were procedurally unconscionable under the state's Unfair Trade Practices Act (UTPA)²⁹¹ because there was substantial evidence that borrowers lacked knowledge, experience, ability, or capacity in credit transactions.²⁹² In addition, statistical evidence proved that prospective New Mexican borrowers had significantly less education than the general population and had "behavioral and cognitive biases" that worked to their detriment in making credit decisions.²⁹³ These biases are some of the very biases that this article analyzed, such as optimism bias, fundamental attribution error, framing, and anchoring; and each type of bias was exhibited in the borrowers' testimony.²⁹⁴ Considering that the New Mexico Supreme Court admitted expert testimony to address cognitive biases attributed to the borrowers to decide upon the signed agreement's fairness or unconscionability under the UPA, this example could serve jurisdictions well in evaluating the biases that franchise candidates fall into that are akin to those of loan borrowers.²⁹⁵ In both franchising and consumer-lending situations, the more experienced, educated, and capable party to the agreement has the opportunity to leverage its know-how over the less experienced "buyer," a power dynamic of asymmetry that should be taken into great consideration in developing a more equitable arrangement both domestically and internationally.²⁹⁶

Robert W. Emerson, *Assessing Awuah v. Coverall North America, Inc.: The Franchisee as a Dependent Contractor*, 19 STAN. J.L. BUS. & FIN. 203 (2014).

²⁹¹ Unfair Practices Act, N.M. STAT. ANN. §§ 57-12-1—57-12-26 (2018) (a New Mexico consumer protection statute).

²⁹² New Mexico *ex rel.* King v. B&B Investment Group, 329 P.3d 658, 665–66 (N.M. 2014).

²⁹³ *Id.*

²⁹⁴ *Id.*

²⁹⁵ *Id.* The State of New Mexico presented an expert, Christopher Peterson, a law professor and associate dean at the University of Utah who specializes in consumer finance, specifically in high-cost, small-principal loans. *Id.* at 665 n.3. Professor Peterson testified that the borrowers had "unrealistic expectations," were "susceptible to distort[ed] perception of costs," and were subject to "information overload," meaning that "when they are presented with a complex loan agreement, they cease trying to understand the terms at all..." *Id.* at 666.

²⁹⁶ Robert W. Emerson, *South African Franchisees as Consumers: The South African Example*, 37 FORDHAM INT'L L. J. 455 (2014). (That is, generally, the pro-franchisee approach of South Africa's Consumer Protection Act ("CPA"), Consumer Protection Act 68 of 2008 (S. Afr.), which expressly considers

4. *Stricter Franchising Regulations in China: The “Two-for-One” Example*

In the last twenty years, franchising has grown dramatically in China, both from a boom in domestic franchise networks and through the rapid entrance of foreign franchisors into the Chinese market.²⁹⁷ In 1997, China issued Interim Measures on Regulating Commercial Franchise Operations, and, ten years later, these regulations were “refined.”²⁹⁸ Three types of franchise contracts can be established in China: single unit franchise agreements, master franchise agreements, and regional development agreements.²⁹⁹ With an emphasis on countering franchisee foibles and difficulties, Chinese franchise law represents the type of proactive legislation intended to compensate for disparities in bargaining power and, at least partially, franchisees’ cognitive biases.³⁰⁰ On its fact, it goes farther in affording franchisees some substantive protections – required practices – than found in most Western nations that have enacted franchise laws.³⁰¹

No matter the type of franchise set up, companies in China must meet the “two-for-one” rule.³⁰² This rule stipulates that foreign franchisors must open and operate at least two units in China or

franchisees to be consumers, deserving of the CPA’s extensive protections. Almost every other nation makes distinctions between these two categories and accords more protection to ordinary consumers than to franchisees, who are considered to be businesspersons, instead).

²⁹⁷ See Richard Hoffmann, *How to Set Up a Franchise in China*, ECOVIS BEIJING (January 4, 2017), <https://perma.cc/JL4T-DM6R>.

²⁹⁸ *Id.*

²⁹⁹ *Id.*

³⁰⁰ See Lin Xiao (林晓), Shu Ping: Wai Zi Qi Yie Cong Shi Te Xu Jing Ying Guan Li Ban Fa (述评：外资企业从事特许经营管理办法) [Review: Foreign-funded Enterprises Engaged in Franchise Management Measures] (2004), <https://perma.cc/XG6T-QZYX>. The reasons for franchisee’s losses are: (1) the franchisor lacks the well-established business mode in Chinese market, and (2) small investors lack crucial information about the franchisor’s financial records and business experience. *Id.*

³⁰¹ See Ella S.K. Cheong, *China*, in INTERNATIONAL FRANCHISING CHN/1, CHN/4-10 (Dennis Campbell ed., 2nd ed. 2017) (describing numerous Chinese laws imposing duties on the franchisor to provide certain contractual rights of the franchisee and duties of the franchisor).

³⁰² William Edwards, *The Pros and Cons of Franchising in China*, CHINESE BUS. REV. (July 1, 2011), <https://perma.cc/SEA2-WL5S>.

anywhere else in the world for at least one year before forming a franchise in China.³⁰³ As a result, franchisors and franchisees (who may want to sub-franchise to a third party) learn to manage their businesses correctly before selling franchise rights to another party.³⁰⁴

The “two-for-one” rule is essentially a precaution for those who may want to undertake a franchise; an uncertain franchisee or sub-franchisee may very well want the original franchisor or franchisee to have added experience before taking on a significant business investment. The rule also provides an opportunity to ensure that the franchisor’s system functions in a new market.³⁰⁵

Although principally designed to protect franchisees,³⁰⁶ the “two-for-one” rule is to be interpreted within the context of norms and practices in franchising generally or within a particular franchised industry.³⁰⁷ There are three matters courts must consider when deciding whether a new franchisor’s outlets have established a successful business model for a market, and thus have satisfied the two-for-one requirements: the franchisor’s two (or more) outlets and the potential franchisee should (1) operate in the same or similar

³⁰³ Zhong Guo Shang Ye Te Xu Jing Ying Guan Li Tiao Li (中国商业特许经营管理条例) [Regulations for the Administration of Commercial Franchising Operations] ST. COUNCIL GAZETTE (May 23, 2007), <https://perma.cc/5T4A-7TGE> (promulgated by the St. Council, Jan. 31, 2007, effective May 1, 2007).

³⁰⁴ Edwards, *supra* note 302.

³⁰⁵ *Id.* Cultures and practices can vary from region to region. Despite any variation, there is no promise on the franchisor’s part to adapt the trademark or processes to accommodate that new region. Through legislation, China was able to require franchisors to make that adjustment at the franchisor’s own expense.

³⁰⁶ See Jiang Zengwei (姜增伟), Vice Minister, Ministry of Com., Jiang Zeng Wei Fu Bu Zhang Zai Di Jie Zhong Guo Te Xu (姜增伟副部长在第届中国特许加盟大会上的讲话) [Taking the Opportunity of Implementing the Regulations on Commercial Franchising Management to Promote Better and Faster Development of Commercial Franchising], Wei Qi Ji Tui Dong Shang Ye Te Xu Xu Jing Ying Geng Hao Geng Kuai De Fa Zhan (为契机推动商业特许经营更好更快地发展) [Speech at the 9th China Franchise Conference] (Mar. 25, 2007) (transcript available at <https://perma.cc/R3H6-V6DY>).

³⁰⁷ Tao Jun (陶钧), Te Xu Jing Ying Jiu Fen Zhong Guan Yu Liang Dian Yi Nian Gui Ding De Li Jie Yu Shi Yong (特许经营纠纷中关于“两店一年”规定的理解与适用) [Understanding and Application of the “Two Stores a Year” Rule in Franchise Disputes] (2013), <https://perma.cc/MD26-4E5M>.

business area³⁰⁸, (2) have the same business model³⁰⁹, and (3) have the same franchising resources.³¹⁰ Failure to meet the “two-for-one” requirement is subject to administrative penalties, including fines, public announcements, an order to cease, confiscation of illegal income, and confiscation of illegal profits.³¹¹ However, unless the violation of the “two-for-one” rules is egregious (typically, with other substantive violations³¹² or fraud³¹³), franchise agreements themselves

³⁰⁸ Shang Wubu Liu Tong Fa Zhan Si (中华人民共和国商务部) [The Ministry of Commerce, People’s Republic of China], *Shang Ye Te Xu Jing Ying Wen Ti Jie Da* (商业特许经营问题解答) [Business Franchise Questions and Answers] (2012),

<http://www.mofcom.gov.cn/article/zhengcejd/bp/201212/20121208472194.shtml>.

³⁰⁹ *Id.* (I.e., online shops should be treated differently in some situations).

³¹⁰ *Id.* Those resources, as defined by China’s Ministry of Commerce, are all resources that can bring benefits to the franchise parties and are protected by exclusive rights and measures, including a franchisor’s brands and trademarks.

³¹¹ *Id.* Article 24 of the 2007 Regulation states:

A franchisor, who is unqualified under Section 2 of Article 7, yet conducts franchising operations, shall be subject to an ordered correction from commerce regulatory authorities, confiscation of profits, a monetary fine between 100,000 and 500,000 yuan, and a public reprimand. Entities or individuals other than in registered enterprises, who conduct franchising operations, shall be subject to an order from regulatory authority to cease illegal operations, confiscation of profits, and a monetary fine between 100,000 and 500,000 yuan.

Regulations for the Administration of Commercial Franchising Operations *supra* note 303.

³¹² Xiaomin Li & Xianbao Song (李晓民, 宋健宝), *Shang Ye Te Xu Jing Ying He Tong Jiu Fen Te You Wen Ti Si Fa Shi Zheng Yan Jiu* (商业特许经营合同纠纷特有司法实证研究) [Judicial Empirical Study on the Unique Issues of Commercial Franchise Contract Disputes] (2016), <https://perma.cc/M8QM-DHNM>; *see* Luo Guangjian (罗广建), *Jie Du Shang Ye Ting Xu Jing Ying Guan Li Tiao Li* (解读商业特许经营管理条例) [Interpretation of the Commercial Franchise Management Regulations] (2007), <https://perma.cc/6JNC-SWDX>. The documents that should be filed according to the Regulation include, among others, the documents showing that the franchisor has met the “2 for 1” requirement. *See* Li & Song, *supra*. Once the department of commerce receives the filing materials from the franchisor, it has the duty to notify the franchisor, keep the documents in record, and publicize the record on the government’s website. Guangjian, *supra*.

³¹³ Li & Song, *supra* note 312. The franchisor’s failure to file the required documents and the failure to *disclose* it to the franchisee constitutes fraud, and the court can hold the agreement invalid based on that failure to disclose. Guangjian, *supra* note 312.

may not be rendered invalid.³¹⁴ In a 2016 case, the Supreme Court of China held that whether failure to meet the “two-for-one” requirement constituted fraud depended on the totality of the circumstances: the franchisor’s qualifications, the false or deceptive materials provided by the franchisor, the facts that the franchisor failed to disclose, and all of the misinformation’s and missing information’s influence on the agreement.³¹⁵ The Court’s focus on the overall purpose of the franchisor’s filing – keeping the government informed about the franchisor’s qualifications and facilitating governmental supervision³¹⁶ – means that a franchisee’s claims of fraud and desire for rescission or other relief are a secondary matter for any court review of an alleged “two-for-one” violation. For example, even if the franchisor failed to file anything related to “two-for-one,” as long as that failure was disclosed to the franchisee, then the franchisee has no grounds for requesting that a court invalidate the franchise agreement.³¹⁷

The United States welcomed China’s action and has been “monitoring developments in this area” since the regulations were issued.³¹⁸ However, those wishing to enter into China for franchising business would be “well advised to closely monitor the franchise regulatory developments.”³¹⁹ Zeidman and Xu further believe that businesspersons can reasonably expect a tighter regulatory environment in China, as many of the more liberal business franchising

³¹⁴ Li & Song, *supra* note 312 (citing Jian Gao v. Beijing Tian Hong Jian Hua Qi Ye Guan Li You Xian Gong Si (2016)). In *Jian Gao*, the Supreme Court of China held that whether the failure to meet “two for one” requirement constituted fraud depended on the totality of the circumstances: the franchisor’s qualification, the information that the franchisor failed to disclose, the false or deceptive information provided by the franchisor, and those information’s influence on the agreement; however, the Court reasoned that the purpose of filing was to keep the government informed of the qualification of the franchisor and facilitate the government’s supervision. *Jian Gao*. The franchisor cannot complete the filing without documents showing the satisfaction of “2 for 1.” Zengwei, *supra* note 306. However, the purpose of filing is to protect the benefits and interests of the franchisee and facilitate the supervision of the franchisor); Guangjian, *supra* note 312.

³¹⁵ Jian Gao v. Beijing Tian Hong Jian Hua Qi Ye Guan Li You Xian Gong Si (2016) (cited in Li & Song, *supra* note 312).

³¹⁶ See Zengwei, *supra* note 306.

³¹⁷ *Id.*

³¹⁸ INT’L TRADE ADMIN., U.S. DEP’T OF COM., 2016 TOP MARKETS REPORT FRANCHISING COUNTRY CASE STUDY: CHINA 2 (2016).

³¹⁹ Philip F. Zeidman & Tao Xu, *China Updates its Franchise Filing and Disclosure Rules: A Mixed Bag*, DLA PIPER (2012), <https://perma.cc/R5EZ-U343>].

rules have not become part of China's revised franchising rules.³²⁰ Changes encompass the mandate that franchisors include more details about support, guidance, and services within a disclosure document and that prospective franchisees keep a franchisor's information strictly confidential, no matter if there was an agreement entered into between a franchisor and the franchisee.³²¹ These changes exemplify the stricter regulatory nature of franchising in China in comparison to the United States.³²²

VII. CONCLUSION

Human cognition has often been shown to be biased and easily influenced by external stimuli.³²³ Whether it is making a tough business decision or recalling a fond memory from one's youth, there is evidence throughout history that the human conscience is strongly influenced by stimuli in a way that lacks rationality or even common sense.³²⁴ Over time, the human mind has evolved to incorporate "past environments."³²⁵ It is these environments that influence our structure and representation of information on one side of the mind, while the other side of the mind involves heuristics and decision-making algorithms.³²⁶ In this article's study and survey, questions about expert advice and opinion (Question 1), reliance on specific information (Question 2), past involvement and success (Questions 3, 4 and 5), non-expert advice and opinion (Question 6), a choice of alternatives (Question 7), and the seeking of additional information post-decision (Question 8), were all asked and tested to evaluate our initial hypothesis that cognitive biases influence potential franchisees. The results of the research study indicate that our hypothesis was partially true, with our predicted biases especially apparent when examining the free-responses of 200-plus franchisees who offered their input.

What our research has shown is that three out of every four franchisees consider their previous franchise successful, with a majority that did not rely on friends or a family member in deciding

³²⁰ *Id.*

³²¹ *Id.*

³²² *See id.*

³²³ Martie G. Haselton & Daniel Nettle, *The Paranoid Optimist: An Integrative Evolutionary Model of Cognitive Biases*, 10 PERSONALITY & SOC. PSYCHOL. REV. 47, 47 (2006).

³²⁴ *See id.*

³²⁵ Andreas Wilke & Rui Mata, *Cognitive Bias*, 1 ENCYCLOPEDIA HUM. BEHAV. 531, 533 (2012).

³²⁶ *Id.*

whether or not to take on another franchise (over 53% had alternatives to select from). These answers demonstrate an independent streak that runs through franchisees, highlighted by a few of their long-form answers from Question 9 of the survey. One franchisee noted that his contract with his franchisor is very “loosely written” and so he just “does his own thing with his franchise and territory.” Another had “little time to make a decision” and, after considering the alternative (becoming an employee of the firm offering the franchise), the franchisee decided that he did not want to be “beholden to the man” and made the decision to be a full-fledged franchisee. One franchisee, even after being an independent contractor for almost twenty years, still personally felt that he signed the agreement “under duress” because of “too many issues on (his) mind at the time” and chose not to hire an attorney. “Many franchisees discover only after the franchise contract is signed that franchisors ordinarily keep close control over the operations at each franchise.”³²⁷ Yet, as these examples show, before and after the franchise agreement is signed, franchisees are inclined to be like the Meineke franchisees in *Broussard v. Meineke Discount Muffler Shops* - independent, sophisticated, if sometimes small, businessmen who pursue their own business interests.³²⁸ To enter into a single-franchise agreement or to not enter into a single-franchise agreement, that is the question. Through the eyes of a prospective franchisee who has just days to arrive at an important business decision, the decision-making process can be a strenuous one. “When two options are presented to us, bias can make us more sensitive to the appearance of gain or loss.”³²⁹ The would-be franchisee may ask himself or herself, “What readily available information can help me make the best decision?” This is when the aspiring franchisee may hedge on one of the mental heuristics that lead to being influenced by cognitive biases.

In our study, one distinct bias—confirmation bias—was evident throughout the responses of the franchisees, hindering them from improving their circumstances by focusing on self-affirming

³²⁷ See Robert W. Emerson, *Franchise Terminations: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates*, 35 AM. BUS. L.J. 559, 610 (1998).

³²⁸ See *Broussard v. Meineke Discount Muffler Shops*, 155 F.3d 331, 348 (4th Cir. 1998) (holding that improper class certification so affected the result that reversal was required and various tort theories and a breach of fiduciary duty suit should not have been allowed).

³²⁹ See Ian Weinstein, *Don't Believe Everything You Think: Cognitive Bias in Legal Decision Making*, 8 CLINICAL L. REV. 783, 785 n. 7 (2002).

information and blinding them to other available ownership opportunities. This selective perception focusses on positive, yet useless, information and disregards negative information simply because that negative information may go against established beliefs. The initial information, from a franchisee, can lead franchisees further away from rational pursuit of the answers to pertinent questions. Specifically, they fail to ask the questions needed to decide how good or bad an investment it may be.³³⁰

Relying on outside information can have both positive and negative ramifications. Moreover, as the world economy becomes increasingly interdependent, each biased decision can have global implications.³³¹ Academic and business researchers will greatly benefit from uncovering improvement techniques in decision-making.³³² These findings will help bring to light instances where potential business owners, many of whom are inexperienced in business yet choose franchising as their first business venture, are entering into agreements while “very uninformed”³³³ and “through no one’s fault but [their] own.”³³⁴ Furthermore, these findings will help those prospective franchisees see the error in their reasoning and encourage them to participate in fair, arm’s length transactions with franchisors.

Cognitive biases exist in business franchising. The survey below makes that clear. Additional research that focuses on the psychology behind personal arrangements and legally-binding agreements will help to further expand and elaborate on this important area of business. For future research studies examining this unique area of franchising, we recommend analyzing the impact that buyer’s remorse has on the franchisee from the time that person signs an agreement to the time he or she relinquishes ownership of the business. Although the results of our study could be disputed due to low participant sample size, the responses that we received indicate that there may be a moderate number of past or current franchisees who feel that they have experienced buyer’s remorse at some point in their ownership experience.

³³⁰ See Emerson, *supra* note 290, at 223.

³³¹ See Katherine Milkman, Dolly Chugh & Max H. Bazerman, *How Can Decision Making Be Improved?*, 4 *PERSP. ON PSYCHOL. SCI.* 379, 379 (2009).

³³² *Id.* at 380.

³³³ See *infra* Appendix, Survey on Franchise Agreements, Question 9 (comments on file with authors).

³³⁴ *Id.*

Another area of study would be to examine the positive as well as negative implications of having alternative franchises from which to choose. Herbert Simon, a theorist who laid the foundation for the study of managerial decision making,³³⁵ stated that “complex circumstances, limited time, and inadequate mental computational power reduce decision makers to a state of bounded rationality.”³³⁶ Thus, we hope that this research study gives insight about the rationality and decision-making of business owners, and most importantly the prospective franchisee.

There is still more to learn about the interactions between franchise applicants and their franchisor as they proceed, usually under the influence of cognitive biases, toward what is supposed to be a sound, rational, reasonable, informed decision, but in fact often is not. With a greater overall business understanding of these biases and – on an individual level – more franchisee self-awareness,³³⁷ the highly consequential contracts and long-term business relationships between franchisors and franchisees can be more reasonably anticipated, precisely crafted, and successfully performed.

APPENDIX: A SURVEY ON FRANCHISE AGREEMENTS

The following is the “Survey on Franchise Agreements” that was distributed to the random population sample of franchisees across the United States, with results recorded from more than 200-plus respondents:

Dear _____,

Information and Consent to Survey

My name is _____. I am a business law professor at _____, where I conduct research on various issues in franchise law. With the help of my assistant, _____, I am studying how franchise agreements are formed. I have developed a short survey (10 questions), which should take about 10 minutes for you to complete.

Please understand that this project is solely for research purposes. No one except the researchers (student assistants and I) will have access to any of your responses. All responses will be kept confidential to the extent provided by law. Of course, your

³³⁵ Leigh Buchanan & Andrew O’Connell, *A Brief History of Decision Making*, HARV. BUS. REV. (Jan. 2006), <https://perma.cc/F9R8-NBU2>.

³³⁶ *Id.* See also Herbert Alexander Simon, 3 MODELS OF BOUNDED RATIONALITY: EMPIRICALLY GROUNDED ECONOMIC REASON 291, 291 (1982).

³³⁷ E.g., of one’s own foibles and predispositions.

participation is voluntary. You do not have to answer any question(s) that you do not wish to answer. There is no penalty for non-participation, and no anticipated risk or direct benefit associated with participation. All study data will be collected through an online survey-collection program called Qualtrics. Qualtrics is a secure site with SAS 70 certification for rigorous privacy standards. Any data that you provide through this program will be encrypted for security purposes using Secure Socket Layers (SSL). Only the study investigators will have access to the data on Qualtrics. To protect your privacy, all participants' IP addresses will be masked by Qualtrics and will be unavailable to, and unidentifiable by, investigators or others. Qualtrics' privacy policy can be obtained at <http://www.qualtrics.com/privacy-statement>. You will not receive any compensation for participating. You may withdraw your consent to participate without penalty at any time. Only the researchers will have access to data, and any link to your identification will be destroyed when the study is completed.

If you have any questions or comments about this research, please feel free to telephone me at _____, or my assistant at _____. I may also be reached at _____, and my assistant can be reached via email at _____. Questions or concerns about research participants' rights may be directed to the University of Florida IRB office at _____.

By pressing "Reply," and responding to this survey, you indicate that you have read the information above, and that you voluntarily agree to participate. Do you consent?

[Of those who responded, 98% indicated their consent and 2% responded "No"; those who responded "Yes" then proceeded to answer the remaining nine questions.]

1) Have you ever hired a franchise expert/attorney to assist you in your decision to operate a franchise?

#	Answer	Response	%
1	Yes	61	30%
2	No	142	70%
	Total	203	100%

2) Before entering into your franchise agreement, did you rely especially on a particular piece of information?

#	Answer	Response	%
1	Yes	96	48%
2	No	105	52%
	Total	201	100%

[Of the ones relying on particular information, respondents specified as follows:]

#	Answer	Response	%
1	FDD/UFOC	33	35%
2	Rest of Answers [e.g., "previous experience" or "had already worked in a franchise"]	60	65%
	Total	93	100%

3) Before acquiring your present franchise, did you own and/or operate one or more franchises?

#	Answer	Response	%
1	Yes	14	7%
2	No	189	93%
	Total	203	100%

4) If you answered "Yes" to the previous question - that, before acquiring your present franchise, you owned and/or operated one or more franchises - please answer these next two questions.

Was the previous franchise in the same field as your current franchise?

#	Answer	Response	%
1	Yes	8	29%
2	No	20	71%
	Total	28	100%

5) Would you consider that previous franchise successful?

#	Answer	Response	%
1	Yes	21	78%
2	No	6	22%
	Total	27	100%

6) Before entering into a single franchise agreement, did you have friends or family that offered an opposing view as to whether you should enter into the agreement?

#	Answer	Response	%
1	Yes	57	29%
2	No	141	71%
	Total	198	100%

7) Before entering into a single franchise agreement, did you have alternatives besides the franchise you currently operate?

If so, please briefly explain why you chose to operate this particular franchise.

#	Answer	Response	%
1	Yes	107	53%
2	No	94	47%
	Total	201	100%

8) After entering into your franchise agreement, did/do you find yourself seeking out more information about your agreement?

#	Answer	Response	%
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1	Yes	70	35%
2	No	132	65%
	Total	202	100%

9) Please use this space to further explain any of your answers to the previous questions, or to comment on anything else.

[The respondents' comments are reported, above, in this article.]

