Fortune Favors the Franchisor: Survey and Analysis of the Franchisee's Decision Whether To Hire Counsel

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I. INTRODUCTION

The franchisee-franchisor relationship has often been referred to as the little guy against the big guy.[1] Franchising may encompass the seemingly innocuous defining characteristics of distribution, know-how, brand identification, profits, risk, independence, control, and standards,[2] but there is much more to this relational contract.[3] If parties enter into a franchise or licensing agreement rather than some other business agreement,[4] this does not necessarily insulate the parties from liability. For example, simply because the parties have formed a franchisor-franchisee relationship does not mean the parties did not also form

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1. *See* Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 375 (Ct. App. 1996) (discussing the franchisee-franchisor relationship in terms of the "small-business person" against the "whip of a giant").

2. *Franchising* has been defined as

> a system for the selective distribution of goods and/or services under a brand name through outlets owned by independent businessmen, called "franchisees." Although the franchisor supplies the franchisee with know-how and brand identification on a continuing basis, the franchisee enjoys the right to profit and runs the risk of loss. The franchisor controls the distribution of his goods and/or services through a contract which regulates activities of franchisee, in order to achieve standardization.

ROBERT ROSENBERG WITH MADELON BEDELL, PROFITS FROM FRANCHISING 41 (1969). Over four decades later, the definition remains accurate, although arguably incomplete. One can say that franchising is a business relationship based on contract law in which a franchised business, the franchisor, grants a franchisee the right to use its trademarks and proprietary information in exchange for royalties. For an extensive treatment of how franchising is defined, see Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 908 n.l (1994); Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1506 n.l, 1508–09 (1990). For a discussion on the growth and maturation of franchising, see Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191, 194–201 (2010).

3. Franchise contracts are relational contracts in that they rarely spell out the details of the franchisor-franchisee transactions and are, in fact, "necessarily incomplete." Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 946, 953 (1990); *see also* ELIZABETH CRAWFORD SPENCER, THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY 84–87 (2010) (discussing how parties cannot reduce the franchise's important terms to well-defined obligations). Courts usually refuse to declare these contract's silent or indefinite terms invalid and instead "look beyond the document [to] identify a configuration of commitments patterned not in the words of the contract but in the underlying relation itself." Hadfield, *supra*, at 979–80; *see also* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 65–66 (1963) (discussing franchising as an example of relational contracting); Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 506 (referring to "highly relational patterns such as franchise agreements").

4. For example, forming a joint venture or a general or limited partnership, or incorporating a business.

an agent-principal (agency) relationship. In addition to the franchise relationship, the latter may be formed, intentionally or unintentionally, if the franchise contract "so 'regulates the activities of the franchisee' as to vest the franchisor with control within the definition of agency."[5] In that case, the agency relationship arises even if a party expressly denies its formation.[6]

Assuming that the parties did not form an agency relationship, then case law interpreting the contractual relationship largely governs the franchisor-franchisee relationship.[7] Under contract law, courts have been quite reluctant to find that franchise agreements establish fiduciary duties between the parties.[8] Only a small minority of courts has found that as a matter of law a fiduciary relationship exists between a franchisor and a franchisee.[9] Defining what duties a franchisor potentially owes to a franchisee is essential to understanding the dynamics of the franchisor-franchisee relationship, especially if the franchisee is "David" facing the "Goliath" franchisor. Still, the more perplexing question about those franchisor duties is: Does the franchisor, or even the franchisor's attorney,

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5. Murphy v. Holiday Inns, Inc., 219 S.E.2d 874, 877 (Va. 1975) (quoting ROSENBERG WITH BEDELL, *supra* note 2, at 41). Agency is defined as "the fiduciary relationship that arises when one person—a "principal"—manifests assent to another person—an "agent"—that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006). Numerous courts have discussed three defining characteristics of an agency relationship: (1) the agent acts on behalf of the principal; (2) the principal consents, expressly or implicitly, to the agent's actions; and (3) the agent is subject to the control, or right of control, of the principal. *See, e.g.*, A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285, 290–91 (Minn. 1981); Norris v. Cox, 2001-CA-00087-COA (¶ 13) (Miss. Ct. App. 2003).

6. *Murphy*, 219 S.E.2d at 877 (holding that the relationship of the parties does not depend upon what the parties themselves call it but rather in law what it actually is, and that in determining whether a contract establishes an agency relationship, the critical test is the nature and extent of the control agreed upon).

7. *See* David Gurnick & Steve Vieux, *Case History of the American Business Franchise*, 24 OKLA. CITY U. L. REV. 37, 50 (1999) ("A franchise is a relationship established by a contract. The contract is formed, interpreted, and governed by the rules of contract law.").

8. *See, e.g.*, Akkaya v. Prime Time Transp., Inc., 845 N.Y.S.2d 827, 828 (App. Div. 2007); Marcella & Co. v. Avon Prods., Inc., 724 N.Y.S.2d 192, 193 (App. Div. 2001); Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 596 (Tex. 1992); Red Roof Inns, Inc. v. Murat Holdings, L.L.C., 223 S.W.3d 676, 690 (Tex. App. 2007).

9. *See, e.g.*, Arnott v. Am. Oil Co., 609 F.2d 873, 883 (8th Cir. 1979); ABA Distribs., Inc. v. Adolph Coors Co., 542 F. Supp. 1272, 1286–87 (W.D. Mo. 1982); Mister Donut of Am., Inc. v. Harris, 723 P.2d 670, 673 (Ariz. 1986).

owe an unrepresented franchisee an additional duty of care during the negotiation process? This difficult proposition is a focus of this Article.

A. A Need To Protect Franchisees?

Consider the history of franchising. After World War II, the entrepreneurial ideal of owning one's own business helped to create a franchise boom.[10] By the 1970s, the need for legislation to regulate franchises became apparent.[11] As the value of and growth in heavily franchised sectors tapered off or even plummeted, franchisees often sought redress from franchisors.[12] A common theme emerged: "fly-by-night franchisors" caused "mom-and-pop franchisees" to lose their life savings by investing in worthless franchises.[13] In the 1970s, the typical franchisee was viewed as an inexperienced businessperson attempting to

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10. *See* William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 24 (2008) (citing THOMAS S. DICKE, FRANCHISING IN AMERICA: THE DEVELOPMENT OF A BUSINESS METHOD, 1840-1980, at 124, 126 (1992)). By purchasing a franchise, a franchisee was able to combine "the economic efficiency of big business with the personal satisfaction and social advantages of small business ownership." *Id.* (citing DICKE, *supra*, at 126).

11. *See id.* at 26; *see also* Rupert M. Barkoff, *Franchise Sales Regulation Reform: Taking the Noose Off the Golden Goose*, 3 ENTREPRENEURIAL BUS. L.J. 233, 238 (2009) (stating that an increase in franchisor fraud in the 1960s received publicity and led to a call for regulation as the 1970s commenced); Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, *in* BUILDING FRANCHISE RELATIONSHIPS: A GUIDE TO ANTICIPATING PROBLEMS, RESOLVING CONFLICTS, AND REPRESENTING CLIENTS 140, 141 (Ann Hurwitz & Rochelle Buchsbaum Spandorf eds., 1996) (concluding that, "[t]he real surge in legislation came in the 1970s as a reaction to early abuses by some unscrupulous franchisors").

12. Several factors led to the decline in the franchise business, including the declining stock market, the fact that many franchisors "recorded their entire initial franchise fee as income the day the franchise agreement was signed," and the emergence of the celebrity franchisor. *See* Killion, *supra* note 10, at 26. These lawsuits were commonly filed as class actions against the franchisor. *Id.*

13. *Id.*; 1 W. MICHAEL GARNER, FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 1:10 (2013) (noting that the first state law requiring franchisor disclosure to prospective franchisees, California's 1970 statute," was adopted in the wake of widespread newspaper stories . . . concerning individuals who had invested their life savings in franchises only to discover that the franchises were not what had been promised."). Former New York Attorney General Louis Lefkowitz characterized the franchising business as "fly-by-night operations often with nothing more substantial than fancy multi-color brochures"; "citizens of this state are surrendering their life savings to buy worthless franchises"; and "criminal elements and high pressure salesmen have infiltrated into the franchise business." Killion, *supra* note 10, at 26 (quoting Memorandum from David Clurman to Attorney General Lefkowitz (Jan. 7, 1970) (reproduced in *The Impact of Franchising on Small Business: Hearings Before the Subcomm. on Urban and Rural Economic Development of the S. Comm. on Small Business*, 91st Cong. 526–38 (1970))).

achieve the American dream.[14] Some of these business babes in the woods invested their life savings with a crooked franchisor, "only to see everything [their dream and their money] evaporate."[15]

As a result of the decline in franchising markets, as well as the mounting reputation of franchisors as dishonest businesspersons looking to swindle investors, state legislation and federal rulemaking attempted to police franchisor representations and, in some cases, the franchisor-franchisee contract.[16] However, some commentators contend that today's franchisee is not the unsophisticated investor of the 1970s.[17] For one thing, he has access to much more information about franchised enterprises than franchisees did forty years ago.[18] Certainly, some empirical evidence supports this contention that franchisees have increasingly acquired some degree of business and legal sophistication.[19]

Thus, many argue that there is no longer a need for allegedly paternalistic legislation to protect the unwary franchisee,[20] that "[f]ranchise legislation and regulations have achieved their goal,"[21] and that, in light of the sophistication of today's franchisee[22] and the amount of information

14. The franchisee was further characterized as a person with no business experience at all "but perhaps a plumber or electrician who has been told he needs no experience to profit handsomely and that the enfranchiser will teach him all he needs to know." Killion, *supra* note 10, at 27 (quoting James MacGregor, *Bursting Bubble: Many Franchise Firms Fall on Hard Times After a 15-Year Boom*, WALL ST. J., May 29, 1970, at 1).

15. *Id.* (quoting MacGregor, *supra* note 14, at 1).

16. *See id.* at 27–28 (discussing the federal and state regulations of the franchise industry).

17. *Id.* at 28.

18. *Id.* at 29. Killion insists that it is a "myth" that franchisees are vulnerable, and posits that this fiction is premised on two outdated assumptions: (1) "that franchisees are generally naïve and unsophisticated in comparison to franchisors and, therefore, need special protection from opportunistic conduct by comparably large franchisors"; and (2) "that there is a 'gross bargaining disparity' between the franchisor and franchisee resulting in one-sided franchise agreements that allow franchisors to control unfairly the fortunes of their franchisees." *Id.* at 23.

19. *See infra* Appendix, Copy of Survey Instrument, Question 12 [hereinafter Appendix, Franchise Lawyer Survey]. *But see infra* Parts II.A and II.B for a discussion of how franchisees still often know little and do not get lawyers who could assist them.

20. *See* Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 106–07 (2004) (discussing the opinion of many franchisors and their advocates that previous legislation has successfully addressed the concern of, and concern for, franchisees).

21. Killion, *supra* note 10, at 29.

22. *See* Am. Bar Ass'n Forum on Franchising, *Thirty Years of Franchising*, 27 FRANCHISE L.J. 85, 90 (2007) (discussing, in part, the greater sophistication of

provided to the franchisee before signing any agreement, contemporary franchisees are no longer vulnerable investors.[23]

While earlier franchisors may have had the upper hand during negotiations, today's sophisticated franchisees may dominate, or so the theory holds: The franchisee can go "franchise shopping" to see where the best opportunities for the best prices lie.[24] Along these lines, commentators dispute the presumption that franchisors present franchise agreements to franchisees on a take-it-or-leave-it basis.[25] These commentators go on to contend that the parties' willingness to enter a franchise agreement—sometimes spanning up to thirty years—shows that the franchisee, not just the franchisor, must have had a say in the agreement's terms.[26]

If today's franchisee is indeed savvier, better informed, and armed with more bargaining power than the franchisees a generation ago,[27] one other necessary premise still remains for arguing that franchisors and prospective franchisees really do meet as relative equals in the bargaining process. That is, in the highly complex world of franchised businesses, both sides having effective counsel. Business acumen and experience are necessary, but alone are insufficient to put franchisees on an even footing with franchisors represented by counsel. Surely, franchisors understand that, despite their own often-formidable business experience and talent, excellent legal counsel is also crucial to their success. Franchisors universally retain lawyers for the most fundamental

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franchisors and franchisees in the "evaluation of their legal rights" in response to past litigation). There are many examples of cases in which courts noted the franchisee was sophisticated. *See, e.g.*, Dunkin' Donuts Franchised Rests. LLC v. Manassas Donut Inc., No. 1:07cv446 (JCC), 2008 WL 110474, at *3 (E.D. Va. Jan. 8, 2008) (holding that waivers franchisee signed are enforceable because franchisee was an "experienced franchisee" who made a conscious decision not to seek counsel before signing the franchise agreement); PostNet Int'l Franchise Corp. v. Amercis Int'l, Inc., No. 06-CV-00125-PSF-BNB, 2006 WL 1775599, at *3 (D. Colo. June 26, 2006) (holding that a waiver was enforceable against a franchisee who consciously did not seek counsel before signing the franchise agreement); Papa John's Int'l, Inc. v. Dynamic Pizza, Inc., 317 F. Supp. 2d 740, 748 (W.D. Ky. 2004) (holding, in part, that the franchisee's sophistication negated a claim of fraud by the franchisor in the negotiation of a franchise agreement).

23. *See* Killion, *supra* note 10, at 29 (noting that the disclosures to prospective franchisees furnish quite helpful tools for evaluating an investment, including obtaining even more data by examining the franchisor's litigation history and even questioning existing franchisees).

24. *See id.*

25. *Id*. at 30 (arguing that "the typical franchise agreement is anything but unconscionable").

26. *Id.*

27. *See id.* at 31 (opining that courts should stop "bail[ing] franchisees out of bad business decisions under an assumption that franchisees are collectively naïve or franchisors are collectively overpowering").

tasks in the franchise relationship—drafting and enforcing the franchise agreement.[28] If franchisors know that they need counseling and act on that presumption, then they cannot deny that franchisees, too, must need lawyers in similar ways, such as to evaluate and negotiate work related to prospective franchise contracts. In fact, most franchisors seem to readily acknowledge that franchisees need lawyers.[29]

B. How the Article Proceeds

Part II of this Article explores the franchisee's decision about whether to hire an attorney for representation throughout the franchise bargaining process. First, this Article analyzes why some franchisees never consult an attorney before proceeding to the bargaining process. It also considers the consequences of such an omission both at law and on the parties' franchise agreement. A survey conducted for this Article demonstrates that many franchisees who need representation simply go without it or otherwise remain without *effective* counsel. In addition, this Article considers the psychological reasons behind why franchisees fail to consult a lawyer before proceeding to the bargaining process.[30] The role of, and need for, the franchisee to utilize an attorney during the bargaining process is therefore explored.[31]

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28. As one would expect, the terms of these contracts tend to favor the franchisor. *See generally* Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641 (examining the current inadequate legal standards employed for the franchising relationship and proposing a new approach to franchise contract interpretation).

29. Indeed, franchisors often tell franchisees that they should hire lawyers. *See* Emerson, *Franchise Contract Clauses*, *supra* note 2, at 959 (noting that many franchise agreements contain clauses that purport the franchisee was advised to obtain legal counsel). Although the Federal Trade Commission (FTC) mandates certain disclosures to prospective franchisees, it has no such required statement from the franchisor about the would-be franchisee's need to hire counsel. *See infra* Part V (discussing, *inter alia*, the FTC disclosure regime).

30. Many franchisees believe they do not need to consult an attorney before they decide to invest. Others believe they are capable of self-representation. *See infra* Part II.C. The irony of the prospective franchisee's decision making is that the least confident persons may be the most capable, while the most confident persons do not know much and are least likely to know they are uninformed. *See infra* Part II.C.

31. *See infra* Part II.D. Indeed, in Part VI.B, *infra*, this Author proposes an explicit warning to potential franchisees that they need representation and, for their own sake, to obtain the assistance of counsel before, as is likely to be the case, proceeding beyond their *pro se* capabilities. Besides bluntly telling prospective franchisees to hire a franchise lawyer, the franchisees-to-be are admonished that, no matter how smart and

Part III examines whether franchisees are truly unsophisticated parties who require additional protections. Some courts have held that when the franchisee has no business experience and reasonably relies on the franchisor's representations, the franchise agreement may be held as void if the franchisor intended to take advantage of the franchisee's inexperience. Conversely, some courts have held that franchisees are sophisticated investors who knowingly enter into a franchise agreement and, therefore, should be bound by the agreement.

Part IV studies the franchisor-franchisee relationship as it is governed under contract law, including the covenant of good faith and fair dealing as well as the concept of unconscionability. Whether the franchisor obtains a windfall when negotiating with unrepresented franchisees is examined. Additionally, this Part considers whether (1) franchise agreements are adhesion contracts, which solely benefit the franchisor; and (2) an attorney owes a duty to the unrepresented franchisee to ensure that procedural rights are not unknowingly contracted away through unconscionable contracts or provisions.

Part V focuses on how the Federal Trade Commission (FTC) and state disclosure laws have handled the issues raised in this Article. In Part VI, the Author proposes two disclosure-based solutions to the problems associated with unrepresented franchisees bargaining for franchises. In support of these solutions, the Author evaluates the strong policy arguments behind enacting better disclosure laws.

II. FRANCHISEES AND THE DECISION WHETHER TO HIRE AN ATTORNEY

The franchisee-franchisor relationship has often been referred to as a "David and Goliath" relationship in light of the unequal bargaining power between the parties.[32] Courts have generally been concerned about the capability of the franchisor and the franchisor's attorney to overpower the franchisee's ability to bargain effectively.[33] For purposes of this Article, that concern is only relevant when the franchisee is—as seems to be increasingly common—*not* represented by counsel. There

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experienced they may otherwise be, they are probably quite unskilled and unaware concerning a particular franchise, the legal documents related to that franchise, and the law of franchising.

32. *See* Newark Motor Inn Corp. v. Holiday Inns, Inc., 472 F. Supp. 1143, 1152 (D.N.J. 1979).

33. *See* Rochelle B. Spandorf & Beata Krakus, *Observations on Negotiating Franchise Agreements in Today's Legal Environment*, LJN'S FRANCHISING BUS. & L. ALERT, Jan. 2007, at 1, 1 (noting that franchisors often "resist prospective franchisee efforts to negotiate better terms for themselves").

are numerous rationales why a franchisee may not seek counsel when negotiating the franchise agreement, including such factors as time, cost, complexity, and the franchisee simply not feeling it is necessary. However, the franchisee's choice not to retain an attorney when bargaining may have implications on the process. Often, the franchisee may not obtain the most beneficial deal possible without representation, and in extreme cases, the agreement will be held void if the court finds that the franchisor or his attorney took advantage of the unrepresented franchisee.[34] Because neither situation is cost effective—at least in the broader social context[35] —it is important to consider various reasons why the franchisee may decide not to hire an attorney.[36]

A. Franchisees Often Fail To Hire an Attorney

Franchisors often resist negotiating with potential franchisees over the terms of the franchise.[37] If a would-be franchisee's attempt to negotiate is, or at least is thought to be, futile, then a logical consequence is the potential franchisee's reluctance to hire someone to dispense "pointless advice."[38] Many sources show that it is common for a franchisee to

34. Perhaps it could be held to be so one-sided, with the franchisor having such an advantage, that it has little of the classic arm's length transaction expected to be present in a business deal. *See infra* note 148 and accompanying text, discussing Schott Motorcycle Supply, Inc. v. Am. Honda Motor Co., 976 F.2d 58, 65 (1st Cir. 1992), for the proposition that a franchise arrangement may not, given the facts, constitute an arm's length transaction.

35. Commentators have pointed out that when a franchisor gets too much of the franchise "deal" at the expense of franchisees, it can be bad for consumers and for the franchising method of conducting business. *See* Uri Benoliel, *Criticizing the Economic Analysis of Franchise Encroachment Law*, 75 ALB. L. REV. 205, 224–25 (2012) (discussing franchisor encroachment causing franchisee failure and also increased social costs such as higher consumer prices and externalized costs passed on to other franchisors).

36. *See infra* Parts II.A and II.C.

37. Spandorf & Krakus, *supra* note 33, at 1 ("While no empirical data exist on the percentage of franchisors that will negotiate the terms of their franchise contract with prospective franchisees, it is fair to conclude that they remain a minority."). Spandorf and Krakus note that "[s]ome franchisors have no incentive to negotiate" because they have a plentiful number of prospects or a desire to avoid administrative burdens or fallout that may arise from negotiating the terms of each franchise contract separately. *Id.*

38. Andrew C. Selden & Rupert M. Barkoff, *Counseling Franchisees*, *in* FUNDAMENTALS OF FRANCHISING 289, 291 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008) (noting that a lawyer may be seen as someone asked to do simply one

enter into a franchise agreement without representation.[39] An e-mail and telephone survey conducted from September to November 2011 and again from March to May 2014 of franchise lawyers who represent more than half of all franchised businesses in the United States revealed that many franchisees do not commonly use counsel at negotiations.[40] In fact, when franchisor attorneys were surveyed, it became apparent that at closings the attorneys had attended within the past two years, counsel represented only 26.07% of the franchisees.[41] Interestingly, the franchisees most likely to obtain legal representation were those with mid-level investments,[42] those negotiating with franchisors that had been in business for ten or more years before becoming franchisors,[43] and those

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thing: "bless" a franchise agreement that the franchisor already has proclaimed "nonnegotiable").

39. *Id.*; *see also* Byron E. Fox & Henry C. Su, *Franchise Regulation—Solutions in Search of Problems?*, 20 OKLA. CITY U. L. REV. 241, 283 n.155 (1995) (discussing the reluctance of franchisees to seek counsel while negotiating a franchise agreement and the rampant belief among franchisees that obtaining an attorney is too cumbersome for the process of negotiations); Nathan E. Ross, *Federalism Versus the Greater Good . . . Should Powerful Franchisors Be Allowed To Contract for the Home Court Advantage Through Forum Selection Clauses?*, 2000 J. DISP. RESOL. 199, 211–12 (citing Zimmerman, *infra*, at 760–61) (arguing that "[t]he franchisor is usually a much larger company, represented by attorneys at the time the agreement is signed; whereas, the franchisee is often a single person unrepresented by legal counsel"); James Zimmerman, *Restrictions on Forum-Selection Clauses in Franchise Agreements and the Federal Arbitration Act: Is State Law Preempted?*, 51 VAND. L. REV. 759, 761 (1998) (discussing the inequalities of the franchise negotiation process when it concerns forum selection clauses).

40. *Infra* Appendix, Franchise Lawyer Survey, Question 2. The names, addresses, and other vital information for conducting the survey were obtained from FRANdata, a database hosted by Franchise Information Services, Inc., an Arlington, Virginia, based company specializing in gathering and reporting data related to franchising. This Author, with the assistance of student assistants, used the FRANdata information to determine e-mail addresses and contact the surveyed lawyers both by e-mail and by telephone. The attorneys contacted averaged fifteen to sixteen years of practice experience (fifteen years median; sixteen years mean). *Infra* Appendix, Franchise Lawyer Survey, Question 10.

41. *Infra* Appendix, Franchise Lawyer Survey, Question 2.

42. Franchisees with an average investment between $150,000 and $350,000 were represented by counsel in 30.5% of closings, while franchisees with over $1.2 million in investments were represented in 26.6% of closings and franchisees with less than $70,000 in investments were represented by counsel in only 16.8% of closings. This Author generated the data from the answers to Franchise Lawyer Survey and the data furnished by FRANdata. *See supra* note 40; *infra* Appendix, Franchise Lawyer Survey, Question 2.

43. This Author generated the data from answers to the Franchise Lawyer Survey and the data furnished by FRANdata. Based on this information, this Author calculated that (1) franchisees entering into a franchise arrangement with franchisors that had been in business for ten or more years before becoming a franchisor were represented by counsel in 26.07% of closings; (2) franchisees dealing with franchisors that had no prior

dealing with franchisors having fewer than 500 units in the franchise system.[44] In response to this Author's survey, the franchisor attorneys offered the following comments:

- "It is unusual for any of [our] franchisees to actually have attorneys and/or accountants represent them in the purchase process."[45]
- "The franchisees are very rarely represented by counsel."[46]
- "[For] existing franchised businesses . . . franchisees are underrepresented and their counsel often ignore the franchise and focus on the assets. I am often amazed at how resolution of the franchise transaction is an afterthought."[47]

Even if the franchisee seeks legal counsel, it may not actually help much. Surveyed franchisor attorneys also stated:

- "[On the rare occasion when franchisees hire lawyers,] they are typically represented by a generalist attorney."[48]
- "Franchisees who have consulted with counsel generally retain a general practitioner [usually their family attorney] who is not familiar with franchising."[49]
- "Franchisees go to the family lawyer or [their] friend[s] for counsel. Franchising law is a specialty, and general practitioners usually aren't familiar with the laws and [regulations]."[50]

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experience in the business before franchising that business were represented by counsel in only 6.1% of closings; and (3) franchisees contracting with franchisors that had between one and five years of business before starting to franchise were represented by counsel in 19.6% of closings. *See supra* note 40 (discussing FRANdata); *infra* Appendix, Franchise Lawyer Survey, Question 2.

44. Franchisees dealing with franchisors having fewer than 500 units in the franchise system were represented by counsel in 42.7% of closings, while franchisees entering into a contract with franchisors that have 500 or more units in the franchise system were represented by counsel in only 8.0% of closings. *See supra* note 40; *infra* Appendix, Franchise Lawyer Survey, Question 2.

45. Comments from Franchise Attorneys, Franchise Lawyer Survey (on file with author).

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

B. Evidence from a Survey of Franchising Counsel: The Uncounseled Franchisee

This Author's survey of franchising lawyers supports what observers of franchising have long concluded: Regardless of the unequal bargaining power, lack of knowledge about the franchisor's business, or lack of knowledge of the process for obtaining a franchise, many franchisees still decide to "go it alone."[51] In other words, despite the many reasons why a franchisee should obtain counsel, such as boiling down contract legalese or simply advocating for a better deal, franchisees are still reluctant to obtain an attorney, particularly one experienced in franchise law. Franchise lawyers who responded to the survey reported that out of the 1607 franchise closings they had attended,[52] only 419 of the closings involved franchisees who were represented by counsel.[53] Moreover, while the business sophistication of franchisees has generally increased over the past ten years,[54] 51.1% of surveyed franchisor attorneys believed that the percentage of franchisees represented by lawyers in franchise closings remained the same, that is, neither increased nor decreased over the past decade.[55] A franchisee's decision to enter negotiations without counsel is largely based on the "prevailing public perception [] that franchise agreements are non-negotiable"[56] and the fact that franchisees

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51. *Id.* However, for the Author's survey of franchisor lawyers, some franchisors commented that franchisees have "increased in sophistication," and come to the negotiations with "more money and a higher level of business experience." *Id.*

52. *Infra* Appendix, Franchise Lawyer Survey, Question 1.

53. *Infra* Appendix, Franchise Lawyer Survey, Question 2.

54. *See Infra* Appendix, Franchise Lawyer Survey, Question 13 (noting that over half of the franchise lawyers interviewed opined that franchisee business sophistication has risen, and nearly one-quarter concluded it has remained about the same, with no one claiming it had fallen).

55. *Infra* Appendix, Franchise Lawyer Survey, Question 11. Such "closings" were defined, for purposes of the survey, as "process[es] in which the franchisor and franchisee, perhaps at a meeting (but not necessarily in such a face-to-face conference), sign the franchise agreement and perhaps related documents." *Infra* Appendix, Franchise Lawyer Survey, Question 1. Note that this majority of the responding franchisor lawyers, as a class of respondents, in turn dealt with a large preponderance of the overall franchised business units in American franchising. Note further that the remainder of the respondents, 24.1%, believed that the percentage of franchisees represented at closings had increased in the past decade, and none thought the percentage had diminished. *Infra* Appendix, Franchise Lawyer Survey, Question 11.

56. Spandorf & Krakus, *supra* note 33, at 1. Despite this public perception, "some degree of negotiation is not uncommon particularly in franchise systems requiring larger initial investments that tend to attract more sophisticated buyers." *Id.* at 2. Additionally, the Federal Trade Commission "believes that franchise sellers and prospective franchisees should be free to negotiate the terms of the franchise agreement." *Id.* (quoting FTC, DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING: STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED

"believe, or are told, that a lawyer will be costly and will only slow down the process or kill the deal."[57]

When franchisees do have legal representation during the negotiation and closing process, some franchisors comment that it is unhelpful.[58] Although franchisee attorneys have become generally more sophisticated about franchise law,[59] franchisor lawyers contested the competence of franchisee lawyers, who "were not franchise attorneys but general practice attorneys, who tended to ask for changes that franchisors would never agree to (e.g., deletion of covenants against competition, change in royalty fees)."[60] The ineffectiveness of legal representation may be further aggravated by a lack of relationship between the lawyer and the franchisee, with some franchisees obtaining counsel less than six months before the closing.[61] Therefore, employing unsophisticated and unfamiliar counsel may result in a lack of protection for the franchisee. Additionally, survey results reveal that the effectiveness of legal counsel at a closing often hinges on the franchisee's and franchisor's characteristics.[62] In fact, only 12% of counsel for those franchisees with investments between $150,000

REVISED TRADE REGULATION RULE (16 CFR PART 436), at 261 (2004), *available at* http://www.ftc.gov/sites/default/files/documents/reports/staff-report-bureau-consumer-protection-federal-trade-commission-and-proposed-revised-trade/0408franchiserulerpt.pdf).

57. Selden & Barkoff, *supra* note 38, at 291.

58. *See Infra* Appendix, Franchise Lawyer Survey, Question 6 (noting that only 9.79% of franchisees had a lawyer whose quality of representation was deemed excellent, while most franchisee counsel were considered good or very good and almost a quarter of franchisee lawyers were found to be, at best, only fair); *supra* text accompanying notes 45–50 (discussing comments of franchisor attorneys disparaging the capabilities of the franchisee's lawyer).

59. *Infra* Appendix, Franchise Lawyer Survey, question 12. On the other hand, some franchise lawyers commented that the franchisees' lawyers "all [had] no understanding of the dynamics of franchising." One lawyer, while praising the sophistication of most of its franchisees—with hotel franchises having an ultimate construction cost of between $20 million and $100 million per location—wrote about how these franchisees tended to hire counsel who knew much about real estate or finance but very little about franchising.

60. Comments from Franchisors, Franchise Lawyer Survey, Question 15 (on file with author). Indeed, some franchisor lawyers opine that the franchisee attorney, if there is one, has very little, if any, experience in representing franchisees. *Infra* Appendix, Franchise Lawyer Survey, Question 8.

61. *See infra* Appendix, Franchise Lawyer Survey, Question 7 (noting that only 21.04% of franchisor attorneys worked with franchisees who had a lawyer that had been their counsel for more than six months prior to the closing; however, most simply did not know the degree of prior contact between franchisees and their lawyer).

62. *See infra* Appendix, Franchise Lawyer Survey, Questions 7, 9.

and $350,000 sought to obtain more favorable terms for their clients.[63] On the other hand, other categories of franchisees fared much better: 73.99% of franchisee lawyers sought more favorable terms for the franchisee when the franchisor had been in business for ten or more years before it started to franchise,[64] and 75.2% of franchisee lawyers sought to negotiate more favorable terms for their clients when dealing with franchise networks with under 500 units.[65] Perhaps prospective franchisees are warier of businesses that wait a long time—ten years or more—to decide whether to franchise the business, or that have yet to reach critical mass in terms of the number of units. At any rate, it is fair to say that even when franchisees are represented by counsel at closing, not all franchisees are represented equally.

Some franchisors remark that it is often the case that franchisees are protected by franchise associations.[66] This type of association "may be an independent organization recognized as such by the franchisor company or an advisory board, the membership of which is either selected or approved by the franchisor company."[67] Generally, the purpose of these associations is to "negotiate the standard form of franchise agreements on behalf of its membership, and those franchise associations generally are represented by expert counsel."[68] Consequently, franchisees that are part of a franchise association may not need independent counsel for each

63. The Author generated the data from the answers to Franchise Lawyer Survey and the data furnished by FRANdata. 86% of counsel for franchisees with investments over $1.2 million sought more favorable terms for their clients; 80% of franchisee lawyers sought to negotiate favorable terms for franchisees with investments under $70,000; and the enormous difference between these high figures and those of the mid-level investments—between $150,000 and $350,000—may be attributed to a relatively small sample size within that subcategory. *See supra* note 40; *infra* Appendix, Franchise Lawyer Survey, Question 2.

64. The Author generated the data from the answers to Franchise Lawyer Survey and the data furnished by FRANdata. 62.5% of franchisee lawyers sought more favorable terms for clients dealing with franchisors with no prior time in business before becoming a franchisor; 45.5% of franchisee attorneys sought to negotiate better terms for franchisees dealing with franchisors having between one and five years of business prior to becoming a franchisor. *See supra* note 40; *infra* Appendix, Franchise Lawyer Survey, Question 3.

65. Again, the author generated the data from the answers to Franchise Lawyer Survey and the data furnished by FRANdata. Only 64.8% of franchisees' lawyers attempted to negotiate better terms for franchisees dealing with franchisors that have 500 or more units in the franchise. *See supra* note 40; *infra* Appendix, Franchise Lawyer Survey, Question 2.

66. Comments from Franchisor Lawyers, Franchise Lawyer Survey (on file with author).

67. *Id.*

68. *Id.*

individual franchise negotiation because they have the benefit of the standard form agreement.[69]

Others argue that because the franchise applicant is frequently unfamiliar with franchising, many franchisees wrongfully believe that the norm is *not* to consult an attorney before investing.[70] Moreover, if the franchisee is told by the franchisor that there is no need to consult an attorney before continuing with the transaction, the franchisee likely will not seek legal advice before entering into the franchise relationship.[71] If the franchisee believes that an attorney will only cost it more money and time and that it can successfully negotiate the agreement itself, the franchisee is less likely to obtain counsel.[72]

Unfortunately for the franchisee, "[f]ranchise agreements are lengthy, complex, and subtle."[73] An attorney can advise the franchisee in numerous areas and can also be a strong advocate.[74] In fact, according to this Author's survey, only 24.82% of franchisee attorneys merely advised the franchisee without also engaging in the franchise negotiations.[75] By not hiring an attorney, the franchisee is implicitly asserting that it is either qualified to perform the requisite duties in all of these areas or unaware

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69. *Id.* According to the results of this Author's survey, perhaps about only a third of franchisees-to-be are the beneficiaries of a standard form contract negotiated by the franchisor and a franchisee association. *Infra* Appendix, Franchise Lawyer Survey, Question 14 (finding such a standard, negotiated contract form for 37.69% of franchised units for which there was a survey response). For more on franchisee associations as a mechanism for individual franchisee relief as well as a tool for system-wide reform, see Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws*, 118 PENN. ST. L. REV. 99 (2013).

70. *See* Selden & Barkoff, *supra* note 38, at 291.

71. *See id.*

72. Practicing franchise lawyers agree. In an interview, franchisor lawyer Robert T. Joseph asked, "How much does it cost a franchisee to get representation? Let's say it is $400 an hour. Is someone really going to pay $3,000 for eight hours of negotiation? Probably not. They should, but they don't." Telephone Interview by Jason Parnell, Assistant to this Author, with Robert T. Joseph, franchisor lawyer and Partner, SNR Denton (June 4, 2012).

73. Selden & Barkoff, *supra* note 38, at 277.

74. The lawyer is counsel to the franchisee in (1) deciding whether to purchase a franchise; (2) selecting and investigating the franchise; (3) reviewing disclosure and registration documents; (4) negotiating franchise agreements; (5) site selection and preparation; (6) forming agreements with other parties; (7) the legal review of the franchisee's operations; (8) monitoring the franchisor's performance; and (9) termination and nonrenewal. GARNER, *supra* note 13, at §§ 2:11–:19 (2013).

75. *Infra* Appendix, Franchise Lawyer Survey, Question 4.

of all the areas that will need to be considered in contracting for the franchise.[76]

The franchisee that believes legal assistance is not required will likely realize later that an attorney is needed, as the agreement becomes increasingly complicated. Further, the franchisee may learn that representation is needed in the event that a dispute arises between the franchisor and franchisee during the negotiations or after the fact. Such a dispute calls for either diplomatic skills to settle the matter, representation in court to reach a resolution, or representation in arbitration when the settlement fails. However, by the time the franchisee comes to this realization, a significant amount of its investment may have already been lost.

C. The Psychological Basis for the Franchisee's Self-Representation

The findings from the Author's survey of lawyers who have participated in franchise closings run in tandem with basic psychology. While many franchisees choose not to hire a lawyer before investing in a franchise because they believe it will cost them time or money, there are other psychological reasons why franchisees may opt to represent themselves in a transaction. Interestingly, franchisees that are the least capable of self-representation are often the ones who insist upon representing themselves.[77] This subpart evaluates the psychological basis for self-representation and considers whether those franchisees that decide to represent themselves need additional protections to guard against their own inexperience.

First, some franchisees decide not to hire an attorney because they believe they do not need assistance. David Dunning, a Professor of Psychology at Cornell University, proposes that "[o]n average, people tend to hold overly favorable views of themselves. They overestimate their skill, their knowledge, their moral character, and their place on the social ladder."[78] For example, when asked "if their skill level is 'average,'

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76. In the latter situation, the franchisee-to-be obviously cannot make an educated determination as to her appropriate course of action.

77. *See* DAVID DUNNING, SELF-INSIGHT: ROADBLOCKS AND DETOURS ON THE PATH TO KNOWING THYSELF 4 (2005) ("[A]s a general rule, people's impressions of their abilities—whether arrogant or humble—are not anchored very closely to their actual level of skill . . . . [W]hat people think about themselves can be quite distinct from the truth of their competence and expertise.").

78. *Id.* at 6; *see also* John R. Chambers & Paul D. Windschitl, *Biases in Social Comparative Judgments: The Role of Nonmotivated Factors in Above-Average and Comparative-Optimism Effects*, 130 PSYCHOL. BULL. 813, 813 (2004) (stating that "people have a pervasive tendency to believe they are better than others in a multitude of ways and that life's negative events are less likely to befall them than their peers"). In

'above average,' or 'below average,' too many people endorse the above average option . . . a belief that cannot be objectively possible."[79]

Dunning also proposes that people's overconfidence is at its peak when they are "*sure* of what they are saying."[80] Yet, even "[w]hen people express 100% certainty in their predictions, they still tend to be wrong roughly one time out of every five, an error rate of 20%."[81] Thus, the surer the franchisee is that it can negotiate on its own, the more likely it is that the franchisee will be mistaken.

Similarly, overconfidence can lead to overoptimism about outcomes in various legal situations. Professor Sean Hannon Williams has reported that an overly rosy view about everything—marriage, employment contracts, credit card use—can lead to an underestimation of potential negative effects and a belief that the law will protect people regardless of their position.[82] Furthermore, the overly optimistic person tends to form a bias in favor of one viewpoint and fails to seriously consider contrary information.[83] In practice, a franchisee may be so optimistic about a new business venture that the franchisee becomes biased in thinking that

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addition, in overestimating their abilities, people may not realize they would have been better off had they been represented by counsel. *See, e.g.*, CARL E. SCHNEIDER & MARGARET F. BRINIG, AN INVITATION TO FAMILY LAW: PRINCIPLES, PROCESS AND PERSPECTIVES 329 (3d ed. 2006) (discussing how "30% of wives were awarded alimony when both parties were represented by counsel, while not one alimony award was made when neither party was represented by counsel").

79. DUNNING, *supra* note 77, at 6. People's average rating of themselves as well above average is sometimes termed "illusory superiority." *See* Vera Hoorens, *Self-Enhancement and Superiority Biases in Social Comparison*, *in* 4 EUR. REVIEW OF SOC. PSYCHOLOGY 117 (Wolfgang Stroebe & Miles Hewstone eds., 1993). This has been a theme in popular culture and has even been labeled the "Lake Wobegon Effect" after humorist Garrison Keillor's fictitious town "where all the women are strong, all the men are good-looking, and all the children are above average." Garrison Keillor, Monologue, A Prairie Home Companion, Massachusetts Public Radio (Mar. 4, 1995).

80. DUNNING, *supra* note 77, at 7.

81. *Id.* However, Dunning does articulate instances when a person is not likely to be overly confident, such as when "the task at hand is particularly easy and performance is high, people tend to be underconfident in their performance." DUNNING, *supra* note 77, at 9.

82. *See* Sean Hannon Williams, *Sticky Expectations: Responses to Persistent Over-Optimism in Marriage, Employment Contracts, and Credit Card Use*, 84 NOTRE DAME L. REV. 733, 734–35 (2009).

83. *See, e.g.*, Lynn A. Baker & Robert E. Emery, *When Every Relationship Is Above Average: Perceptions and Expectations of Divorce at the Time of Marriage*, 17 L. & HUM. BEHAV. 439, 443 (1993) (discussing how married couples will typically underestimate the likelihood of divorce, despite statistics to the contrary).

the franchise agreement is sound and that nothing in the future could go wrong.

Additionally, many inexperienced franchisees that choose to represent themselves believe that they possess the skills to negotiate the contract on their own. Thus, many inexperienced franchisees are unaware that they need professional representation during the transaction. In the case of many franchisees, "not only do [they] reach erroneous conclusions and make unfortunate choices, but their incompetence robs them of the . . . ability to realize it."[84] They do not actively decide against seeking help, but passively fail to even consider pursuing legal or other assistance.

A research experiment conducted by Justin Kruger and David Dunning at Cornell University revealed that "people who lack the knowledge or wisdom to perform well are often unaware of this fact."[85] This lack of wisdom results in a double-edged sword: "[T]he same incompetence that leads them to make wrong choices also deprives them of the savvy necessary to recognize competence, be it their own or anyone else's."[86] Thus, these franchisees suffer a double burden.[87] First, these franchisees lack the knowledge that would enable them to represent themselves in the transaction. Secondly, their lack of knowledge plagues the franchisees by giving them a false sense of competence and blinding them to the fact that they are in no position to represent themselves.[88] These franchisees who represent themselves not only believe they are capable of effectively doing so, but also tend to believe that their performance is "above average."[89]

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84. 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); *see also* DUNNING, *supra* note 77, at 15 (suggesting that it is not that people who are performing poorly "fail to recognize their incompetence," but rather, "people performing poorly cannot be *expected* to recognize their ineptitude. They are simply not in a position to know that they are doing badly. The ability to recognize the depth of their inadequacies is beyond them").

85. Kruger & Dunning, *supra* note 84, at 1126.

86. *Id.*

87. *Id.* at 1121.

88. *See id.* at 1130 (noting that "incompetence . . . not only causes poor performance but also the inability to recognize that one's performance is poor").

89. *See id.* at 1122; *see also id.* at 1125, Figure 2 (depicting that those who scored in the lowest percentile in perceived logical reasoning ability and test performances believed they scored above average). There is no reason to believe franchisees are substantially different than employees who, on average, "think that they're well above average [relative to] everybody else" with regard to their more expertise, leadership, sophistication, and even idealism. Alix Spiegel, *American's Flunk Self-Assessment*, NPR (Oct. 6, 2007, 4:00 PM), http://www.npr.org/templates/story/story.php?storyId=15073430 (transcribing NPR's A*ll Things Considered* radio broadcast). Dunning notes that the phenomenon of a populace that tends to overestimate its relative abilities is

D. The Role of the Counselor

There are essentially four stages for potential counseling in the franchising process.[90] The first stage is the purchase of the franchise.[91] It is important for the franchisee to have representation at this stage because "the franchisee needs a professional advisor who is familiar with investments in business but who also has some knowledge of the idiosyncrasies of franchising."[92] Legal advice at the time of purchase is also important; an attorney who commonly engages in franchise negotiations may be in a better position to determine whether it is a quality investment and can prevent an unwary franchisee from making an unwise business decision.[93]

The second stage of counseling is ownership.[94] At this point, representation is important because "business-related counseling is

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restricted to North America and Europe; in Japan or China, people are more likely to say that they are "average" or "slightly below average." *Id.*

There may be other psychological reasons why a franchisee believes that he is capable of self-representation. For example, Dunning also notes that it is possible that those who are incompetent are relatively aware of this fact at some level. DUNNING, *supra* note 77, at 28. Yet, these people are incompetent because "to admit to poor performance either to themselves or other people is an action that they are motivated to avoid." *Id.* Thus, Dunning proposes that some of those who are "incompetent are actively engaged in denial. They just refuse to recognize their errors; they deliberately short-circuit any awareness they may have of their mistakes." *Id.* Therefore, some franchisees may be cognitively aware that they are not adequately capable of representing themselves in the transaction. Yet, rather than admitting this fact, they engage in "denial" and convince themselves that they are capable of self-representation. *See id.* at 29.

90. Selden & Barkoff, *supra* note 38, at 289.

91. *Id.*

92. *Id.* at 289–90. Although desirable, the doubly qualified advisor—knowledgeable about both business generally and franchising in particular—may be a rarity. Usually, prospective franchisees have attorneys that are not capable of representing them. Telephone Interview by Jason Parnell, Assistant to the Author, with Lee J. Plave, franchisor lawyer and Partner, Plave Koch PLC (May 17, 2012). For example, in some cases, a personal injury lawyer will go beyond his typical area of practice and, for a current or past personal injury client who is a prospective franchisee, engage in franchise agreement negotiations. *Id.* In these circumstances, competence is a substantial issue. *Id.* Accordingly, even if a franchisee has an attorney, there is no guarantee that the lawyer chosen by the franchisee will be competent or effective. *Id.*

93. *See* Warren Pengilley, *International Franchising Arrangements and Problems in Their Negotiation*, NW. J. INT'L L. & BUS. 185, 193–94 (1985) (describing how lawyer involvement in franchise negotiation is "desirable at an early stage").

94. Selden & Barkoff, *supra* note 38, at 290.

often required."[95] An attorney's negotiating skills are essential at this stage because he can effectively protect the "franchisee's legal rights" or "business interests" in the event of a franchisor-franchisee dispute.[96]

In the third stage, the attorney may be required to take a more diplomatic stance to mitigate any conflict between the franchisor and franchisee.[97] The franchisees' attorneys "must be familiar with the business arrangements" and "understand what the bargaining positions of the franchisees may be."[98] The goal of the attorney at this point is to ensure that the franchisor cooperates in the negotiations while still satisfying the demands of his client, the franchisee. The franchisee's attorney may "play a role in negotiating a collective agreement with the franchisor" to ensure that his client's interests are fulfilled.[99]

The last stage begins when disputes arise and "diplomacy has failed."[100] Here, the attorney assumes a more traditional role as an advocate for his client, potentially at trial. The attorney should also be proficient in alternative dispute resolution because, alternatively, he may be required to settle the issue in front of an arbitration or dispute resolution panel rather than by trial.[101]

Thus, there are various roles the attorney is required to assume when representing a franchisee. These roles require that the attorney is equipped with knowledge of how the franchising process works. Many franchisees are not sophisticated in their business experiences and therefore could easily be taken advantage of by the franchisor or his attorney in the negotiating process.[102] Nevertheless, many franchisees choose not to retain counsel before investing, regardless of the possible ramifications. Only later is a hard lesson learned.

Many franchisees learn after the fact that starting a franchise is an extremely complicated process and that there are steps that could be taken to make the process run smoother. According to a Wells Fargo/ Gallup Small Business Index poll, many small business owners reported various things they would do differently if they could go through the

95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* Even at this stage, however, a lawyer still must recognize "the needs of the commercial community." Pengilley, *supra* note 93, at 193. Too often lawyers think they can or should run the direction of the negotiations. *Id.* at 194. This, however, is not always a commercial reality and can actually stifle the progress of the proposed business deal. *See id.* A lawyer's role, therefore, at least in this context, should be that of an advisor rather than an adversary. *See id.*
100. Selden & Barkoff, *supra* note 38, at 290.
101. *Id.*
102. *See infra* Part III.B.

startup process again.[103] For example, many reported that they would have had more capital backing, asked for more advice from experienced business owners, or obtained a better understanding of financial management rights before getting started.[104] Additionally, one in three of those surveyed reported that obtaining more legal advice would have been helpful.[105] This Author's survey revealed that 27.92% of franchisee attorneys had a high level of prior experience in their clients' respective franchise industries, although only 8.11% had no experience at all.[106] Thus, legal advice can be especially beneficial to franchisees that lack business expertise and experience.[107] Yet, it is still important for those who do have business familiarity to obtain legal advice. Although "experience and knowing the competition is extremely helpful in any business," the attorney's role encompasses much more than merely detailing the particular business.[108] It also requires strong negotiation and advocacy skills, which a lawyer is more likely to possess than a franchisee.

III. FRANCHISEE: SOPHISTICATED BUSINESSPERSON OR INEXPERIENCED INVESTOR?

As established above, some courts may be more sympathetic to inexperienced franchisees that negotiate with more sophisticated franchisors represented by counsel.[109] However, a franchisee will not be able to rely

103. *See* Dennis Jacobe, *Lessons Learned About Starting a Small Business: Small Business Owners Share What Would Have Made Starting Their Businesses Easier*, GALLUP (Sept. 18, 2006), http://www.gallup.com/poll/24574/Lessons-Learned-About-Starting-Small-Business.aspx.

> Results for the Wells Fargo/Gallup Small Business Index poll are based on telephone interviews with 602 small business owners conducted May 22–June 9, 2006. For results based on the total sample of investors, one can say with 95% confidence that the maximum margin of sampling error is ±4 percentage points.

Id.

104. *See id.*

105. This factor ranked fourth among those polled regarding things that would have helped in starting a business. *See id.*

106. *Infra* Appendix, Franchise Lawyer Survey, Question 9.

107. One in five small business owners surveyed reported that they had no business experience before starting their businesses. Jacobe, *supra* note 103.

108. *Id.*

109. *See, e.g.*, Nagrampa v. Mailcoups, Inc., 469 F.3d 1257, 1282–83 (9th Cir. 2006) (discussing how "[f]ranchising involves the unequal bargaining power of franchisors and franchisees and therefore carries within itself the seeds of abuse"

on judicially favorable predispositions if that franchisee is deemed "a sophisticated investor."[110] The next two subparts discuss the distinctions between the two types of franchisees and the additional protections courts are willing or unwilling to grant them.

A. The Sophisticated Businessperson

In *North American Financial Group, Ltd. v. S.M.R. Enterprises, Inc.*, the plaintiff, prospective franchisee North American Financial Group, was "in the business of raising venture capital and investing or loaning venture capital," and defendant S.M.R. Enterprises franchised hair care centers operating under the mark "Fantastic Sam's."[111] The parties had negotiated on and off, in three distinct time periods, for three supposed deals made or formed anew.[112] The last deal was for the sale of a franchise area, but when Fantastic Sam's refused to tender the franchise pursuant to the alleged agreement, North American Financial Group filed suit and claimed that Fantastic Sam's had violated the Securities Act of 1933,[113] the Racketeer Influenced and Corrupt Organizations Act (RICO),[114] and the Illinois Franchise Disclosure Act,[115] as well as committed common law fraud.[116] The court noted that under Illinois law common law fraud is defined as "anything calculated to deceive, whether positive acts, omissions or concealments, where a legal or equitable

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(quoting Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 374 (1996))). However, some franchisor lawyers will not negotiate with a prospective franchisee unless that person has a lawyer present or on call. E-mail Interview by Jason Parnell, Assistant to the Author, with Tom Pitegoff, franchisor lawyer, Pitegoff Law Office PLLC (Apr. 24, 2012). Similarly, some franchisor lawyers, just by the very nature of how the franchisor does business, will rarely interface with franchisees, with the exception of international development deals that have a great amount of money at stake. Telephone Interview by Jason Parnell, Assistant to the Author, with Rochelle Spandorf, franchisor lawyer and Partner, Davis Wright Tremaine LLP (June 14, 2012).

110. *See* 62B AM. JUR. 2D *Private Franchise Contracts* § 260 (2013) (discussing that a franchisee may not be able to claim reasonable reliance when the franchisee is a sophisticated investor).

111. 583 F. Supp. 691, 693 (N.D. Ill. 1984).

112. *Id.* at 693–95.

113. *Id.* at 695. The alleged violation was Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982).

114. *Id.* at 697. North American Financial Group based its RICO allegations on claims of two predicate offenses: mail fraud and wire fraud arising under 18 U.S.C. §§ 1341, 1343, 1961(1)(B) (1982).

115. *Id.* at 699–700 (citing ILL. REV. STAT. 1991, ch. 121 $^{1}/_{2}$, para. 701–40 (current version at 815 ILL. COMP. STAT. 705/1–/44 (2013)).

116. *Id.* at 697–99.

duty is breached causing damage to the plaintiff."[117] Thus, for North American Financial Group to prevail on a claim of common law fraud it had to establish

> (1) that the defendants made a false representation of a material past or existing fact; (2) which was known to be false when made; (3) the misrepresentation must have been made intentionally to induce the plaintiff to act; (4) the plaintiff must rely on the misrepresentation and have the right to rely; and (5) the plaintiff must be injured as a result of such reliance.[118]

In considering these elements, the *North American Financial Group* court noted that the "background, special expertise or education" of the claimant should be examined to determine whether reliance on the alleged misrepresentation was reasonable.[119]

Here, the court held that North American Financial Group had no claim in law against Fantastic Sam's for common law fraud.[120] First, the court noted that the alleged misrepresentations[121] cited by North American Financial Group were "likely discoverable" by the franchisee before it entered into its franchise agreement with Fantastic Sam's.[122] Further, the court found that it "certainly is reasonable to assume that an entity planning to commit as much as one half million dollars in an unknown enterprise would check out the president of that enterprise," and that North American Financial Group's failure to do so was unreasonable.[123] It appears that the court deemed North American Financial Group a sophisticated investor, most likely because it was in the business of raising, investing, or lending venture capital.

Similarly, in *Payne v. McDonald's Corp.*,[124] plaintiff Osborne Allen Payne, a long-time, multiple-franchise-owning McDonald's franchisee

117. *Id.* at 697 (citing Majewski v. Gallina, 160 N.E.2d 783, 788 (Ill. 1959); Casey Electric Contracting, Inc. v. First Nat'l Bank of Elgin, 392 N.E.2d 759, 762 (Ill. App. Ct. 1979)).
118. *Id.*
119. *Id.* at 698.
120. *See id.*
121. North American Financial Group alleged that Fantastic Sam's president and director "misrepresented his past business ventures and successes expressly to induce North American into investing in Fantastic." *Id.* at 693. The court, however, held that North American failed to show that these were material misrepresentations or omissions. *See id.* at 698.
122. *See id.*
123. *Id.*
124. 957 F. Supp. 749 (D. Md. 1997).

in Baltimore, claimed, among other things,[125] that he reasonably relied on McDonald's misrepresentations and thereby suffered decreased revenues, loss of profitability, and inability to sell his restaurants.[126] McDonald's allegedly had misrepresented (1) the franchisee's cost to rebuild one of the franchisee's four restaurants—the Broadway location, (2) the rebuilt Broadway location's projected profits, and (3) the impact that opening two nearby McDonald's restaurants would have on sales at the Broadway restaurant.[127] Payne asserted that, in light of the fact that the franchisor possessed "exclusive or superior knowledge and should have been aware that the other party would rely heavily on its assertions," he should be entitled to relief for reliance on such statements.[128] The court disagreed.[129]

The *Payne* court cited to the decision of the U.S. Court of Appeals for the Fourth Circuit in *Miller v. Premier Corp.*, holding "that the questions of 'superior knowledge' and of 'reasonable reliance' are intertwined."[130] In applying this principle, the court determined that the issue was "[w]hether reliance on future projections of profit [wa]s reasonable," which depended "both upon the manner in which the projections [we]re represented and what in fact was known by the person claiming inferior knowledge."[131]

In applying these principles, the *Payne* court determined that the franchisee was not in a position to claim inferior knowledge.[132] In fact, the court noted that the franchisee possessed "extensive knowledge concerning the cost of constructing franchised McDonald's restaurants and the profits which might be expected to accrue from the operation of such restaurants, as well as an understanding of the impact which new restaurants in the area might have on his [other] facility."[133] Thus, the

125. For example, McDonald's breach of the license agreement, breach of the implied covenant of good faith and fair dealing, and other fraud based claims. *See id.* at 751.

126. *See id.* at 751–54.

127. *Id.* at 760.

128. *Id.* at 761 (citing Miller v. Premier Corp., 608 F.2d 973, 981 (4th Cir. 1979)). Here, the assertions that the franchisee relied upon were all predictive statements, including "the projected cost of the rebuilding of the Broadway facility, the projected profits of the Broadway restaurant after it was rebuilt and the projected impact of the new restaurants on sales at the Broadway location." *Id.* Defendant franchisor argued that these assertions addressed the potential of what could occur, and therefore, were not actionable as fraud. *Id.*

129. *Id.*

130. *Id.* at 761 (citing *Miller*, 608 F.2d at 981).

131. *Id.*

132. *Id.*

133. *Id.* Additionally, the court noted,

court held that it was not reasonable for the franchisee to rely on the franchisor's future predictions when the franchisee was such a sophisticated investor.[134]

These cases suggest that the reasonableness of a franchisee's reliance upon the franchisor's statements depends upon the sophistication of the franchisee. If the franchisee has previously negotiated franchise agreements or knows the intricacies of the business, courts may be less likely to find that its reliance on the franchisor's statements is reasonable. However, this situation may be different if the franchisee is deemed inexperienced.

B. The Inexperienced Investor

Although courts may be unwilling to provide more protections for sophisticated franchisees, some courts have granted these additional protections when the franchisee had no prior business experience and relied on statements made by an experienced franchisor.[135] In the latter situation, the inexperienced franchisee's reliance on statements made by the experienced franchisor may be deemed reasonable, making the franchisor liable for any breach of those statements.[136] The facts are crucial in these cases, which makes a thorough examination of a factually rich but—on legal grounds, at least—typical case for franchising fraud, *Fisher v. Mr. Harold's Hair Lab, Inc.*, important. *Fisher* illustrates how the inexperienced franchisee may be shielded from the machinations of an unscrupulous franchisor.[137]

> Not only had [the franchisee] operated the Broadway restaurant itself for almost twenty years before 1994, but he had also operated restaurants at his other three Baltimore locations over a period of many years. Moreover, in 1976 and 1978, he operated for several years two additional McDonald's restaurants, one on Eutaw Street and the other on Liberty Road. Both in 1988 and later in 1990, [the franchisee] had objected to the opening of new facilities in the vicinity of his Broadway restaurant. Expressing his firm disagreement with the predictions made by McDonald's that the new restaurants would have minimal impact on sales at the Broadway facilities, [the franchisee] had his own decided views on the matter. Under such circumstances, it can hardly be claimed that [the franchisee] relied to his detriment on McDonald's predictions.

Id.

134. *See id.*
135. *See* 62B AM. JUR. 2D, *supra* note 110, § 283.
136. *See id.*
137. *See* 527 P.2d 1026 (Kan. 1974).

In *Fisher*, the Kansas Supreme Court found that the plaintiff franchisee had reasonably relied on statements made by the defendant franchisor, which induced him to purchase the franchise to his detriment.[138] The franchisors, Harold and Carolyn Wilborn, were sole stockholders of the corporation Mr. Harold's East—Your Toupee Establishment (Mr. Harold's), which sold men's hairpieces, toupees, and other services and supplies connected therein.[139] The franchisee, Charles F. Fisher, was "a senior experiment test pilot with the Boeing Company," whose "only experience in business management had been some executive training furnished by Boeing."[140] After discussions with the Wilborns, Fisher decided to purchase a Mr. Harold's franchise, as well as the right to sell franchises to others.[141] However, Fisher soon encountered difficulties in selling franchises, and he "discontinued his efforts to sell [them]."[142]

Subsequently, Fisher sued Mr. Harold's and each Wilborn individually, claiming "eighteen specific fraudulent representations allegedly made by the Wilborns and relied on by Fisher in entering into the agreements."[143] The Wilborns argued that the alleged representations constituted opinion or puffing and Fisher had not relied upon them.[144] The court disagreed.[145]

Although the general rule is that for a "fraudulent concealment to be actionable [it must] be material to the transaction," and "[a] matter is material if it is one to which a reasonable man would attach importance in determining his choice of action in the transaction in question," there are exceptions.[146] A misrepresentation of a material fact need not be made if "a party to a bargain has made misrepresentations for the purpose of inducing action by the other, and the other party has acted, relying upon the misrepresentations."[147]

Ostensibly, this exception is intended to protect less sophisticated parties who are bargaining with more sophisticated businesspersons.[148]

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138. *See id.* at 1035.

139. *Id.* at 1028.

140. *Id.* Allegedly, Mr. Fisher desired to purchase a Mr. Harold's franchise as a business investment in case the aerospace industry continued to decline. *Id.*

141. *Id.* at 1029. According to the three agreements executed between the parties, Mr. Fisher was entitled to own a franchise and to sell additional Mr. Harold's franchises. *Id.*

142. *Id.*

143. *Id.* at 1030.

144. *Id.* at 1033.

145. *See id.*

146. *Id.* (quoting Griffith v. Byers Constr. Co., 510 P.2d 198, 205 (Kan. 1973)).

147. *Id.* (quoting 12 SAMUEL WILLISTON & WALTER H.E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 1490 (3d ed. 1970)).

148. *See, e.g.*, Schott Motorcycle Supply, Inc. v. Am. Honda Motor Co., 976 F.2d 58, 65 (1st Cir. 1992) (recognizing that an expression of opinion may constitute fraud

According to the *Fisher* court, if the parties have equal bargaining power, then the franchisee "has no[] right to rely, since he is assumed to be equally able to form his own opinion."[149] However, "where the terms of dealing are not equal, and the representor has superior knowledge of the subject, a statement which would otherwise be one of opinion will be regarded as one of fact."[150] Applying these principles, the Kansas Supreme Court found that although the statements made by the Wilborns to Fisher "regarding Mr. Harold's fame might properly be regarded as puffing," the statements they made about having "thirty years' experience with men's hair pieces and [that they] did not manufacture their own hair pieces" were not.[151] Additionally, the representations the Wilborns made regarding the "number of stores in operation" were not considered puffing.[152]

The Wilborns also argued that Fisher's claim was not actionable because "where goods are open to the inspection of the buyer, he is presumed to be as competent a judge of their value as the seller."[153] Yet, the court also noted an exception to this general rule: The general rule "applies *only* where the parties stand on an equal footing and have equal means of knowledge, with no relation of trust or confidence existing between them."[154] Moreover, in the instance that "one of the parties to a bargain represents himself as having special knowledge or his position is such that business expectations suggest that he is better informed than members of the general public or if one of the parties is obviously in a disadvantageous bargaining position," the weaker party would likely be

where the relation between the parties is such that they do not deal at arm's length or on equal terms).

149. *Fisher*, 527 P.2d at 1033 (citing 37 C.J.S. *Fraud* § 10 (current version at 37 C.J.S. *Fraud* § 21 (2014)).

150. *Id.* (citing 37 C.J.S. *Fraud* § 10 (current version at 37 C.J.S. *Fraud* § 22 (2014))); *see also* Bank IV Salina, N.A. v. Aetna Cas. & Sur. Co., 810 F. Supp. 1196, 1208 (D. Kan. 1992) (finding that where the person expressing the opinion possesses, or professes to possess, superior knowledge of the subject or special information regarding it, the opinion may be reasonably regarded as "fact"); Reynolds v. Mitchell, 529 So. 2d 227, 231 (Ala. 1988) (same); Reeve v. Ga.-Pac. Corp., 510 N.E.2d 1378, 1383 (Ind. Ct. App. 1987) (same); McCollum v. P/S Invs., Ltd., 764 S.W.2d 252, 254 (Tex. App. 1988) (same).

151. *Fisher*, 527 P.2d at 1033.

152. *Id.*

153. *Id.*

154. *Id.* (emphasis added) (quoting 37 AM. JUR. 2D *Fraud and Deceit* § 171).

protected by allowing it to rely on statements made by the representor, which would not be actionable under normal circumstances.[155]

Again, the Kansas Supreme Court found that Fisher was an unsophisticated investor because he had no background in business, certainly not in hairpieces, but was instead affiliated with the aerospace industry.[156] Although Fisher did examine some of the hairpieces during the negotiations, the court determined that "he lacked the knowledge to assess the quality of the merchandise he saw."[157] However, the court found that the law would not "deprive a defrauded party of relief because he had opportunity to investigate, when his lack of knowledge was such that the investigation would disclose nothing to him."[158] Thus, although Fisher did inspect some of the merchandise, he was not truly sure what he was inspecting; therefore, Fisher relied upon the Wilborns' statements to his detriment.[159]

Lastly, the Wilborns argued that their statements were not actionable because they were mere opinions or predictions relating to future profits of the business.[160] The general rule regarding opinions or predictions is that these do not constitute fraudulent misrepresentations unless the misrepresentations "relate to some material past or existing fact."[161] Nonetheless, the court noted that there was an exception applicable to this general rule, too, which establishes that

> [f]alse representations of future profits of a business may be so gross as to constitute fraud, especially where the representor is experienced and has superior knowledge of the business and the representee is inexperienced and ignorant of the facts and prospects respecting such business. Thus, in some cases wherein the defendant was held liable for false predictions concerning future profits or income, considerable emphasis was placed on the fact that the defendant had or professed to have superior knowledge, whereas the plaintiff did not have such knowledge and relied on the defendant's statements. In this connection it is held that a positive statement concerning future rents, profits, or income implies that the speaker has knowledge of facts which justify the prediction.[162]

Further, the court found that if the weaker, or less sophisticated, party does rely on the opinions or predictions given by the stronger, or more sophisticated, party, then "courts will ordinarily give [the opinions or

155. *Id.* at 1034 (quoting James R. Ahrens, *Some Observations on the Law of Misrepresentation in Kansas*, 9 WASHBURN L.J. 315, 326 (1970)).
156. *See id.*
157. *Id.*
158. *Id.* (quoting Wolf v. Brungardt, 524 P.2d 726, 728 (Kan. 1974)).
159. *See id.*
160. *Id.*
161. *Id.*
162. *Id.* at 1035 (quoting 37 AM. JUR. 2D, *supra* note 154, § 181).

prediction] the legal effect of a statement of existing fact," which means that the statements could then be actionable in fraud as a past or existing material fact.[163] Thus, statements that are deemed opinions or predictions, which generally are not actionable, may become actionable if an unsophisticated party relied upon the statements of a sophisticated party.[164]

The Kansas Supreme Court held that the Wilborns' statements were actionable in fraud.[165] Fisher relied upon what normally would be considered future predictions regarding the business's annual return.[166] The fact that Fisher was not sophisticated in the hair business, and that the Wilborns held themselves out as possessing superior knowledge of the business, transformed the Wilborns' assurance that Fisher would have an annual return of $25,000 from prediction to existing material fact. Therefore, this fraudulent statement was actionable because it induced Fisher to enter the transaction.[167]

As set forth above, the reasonableness of a franchisee's reliance on a franchisor's representations of the franchisor often depends upon the franchisee's sophistication and business experience in the particular franchise industry. In determining when prospective franchisees are sophisticated and thus less likely to be misled by the franchisor, courts consider a number of factors, including (1) the general business experience of the franchisee,[168] (2) the franchisee's knowledge and experience in the same line of business as the franchise,[169] (3) the franchisee's prior dealings with a particular franchise,[170] and (4) the franchisee's ability to protect itself from false or misleading statements.[171] If the franchisee has previously negotiated franchise agreements or has experience in the franchise's industry, a court is likely to find its reliance on the franchisor

163. *Id.* (quoting 37 AM. JUR. 2D, *supra* note 154, § 181).

164. *See id.* Under this theory, opinions or predictions transform into existing material facts, which then makes them actionable. *See id.*

165. *See id.* at 1033–35.

166. *See id.* at 1035.

167. *See id.*

168. *See* N. Am. Fin. Grp., Ltd. v. S.M.R. Enters., Inc., 583 F. Supp. 691, 698 (N.D. Ill. 1984) (holding that a franchisee with a background in investments was sophisticated).

169. *See id.*

170. *See* Payne v. McDonald's Corp., 957 F. Supp. 749, 761 (D. Md. 1997) (finding a franchisee sophisticated due to its extensive knowledge of the franchisor's business).

171. *See Fisher*, 527 P.2d at 1033 (discussing the unequal bargaining power of the parties).

unreasonable. However, if the franchisee has little business experience, particularly in the area of the franchise, a court will probably determine that it is an inexperienced investor and worthy of judicial protection.[172] As franchisees become more sophisticated and continue to enter negotiations without legal representation, this analysis will be critical in determining if there is a need to protect individual franchisees in their dealings with franchisors.[173]

IV. Ways That Contract Law Can Protect Franchisees

A. Contract Law's Covenant of Good Faith and Fair Dealing

"Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[174] Good faith is broadly defined, but generally it requires the parties to act with "honest[y] in fact in the conduct or transaction concerned."[175] Under the Uniform Franchise and Business Opportunities Act of 1987, "[a] franchise or business opportunity imposes on the parties a duty of good faith in its performance and enforcement,"[176] and good faith is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[177]

The duty of good faith and fair dealing is imposed upon the parties when the franchise agreement is formed[178] and is intended "to prevent arbitrary, malicious or abusive conduct, or conduct that deprives the other contracting party of the benefit of the bargain, and to preserve the

172. It should be noted that some legislators have also followed the trend of courts in protecting unsophisticated franchisees. For example, the Michigan legislature created a law specifically "to remedy perceived abuses by large franchisors engaged in manipulating, coercing or lying to *unsophisticated* investor franchisees." Jerome-Duncan, Inc. v. Auto-By-Te, L.L.C., 989 F. Supp. 838, 842 (E.D. Mich. 1997) (emphasis added); *see also* Geib v. Amoco Oil Co., 29 F.3d 1050, 1056 (6th Cir. 1994) (discussing that under Michigan's Franchise Investment Law, contractual provisions that permit a franchisor to "refuse to renew a franchise without fairly compensating the franchisee" are "void and unenforceable" (quoting MICH. COMP. LAWS ANN. § 445.1527(d))).

173. For a discussion of the general trends in the sophistication of franchisees, see *supra* Part III.A. For a discussion on the resistance of many franchisees to hire an attorney, *see supra* Parts II.B and II.C.

174. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

175. *Id.* cmt. a (citing U.C.C. § 1-201(19) (1978)).

176. *See* UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 201 (1987).

177. *Id.* The comments following Section 201 of the Uniform Franchise & Business Opportunities Act note that the section adheres to the principles set forth in section 205 of the Restatement (Second) of Contracts and in *Uniform Commercial Code* section 2-103. *Id.* cmt. 1.

178. *Id.* cmt. 1. For the various requirements for the formation of a contract, see also RESTATEMENT (SECOND) OF CONTRACTS §§ 9, 17, 71 (1981).

justifiable expectations of the parties to a franchise or business opportunity relationship."[179] However, the imposition of this duty is not the equivalent of a fiduciary duty.[180] Many courts have held that no fiduciary duties are established by the creation of a franchise agreement,[181] while only a few courts, whose reasoning has since been repudiated, have found that a fiduciary relationship is established between the franchisor and franchisee in certain circumstances.[182] Comment 1 of section 201 of the Uniform Franchise and Business Opportunities Act explains the more limited nature of the duty of good faith and fair dealing:

> The duty is imposed to modify and limit the exercise of discretion or power reserved in a contract, rather than add to or override substantive provisions of a contract, especially in longer term relational contracts which must, by their nature, reserve significant discretionary authority to provide marketing flexibility over the term of the arrangement.[183]

Although establishing a fiduciary relationship between the franchisor's lawyer and the franchisee can be a difficult burden to overcome, it is

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179. UNIF. FRANCHISED BUS. & OPPORTUNITIES ACT § 201 cmt. 1 (1987). The comment notes, however, that the duty of good faith and fair dealing "does not apply in the give and take of bargaining preceding the formation of the agreement" and "[i]t is not intended to eliminate risk." *Id.*

180. *Id.*

181. *Id.* (citing Bain v. Champlin Petroleum Co., 692 F.2d 43, 47 (8th Cir. 1982)). In *Bain*, the court held that

> [i]n *every* contract there is an implied covenant of good faith and fair dealing on the part of *both* parties . . . . However, although the existence of trust and confidence in another is inherent in all fiduciary relationships, its mere presence does not suffice to automatically make either party to a business relationship such as here present a fiduciary in every aspect of that relationship.

Bain, 692 F.2d at 47 (citations omitted).

182. For example, in *Arnott v. Am. Oil Co.*, 609 F.2d 873 (8th Cir. 1979), the court found that the defendant, American Oil, breached its fiduciary duty owed to the plaintiff, George Arnott, when American Oil entered into a lease agreement with Arnott to become a service station dealer for American Oil. *Id.* at 881. Subsequently, American Oil terminated the lease agreement and evicted Arnott from the station. *Id.* at 876. The court found that American Oil breached its fiduciary duty of good faith and fair dealing owed to Arnott by terminating the lease agreement without good cause. *Id.* at 884. The court specifically noted, "the franchise relationship imposes a duty upon franchisors not to act arbitrarily in terminating the franchise." *Id.* at 882.

183. UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 201 cmt. 1 (1987) (citing Steven J. Burton, *Breach of Contract and the Common Law Duty To Perform in Good Faith*, 94 HARV. L. REV. 369, 401 (1980); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1139 (1981)).

more difficult to establish that a franchisor owes fiduciary duties to the franchisee itself.[184]

The fact that the franchisor potentially owes the franchisee a duty of fair dealing does not necessarily establish fiduciary duties between the franchisor's attorney and the franchisee. The relationship of the franchisor and its lawyer is one based on agency law, where essentially the lawyer is the agent of the franchisor, who is the principal.[185] Accordingly, lawyers owe fiduciary duties to their clients.[186] Even though a fiduciary relationship may be established between franchisee and franchisor and between franchisor and attorney, the presence of the relationships does not automatically create a fiduciary relationship between the franchisee and the franchisor's lawyer.

In the event that a fiduciary relationship is created between the franchisor and the franchisee and the franchisor subsequently violates its duties owed to the franchisee, liability is not automatically imposed on the franchisor's agent, that is, its lawyer.[187] Under agency law, the agent is not responsible for the principal's negligent acts.[188] If the agent were to incur damages as a result of the principal's negligence, then the agent would be entitled to indemnification from the principal for damages the agent incurred.[189]

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184. *See Bain*, 692 F.2d at 48 (holding that the franchisor and franchisee are not in a fiduciary relationship); *see also In re* Sizzler Rests. Int'l, Inc., 225 B.R. 466, 473 (Bankr. C.D. Cal. 1998) (holding that a franchisor does not owe a franchisee a fiduciary duty); Eichman v. Fotomat Corp., 880 F.2d 149, 169 (9th Cir. 1989) (holding no special relationship exists in a franchisor-franchisee relationship).

185. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

186. *See id.* § 8.01 ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (2000) (describing the fiduciary relationship established between a lawyer and their client).

187. According to one practicing franchise lawyer, this may not always be true. In recent years, franchisor lawyers have started to be named as parties in lawsuits between the franchisor and franchisee. Telephone Interview by Jason Parnell, Assistant to the Author, with Andrew A. Caffey, franchisor lawyer, Law Offices of Andrew A. Caffey (June 8, 2012). In those lawsuits, the franchisee argues that the lawyer for the franchisor, as author of the disclosure documents, conspired with the franchisor to create inaccurate disclosure documents designed to mislead franchisees. *Id.* Although in most, if not all, situations franchisors' lawyers only acts as an agent for their clients, the franchisees' attorneys are, as a tactical matter, naming those lawyers as parties in order to squeeze money out of the lawyers' insurance companies. *Id.* According to the practitioner, "It is an ugly business—but a real one—that is plaguing those who practice franchising law." *Id.*

188. *See* RESTATEMENT (THIRD) OF AGENCY § 8.14 (2006).

189. *See id.* cmt. b ("In general, a principal's obligation to indemnify an agent arises when the agent makes a payment or incurs an expense or other loss while acting on behalf of the principal.").

Unfortunately for the principal-franchisor, if the agent-lawyer violated their duty to the franchisee, assuming a duty has been established through the third-party beneficiary principle or otherwise under the *Restatement (Third) of the Laws Governing Lawyers*,[190] the franchisor could be held liable in addition to the lawyer.[191] However, if the lawyer owed the franchisee no duty of care, then the franchisor alone would bear any liability for negligence.[192] Yet, the franchisor may then have a claim against the lawyer for legal malpractice if the lawyer breached his duties owed to the franchisor.[193] Nevertheless, even if the lawyer breaches their duties to the franchisor, this is not an independent basis for the lawyer's tort liability to the franchisee.[194]

Therefore, for purposes of this discussion, although the franchisor and franchisee owe fiduciary duties to each other, the franchisor's lawyer does not automatically assume a fiduciary relationship with the franchisee as well. Rather, the lawyer only owes the nonclient fiduciary duties in limited circumstances, such as if the lawyer were to explicitly create an attorney-client relationship with the franchisee or, more realistically, if the franchisee is a third-party beneficiary for the attorney's legal advice. Only in these limited circumstances would the franchisor's lawyer be liable to the franchisee in a legal malpractice claim. If franchisees were generally able to hold franchisors' attorneys liable, this would undermine the most fundamental purposes underlying the attorney-client relationship: ensuring that lawyers are zealous advocates for their clients, and enabling lawyers to maintain the confidentiality of communications between themselves and their clients. If lawyers owed a duty of care to their opposing party, for example, the franchisee, this likely would prevent them from effectively representing their actual clients. Additionally, it

190. *See* Robert W. Emerson, *Franchisee Protection Via Professional Responsibility Standards* (Aug. 15, 2013) (unpublished manuscript) (on file with author); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 51 (2000) (describing duty of care a lawyer owes to nonclients, prospective clients, and clients).

191. *See* RESTATEMENT (THIRD) OF AGENCY § 7.03 (2006) (describing principal's liability for tortious act of agent); *see also id.* § 7.01 (describing agent's liability for tortious act to a third party).

192. *Id.* § 7.02 ("An agent is subject to tort liability to a third party harmed by the agent's conduct only when the agent's conduct breaches a duty that the agent owes to the third party.").

193. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 49 (2000) (discussing civil liability of lawyer to client for professional negligence and breach of fiduciary duty).

194. *See* RESTATEMENT (THIRD) OF AGENCY § 7.02 (2006).

could force lawyers to disclose confidential information in order to defend themselves in negligence claims brought by these nonclients.

In the event that an experienced, counseled franchisor takes advantage of an unrepresented franchisee, that franchisor would likely do so during the contract negotiation process.[195] Neither section 201 of the Uniform Franchise and Business Opportunities Act nor section 205 of the *Restatement (Second) of Contracts* specifies that the franchisor owes the franchisee a duty of good faith and fair dealing during the process of forming the contract.[196] Nonetheless, the comments accompanying this section note, "Bad faith in negotiation, although not within the scope of this Section, may be subject to sanctions."[197] Violations of good faith and fair dealing during the negotiation of a contract could result from the presence of such factors as incapacity to bargain,[198] duress,[199] misrepresentation,[200] undue influence,[201] or unconscionability during the negotiation process.[202]

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195. Franchise negotiations can include everything from procedural rights to business terms. Telephone Interview with Lee J. Plave, *supra* note 92. For example, a franchisee may be able to negotiate rate structure and renewal. Telephone Interview with Robert T. Joseph, *supra* note 72. Negotiations will depend on the market, the type of franchisor, and other market-related issues. *Id*. Some franchisors will negotiate and some will not. Telephone Interview with Lee J. Plave, *supra* note 92. Moreover, some franchise lawyers believe that it is easier for a franchisee to negotiate with a new franchisor than an older, more established one. Telephone Interview with Robert T. Joseph, *supra* note 72. Similarly, franchisees may have more success negotiating procedural terms rather than attacking the basic economic terms of the franchise agreement. *Id.* Rarely, however, will franchisors negotiate terms—procedural or otherwise—that plainly work to their detriment. Telephone Interview with Lee J. Plave, *supra* note 92.

196. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) (imposing "a duty of good faith and fair dealing in [the] performance and . . . enforcement" of a contract, which implies that a contract has already been established between the parties); *see also* UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 201 cmt. 1 (1987) (noting that the duty of good faith and fair dealing "does not apply in the give and take of bargaining preceding the formation of the agreement" and "is not intended to eliminate risk").

197. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. c (1981). These comments would also apply to the Uniform Franchise and Business Opportunities Act because comment 1 accompanying section 201 states that the section follows the principles espoused in section 205 of the Restatement of Contracts. *See* UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 201 cmt. 1 (1987).

198. *See* RESTATEMENT (SECOND) OF CONTRACTS § 14 (1981).

199. *See id.* § 175.

200. *See id.* § 164.

201. *See id.* § 177.

202. *See* UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 106 (1987). For more on unconscionability—that a franchise agreement between represented franchisors and uncounseled franchisees is sometimes grossly unfair, both procedurally and substantively, because of unequal bargaining power between the parties—see *infra* Part IV.B.

In *Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, the plaintiff-franchisor sued the franchisee for trademark infringement.[203] The defendant-franchisee counterclaimed by asserting that the franchisor had terminated the franchise in violation of the franchise agreement.[204] In reaching its decision, the court recognized that parties to a contract owe each other the duties of good faith and fair dealing.[205] Illinois case law precedent had previously defined this duty as "'a determination of commercial reasonability,'" which ultimately gave judges "carte blanche to declare contractual provisions negotiated by competent adults unreasonable and to refuse to enforce them."[206] The *Cookie Co.* court refused to follow this precedent. Rather, in a 2-1 decision by Judge Richard Posner, the court held, "There is no blanket duty of good faith; nor is reasonableness the test of good faith."[207]

Although parties to a contract owe each other the duty of good faith, that duty "does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper."[208] The court found that if parties to a contract were their

203. 970 F.2d 273, 275 (7th Cir. 1992). Franchisor claimed that the franchisee continued to sell their product under their name after the franchisee's franchise terminated. *Id.*

204. *Id.* Defendant also claimed a violation of the Illinois Franchise Disclosure Act. *Id.*

205. *Id.* at 279.

206. *Id.* at 280 (citing Dayan v. McDonald's Corp., 466 N.E.2d 958, 973 (Ill. App. Ct. 1984)).

207. *Id.*

208. *Id.* In a strongly worded dissent, Judge Richard Cudahy concluded that the majority engages in speculation and ignores business reality and "puts the [franchisees] out of business." *Id.* at 283 (Cudahy, J., dissenting). Noting that the franchisees "have far more to lose than does the [franchisor]," Judge Cudahy opined that the court's factual review "is so lopsided as to be almost droll—if it were not serious business." *Id.* Instead, it was the magistrate judge whose decision the appeals court overturned that had a "detailed probing" of the facts that was "considerably more balanced and fair." *Id.* Equally disturbing to Judge Cudahy was the majority's discussion of the Illinois Franchise Disclosure Act (ILL. COMP. STAT. §§ 705/1–/44):

> Illinois did not enact this law because it thought franchisors were being abused by their franchisees, as the majority seems to believe. Apparently, the legislators had not read enough scholarly musings to realize that any efforts to protect the weak against the strong would, through the exhilarating alchemy of economic theory, increase rather than diminish the burden upon the powerless. I agree that the thumb of judges ought not be placed on the scales of justice. But judges have no obligation to ignore the numerous thumbs already put down on the side of economic power, nor the thumb of the legislature on the other side.

brother's keeper, then this would ultimately impose a fiduciary duty upon the parties, yet "parties to a contract are not each other's fiduciaries—even if the contract is a franchise."[209] The court ultimately defined the good faith duty imposed upon the contractual parties *not* as one that is "reasonable" but rather as one that does not take "advantage of gaps in a contract in order to exploit the vulnerabilities that arise when contractual performance is sequential rather than simultaneous."[210] Only a violation of the latter would be considered acting in "bad faith" and render the contract, or a provision within, unenforceable.[211]

Here, the court held that this would have been considered unconscionable had the franchisor attempted to take advantage of the vulnerability of an unsophisticated franchisee.[212] However, the court found that such was not the case and ruled that the franchise agreement was not unconscionable.[213] The court further noted that, although contract law prohibits parties from acting unconscionably, the law "does not provide remedies for spiteful conduct or refuse enforcement of contractual provisions invoked out of personal nastiness."[214] This principle

Id.

209. *Id.* at 280 (majority opinion) (citations omitted).

210. *Id.* (citing Market St. Assocs. Ltd. Partnership V. Frey, 941 F.2d 588, 593–96 (7th Cir. 1991)).

211. *See id.* As the court similarly noted in *Morin Bldg. Prods. Co. v. Baystone Constr., Inc.*, 717 F.2d 413, 415 (7th Cir. 1983), a contract was established in bad faith, "not because any provision of the contract was unreasonable and had to be reformed but because a provision had been invoked dishonestly to achieve a purpose contrary to that for which the contract had been made." *Id.*

212. *See id.* This could have been accomplished if the franchisee had built an extremely profitable franchise and the franchisor, looking to appropriate the franchisee's profits, determined to cancel the franchise agreement based on the franchisee's trivial violations of the agreement. *See id.*

213. *Id.* at 281. The court held,

> Not only were many of the violations not trivial, but there is no suggestion of exceptional performance by the [franchisee]. True, it was a new franchise, and it has been doing well ever since the incompetent manager was booted out; but it is in a prime location, and the company in negotiating the terms of the franchise rated it a "good" franchise—one very likely to do well.

Id. at 280. Moreover, the court found that the franchisor was not attempting to take over the franchise in this case. *Id.*

214. *Id.* At oral argument, the franchisee's lawyer denied that the franchisor had behaved opportunistically and instead attributed the franchise's termination to the spite of a franchisor officer. *See id.* The court cited *Proimos v. Fair Auto. Repair, Inc.*, 808 F.2d 1273, 1275 (7th Cir. 1987), noting "[t]hough a number of states do recognize liability in cases where out of pure spite a landowner builds a fence that blocks his neighbor's light or view." *Id.* at 280–81.

does not replace the duty of good faith, which protects parties to a contract against opportunistic behavior by the other party.[215]

The court established a connection between the terms *unconscionability* and *commercial reasonableness*.[216] While the former is intended to "prevent overreaching at the contract formation stage," the latter infers "that no one in his right mind would have agreed to" the terms of the contract as presented.[217] The court noted that, although it is valuable to consider whether a contract is commercially reasonable in determining whether a contract is unconscionable, to find that a contract is commercially unreasonable does not mean that it is also automatically unconscionable.[218]

Clearly, sustaining an action for a breach of the covenant of good faith and fair dealing is not an easy task. For example, in *Barnes v. Burger King Corp.*, the franchisee, Zuri Barnes, signed a franchise agreement with the franchisor, Burger King Corportion (BKC), to operate a Burger King franchised restaurant.[219] However, after Barnes allegedly was compelled to close his restaurant,[220] he brought an action against BKC claiming, among other things, a breach of the implied covenant of good faith and fair dealing.[221] Barnes argued that BKC breached this covenant by allowing another Burger King franchise to open in close proximity to its franchise location.[222] The court disagreed.[223]

The *Barnes* court acknowledged "that Florida contract law recognizes the implied covenant of good faith and fair dealing in every contract."[224]

215. *Id.* at 281 (noting that the duty of good faith is intended to prevent opportunistic behavior, which is "designed to change the bargain struck by the parties in favor of the opportunist[]"). The *Cookie Company* court found that the franchisee failed to establish any opportunistic behavior on the part of the franchisor. *Id.*

216. *See id.* The court also noted that unconscionability is closely allied to "fraud and duress." *Id.*

217. *Id.*

218. *See id.*

219. 932 F. Supp. 1420, 1422 (S.D. Fla. 1996).

220. Barnes argued that he was forced to close his franchise because of substantial losses in profits he suffered as a result of another Burger King franchise operating five blocks from Barnes's franchise in downtown Los Angeles, California. *See id.* at 1424.

221. Barnes's complaint against BKC consisted of eight counts, including fraud in the inducement, violation of the Florida Franchise Act, violation of the Florida Sale of Business Opportunities Act, breach of the implied covenant of noncompetition, breach of the implied covenant of good faith and fair dealing, breach of contract, promissory estoppel, and a request for permanent and injunctive relief. *Id.*

222. *Id.* at 1437.

223. *See id.*

224. *Id.* at 1437–38.

However, the court also noted that there are limits to the application of the covenant "and there are many circumstances under which courts will not allow a party to pursue a cause of action for breach of the implied covenant."[225] The *Barnes* court identified two such circumstances: "[W]here application of the covenant would contravene the express terms of the agreement [and] where there is no accompanying action for breach of an express term of the agreement."[226]

For the first factor or circumstance, the court held that the "implied covenant of good faith should not be invoked to override the express terms of the agreement between the parties."[227] Here, the court found that application of the covenant would not supersede the express terms to which the parties had agreed because the franchise contract between Barnes and BKC expressly permitted BKC to open additional franchise restaurants in the vicinity of Barnes's franchise.[228] Thus, the court would "not enforce Barnes'[s] claim for breach of the implied covenant of good faith based on [BKC's] opening of an additional franchise in derogation of those express terms."[229]

As for the second factor, the court cited precedent establishing "that a claim for breach of the implied covenant of good faith and fair dealing cannot be maintained under Florida law absent an allegation that an express term of the contract has been breached."[230] Thus, Barnes would only be permitted to maintain a claim for breach of the implied covenant of good faith and fair dealing if he could sustain a claim for breach of at least one of the expressed terms in the franchise agreement.[231] The court found that "the unambiguous terms of the Franchise Agreement adequately establish[ed] that [BKC was permitted to] open additional franchises in the vicinity of Barnes'[s] franchise."[232] Accordingly, Barnes's claim for

225. *Id.* at 1438.

226. *Id.*

227. *Id.*; *see also* Robert W. Emerson, *Franchisees in a Fringe Banking World: Striking the Balance Between Entrepreneurial Autonomy and Consumer Protection*, 46 AKRON L. REV. 1, 45–46 (2013) (discussing the *Barnes* case with regard to materiality, disclosures, objective standards, and alleged fraud).

228. *See Barnes*, 932 F. Supp. at 1438.

229. *Id.*

230. *Id.* at 1439 (citing Burger King Corp. v. Weaver, No. 90-2191-CIV-MARCUS (S.D. Fla. 1995), *aff'd*, 169 F.3d 1310 (11th Cir. 1999)); *see also* Alan's of Atlanta, Inc. v. Minolta Corp., 903 F.2d 1414, 1429 (11th Cir. 1990) (holding the covenant is not an undertaking that can be breached apart from expressed contract terms); Burger King Corp. v. Holder, 844 F. Supp. 1528, 1530 (S.D. Fla. 1993) (holding the implied covenant of good faith and fair dealing is not actionable absent a breach of the contract's express terms).

231. *Barnes*, 932 F. Supp. at 1439.

232. *Id.*

breach of the implied covenant of good faith and fair dealing failed as a matter of law.

As *Barnes* demonstrates, the two-pronged test to sustain an action for breach of the implied covenant of good faith and fair dealing is a high standard. Potentially, the easiest way for a franchisee to meet the burden is to claim that the franchise agreement is an adhesion contract or is essentially unconscionable. If the franchisee can sustain this claim, then the franchisee would be able to bootstrap a claim for breach of the implied covenant of good faith and fair dealing. Moreover, courts are more likely to find that a franchise agreement is an adhesion contract or unconscionable than to sustain a breach of the implied covenant.

B. Unconscionable Franchise Agreements and Adhesion Contracts

Franchise agreements present inherent dangers to franchisees, namely that franchisors can offer to unsophisticated franchisees an uneven agreement.[233] However, an uneven agreement does not go without repercussions. Courts will examine the fairness of the agreement from the point in time that it was negotiated, rather than focus solely on the relationship between the parties after the agreement has been signed.[234] In addition, after the agreement has been signed, the franchisor will owe an implied duty of good faith and fair dealing to the franchisee.[235] Furthermore, if the franchisor attempts to uphold a clause of the agreement and the franchisee disapproves, there could be a court battle to determine whether the agreement is unconscionable.[236]

233. *See* Am. Nursing Care of Toledo, Inc. v. Leisure, 609 F. Supp. 419, 431 (N.D. Ohio 1984); *see also* Joel Iglesias, Comment, *Applying the Implied Covenant of Good Faith and Fair Dealing to Franchises*, 40 HOUS. L. REV. 1423, 1453 (2004) (discussing the ability of franchisors to draft agreements to better control the franchise, leaving franchisees "with few options for self-protection").

234. *See* Lee A. Rau, *Implied Obligations in Franchising: Beyond Terminations*, 47 BUS. LAW. 1053, 1065 n.75 (1992) (citing RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981)).

235. *See* Frank J. Cavico, *The Covenant of Good Faith and Fair Dealing in the Franchise Business Relationship*, 6 BARRY L. REV. 61, 66 (2006) (stating the contractual duties owed by the franchisor to the franchisee).

236. *See id.* at 99. The article gives an example about an arbitration clause: "Moreover, if an arbitration clause in the franchise agreement is too one-sided, for example, by requiring the franchisee but not the franchisor to arbitrate, a court may strike the arbitration clause down as an 'unconscionable' one." *Id.* at 98. It should also be noted that some courts find that unconscionability should be applied at the contract formation stage to prevent overreaching before the agreement is formed. *See* 8 SAMUEL WILLISTON

Frequently, courts will presume franchise agreements to be adhesion contracts because the "parties are in unequal bargaining positions, and the provisions are highly favorable to the franchisor while offering the franchisees little protection."[237] For example, in *American Nursing Care of Toledo, Inc. v. Leisure*, the court was presented with the issue of whether a franchise agreement between a franchisor and a franchisee was terminated and replaced by an oral agreement between the parties, as claimed by the franchisee.[238] In reaching its decision, the court noted that it would "exercise great caution in construing and applying the provisions of the license agreements in question" because of the disproportionate bargaining power of the parties inherent to franchise agreements.[239]

However, some courts are more reluctant to find that franchise agreements are inherently adhesion contracts. Unlike consumer contracts where only one party—the business—would be considered sophisticated, franchise negotiation may bring at least a marginally sophisticated businessperson to even the presumably weaker end of the bargaining table—the franchisee's position. Thus, although courts may be willing to find that regular consumer contracts are unconscionable or adhesion contracts because of the disparate bargaining power between the parties, courts may be less inclined to find such unequal bargaining power between franchisors and franchisees. This result may be because franchisees receive federally mandated disclosures from the franchisor or

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& RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 18.8 n.7 (4th ed. 2010) (quoting Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 281 (7th Cir. 1992)). These courts analyze whether the franchisor took advantage of the franchisee's ignorance or desperation prior to signing the contract "to force unreasonable terms upon them." *See id.* (quoting *Cookie Co.*, 970 F.2d at 281).

237. 62B AM. JUR. 2D, *supra* note 110, § 174; *see also* Spandorf & Krakus, *supra* note 33, at 1 (citing Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931, 939 (9th Cir. 2001); Bolter v. Super. Ct., 104 Cal. Rptr. 2d 888, 893 (2001)) ("Franchise law has long characterized franchise agreements as adhesion contracts.").

238. *See* 609 F. Supp. at 426. The franchisor claimed that no such agreement was ever concluded. *Id.*

239. *Id.* at 431. The court held that there was no oral agreement that superseded the written franchise agreement as contended by the franchisee. *Id.* at 426. The court also noted that "[a]ll parties understood that a fair price would be paid for equity interests, but the parties never proceeded to the point of setting a definitive price or number of shares." *Id.* Additionally, "[t]he franchisees were represented by counsel through these discussions." *Id.* The court ruled in favor of the franchisor, holding that the franchisee breached the franchise agreement. *See id.* at 431–32. However, the court was unwilling to enforce the provision that stipulated the franchisee could not compete with the franchisor because the franchisor failed to establish that the time and area these covenants covered was reasonable. *See id.* at 433. For a review of franchise-related noncompetition agreements, see Robert W. Emerson, *Franchising Covenants Against Competition*, 80 IOWA L. REV. 1049 (1995).

other protections through state franchising laws.[240] The receipt of disclosures and the existence of state law protections may somewhat supplement, but certainly does not replace, the effect and benefit of a franchisee having an attorney at the negotiating table.

Yet, courts still seem reluctant to provide franchisees with more protection. For example, similar to *Cookie Co.*, where the court concluded that the franchisees were sophisticated businesspersons, the Seventh Circuit found a franchise agreement's arbitration clause to be enforceable because it did not create an unfair surprise to the franchisee.[241] In fact, in *We Care Hair Development, Inc. v. Engen*, the court cited *Cookie Co.* and found that the franchisees were "'not vulnerable consumers or helpless workers,' but rather 'business people who bought a franchise,'" and they were not "forced to swallow unpalatable terms."[242]

240. *See, e.g.*, 16 C.F.R. §§ 436.1–.11 (2014); ARK. CODE ANN. § 4-72-206 (2013); CAL. BUS. & PROF. CODE § 20010 (West 2014); CONN. GEN. STAT. ANN. § 42-133f(f) (West 2010); D.C. CODE § 36-303.01(a)(9) (LexisNexis 2011); HAW. REV. STAT. § 482E-6(2)(F) (2008); IND. CODE § 23-2-2.7-1(5) (2013); IOWA CODE ANN. § 523H.4 (West 2007); MD. CODE ANN., BUS. REG. § 14-226 (LexisNexis 2010); MICH. COMP. LAWS ANN. § 445.1527(b) (West 2002); MINN. R. 2860.4400(D) (2013); NEB. REV. STAT. § 87-406(1) (2008); N.J. STAT. ANN. § 56:10-7(a) (West 2012); S.D. CODIFIED LAWS § 37-5A-86 (repealed 2008).

241. *See* We Care Hair Dev., Inc. v. Engen, 180 F.3d 838, 843 (7th Cir. 1999). The court noted, "Before signing the franchise agreement and the sublease, each franchisee was provided with a copy of the uniform offering circular which clearly disclosed that the leasing company could bring eviction proceedings for any breach of the sublease, including a breach of the franchise agreement." *Id.*; *cf.* Nagrampa v. MailCoups, Inc., 469 F.3d 1257, 1282 (9th Cir. 2006). The *Nagrampa* court held,

> Although franchise agreements are commercial contracts they exhibit many of the attributes of consumer contracts. The relationship between franchisor and franchisee is characterized by a prevailing, although not universal, inequality of economic resources between the contracting parties. Franchisees typically, but not always, are small businessmen or businesswomen or people like the [defendants] seeking to make the transition from being wage earners and for whom the franchise is their very first business. Franchisors typically, but not always, are large corporations. The agreements themselves tend to reflect this gross bargaining disparity. Usually they are form contracts the franchisor prepared and offered to franchisees on a take-it- or leave-it basis.
>
> Franchising involves the unequal bargaining power of franchisors and franchisees and therefore carries within itself the seeds of abuse. Before the relationship is established, abuse is threatened by the franchisor's use of contracts of adhesion presented on a take-it-or-leave-it basis.

Id. (quoting Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 373–74 (1996)).

242. *We Care Hair*, 180 F.3d at 843 (citing Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 281 (7th Cir. 1992)). For

Further, in *Choice Hotels International, Inc. v. Chewl's Hospitality, Inc.*, the U.S. Court of Appeals for the Fourth Circuit defined a contract of adhesion as "one that is 'drafted unilaterally by the dominant party and then presented on a take-it-or-leave-it basis to the weaker party who has no real opportunity to bargain about its terms.'"[243] Here, the court made an explicit distinction between consumer contracts and commercial contracts and found that franchise agreements fall within the latter category.[244] The court cited the trial court's findings that the defendant franchisee was "not an unsophisticated consumer," but rather "an experienced hotel franchise owner, having purchased at least one other franchise in the past," and held that the franchisee could not demonstrate that these findings were clearly erroneous, an extremely high standard to meet.[245] Thus, the court held, as the *We Care Hair* court did, that the arbitration clause included within the franchise agreement was not unconscionable.[246]

discussion of holdings that alleged franchisees are in fact mere employees, such as in *Awuah v. Coverall N. Am., Inc.*, 707 F. Supp. 2d 80, 85 (D. Mass. 2010), see Robert W. Emerson, *Assessing* Awuah v. Coverall North America, Inc.*: The Franchisee as a Dependent Contractor*, 19 STAN. J.L. BUS. & FIN. (forthcoming 2014). For a discussion on the idea that franchisees and consumers can and should be treated similarly, see Robert W. Emerson, *Franchisees as Consumers: The South African Example*, 37 FORDHAM INT'L L.J. 455 (2014).

243. Choice Hotels Int'l, Inc. v. Chewl's Hospitality, Inc., 91 F. App'x 810, 815 (4th Cir. 2003) (quoting Meyer v. State Farm Fire & Cas. Co., 582 A.2d 275, 278 (Md. Ct. Spec. App. 1990)). This is the definition of adhesion contract in accordance with Maryland law. *Id.* at 815.

244. *See id.*

245. *Id.* The court further noted,

> [The franchisee] has not demonstrated that it had no viable alternatives, or that it faced the possibility of being excluded from the hotel franchise business if it had refused such an arbitration contract. Rather, the facts of this case suggest that [the franchisee] made a conscious decision to contract with Choice Hotels and change its affiliation, because it believed that the Quality Inn mark, as opposed to the Holiday Inn mark, would increase profitability. Further, addendums to the Agreement make clear that at least some negotiations took place before the Agreement was finalized, and that [the franchisee] willingly accepted the burdens of the franchise agreement.

Id.

246. *Id.* In its motion, the franchisee relied on *Ticknor v. Choice Hotels Int'l, Inc.*, which held that an arbitration clause was unconscionable, not merely unenforceable against the franchisee. *See* Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931, 939 (9th Cir. 2001). However, the *Ticknor* holding concerned Montana law, rather than the Maryland law applied in *Chewl's Hospitality*. Under Montana law, an adhesion contract is one that "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter" and is essentially decided "as a matter of public policy." *Id.* (quoting Iwen v. U.S. W. Direct, 1999 MT 63, ¶ 32, 293 Mont. 512, 977 P.2d 989).

Nonetheless, courts may be more willing to find that a franchise agreement is an adhesion contract when counsel represented the franchisor during negotiation, but the franchisee had no such representation. In such instances, franchisors' attorneys draft the franchise agreement, which commonly favor their clients over the nonclient franchisees. However, unbeknownst to many attorneys, "[l]awyers writing standard form contracts for clients to use in recording transactions with parties not represented by counsel have a professional duty to restrain their zeal."[247] Rather, what many attorneys do, while drafting contracts on behalf of their clients, is limit their clients' liability and the adverse parties' procedural rights, such as

> (1) a convenient forum, (2) trial by jury, (3) a public hearing, (4) an impartial judge, (5) one who is accountable to a higher court for his or her adherence to the governing law, (6) exemplary or treble damages if provided by controlling law, (7) provisional remedies such as preliminary injunctions or attachments, (8) the traditional American rule with respect to the taxation of attorneys' fees, (9) the right to conduct a private investigation of possible wrongdoing and gain access to the information of an adversary through the use of modern discovery rules, and (10) the right to participate in a class action.[248]

Although all of these procedural rights can be legally waived by contracting parties, the concern is whether franchisees are waiving these rights without truly understanding what the waiver means. Franchisees may give up rights "before they are engaged in a dispute [and thus before they could] reasonably be expected to contemplate future disagreement."[249] Without the franchisee being represented by counsel during negotiations, the franchisee is even less likely to consider the potential for future disagreements with the franchisor and even more likely to "have little or no bargaining power with the firm that is imposing its business form on [it] as a record of an unnegotiated transaction."[250]

Further, negotiations between a franchisor and franchisee place the franchisee in a delicate situation. Much like a person seeking employment, a franchisee could not easily ask the franchisor or its counsels what rights the franchisee would have if sued by the franchisor.[251] Rather, if a

247. Paul D. Carrington, *Unconscionable Lawyers*, 19 GA. ST. U. L. REV. 361, 361 (2002).
248. *Id.* at 362.
249. *Id.*
250. *Id.* at 363.
251. *See id.* at 366. The article notes that a prospective employee, or likely franchisee for that matter, could ask the prospective employer or franchisor such a

prospective employee or franchisee were to pose such a question, it would not likely be received positively.[252] Prospective franchisees and employees do not ask such questions because they lack bargaining power and fear that they will not become employees or franchisees if they step on the employer's or franchisor's toes.[253] If "small franchisees had the power to secure fair terms, there would be no need for legislation to protect them."[254]

This argument proposed by some scholars would likely not be persuasive in those courts that routinely find franchisees are sophisticated businesspersons who are not forced to swallow the terms of a franchise agreement on a take-it-or-leave-it basis. Rather, these courts are more likely to find that franchise agreements are fair and enforceable because "they are made between business people who are familiar with bargaining and the process of allocating risks."[255] This principle would likely even be true in the situation where counsel does not represent the franchisee during the negotiation process with the franchisor and its counsel. Because courts rarely find commercial contracts unconscionable, an unrepresented franchisee that agrees to an adhesion contract is unlikely to receive judicial protection.[256]

Thus, jurisdictions vary widely in finding that a franchise agreement is unconscionable. Some jurisdictions view franchise agreements as inherently being adhesion contracts, finding that franchisees do not have the same bargaining powers as franchisors. Yet, other jurisdictions find that franchisees are sophisticated parties who are capable of bargaining for terms of the franchise agreement with the franchisors, even if the franchisor was represented and the franchisee was not during contract negotiations with the franchisor. These latter courts have also found that the terms of franchise agreements are generally not drafted on a take-it-or-leave-it basis. Accordingly, they do not see franchisees as being forced to accept unconscionable terms in order to acquire the franchise.

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question, but only if "he was an extraordinary talent in great demand in the employment market." *Id.* at 367.

252. *See id.*

253. *See id.*

254. *Id.*

255. GARNER, *supra* note 13, § 8:37. Moreover, courts will rarely find a commercial contract unconscionable, and are more willing to do so for consumer contracts. *See id.*

256. However, this situation might be different if the franchisee was an individual rather than a business entity. When there are negotiations between two businesses, courts likely will not find the business franchise was composed of unsophisticated parties. Yet, if the franchisee were an individual negotiating with a represented business franchisor, the court may be more willing to find the commercial contract unconscionable. It may also matter whether the individual franchisee had ever owned a franchise before, and whether he possesses other business background. *See id.*

Whether a franchise agreement is viewed as an adhesion contract or a contract negotiated by parties of equal bargaining powers will vary largely by jurisdiction and applicable state case law. Even so, how sophisticated must a franchisee be before courts are likely to find equal bargaining power between the franchisee and the franchisor?[257]

V. HOW REQUIRED DISCLOSURES CAN PROTECT FRANCHISEES

In 2007, the FTC announced revisions to its Franchise Rule (Amended Rule).[258] One year later, the FTC made compliance with the Amended Rule mandatory.[259] As promulgated nearly thirty years earlier, the Franchise Rule initially required that disclosures about a franchise's financial performance include costs, expenses, profits, earnings, and other methods of calculating the financial soundness of the company.[260] However, the Amended Rule does away with the requirements of revealing costs and expenses when making claims about financial performance.[261] Furthermore, the Amended Rule extends the time of the disclosure deadline.[262] The franchisor must submit disclosure documents no later than two weeks before either a payment is made or an agreement is executed, or at any time upon the reasonable request of the franchisee.[263] Additionally, the Amended Rule no longer makes it a requirement to submit the final franchise agreement five days before signing.[264] However, if the franchisor makes material changes to the document, the final agreement must be submitted to the franchisee seven days before signing.[265] Furthermore, the Amended Rule expands the methods for

257. For a discussion of how the Model Rules of Professional Conduct can protect unrepresented franchisees, see Emerson, *supra* note 190.

258. Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444 (Mar. 30, 2007) (codified at 16 C.F.R. pts. 436, 437); *see also* Gerald C. Wells & Dennis E. Wieczorek, *A Road Map to the New FTC Franchise Rule*, 27 FRANCHISE L.J. 105, 105 (2007) (providing an overview of the Amended Rule and its implications for the franchise industry).

259. Wells & Wieczorek, *supra* note 258, at 105.

260. *Id.*

261. *Id.*

262. *See id.* at 106–07.

263. *Id.*; *see also* 16 C.F.R. § 436.2(a) (2013) (setting forth the requirements of the Amended Rule); 16 C.F.R. § 436.9(e) (2013) (same).

264. *See* 16 C.F.R. § 436.2(b) (2013); 16 C.F.R. § 436.9(e) (2013).

265. 16 C.F.R. § 436.2(b). The FTC lists traditional hard copy, fax, CD-ROM, e-mail, or Internet disclosure as ways to submit disclosure documents. *See* 16 C.F.R. § 436.2(c) (2013).

submitting the disclosure to include e-mail or website submissions, followed by any necessary instructions to guide the franchisee in viewing the document.[266] The disclosure documents must be stored for review as well.[267]

The Amended Rule also includes substantial changes to the disclosure document itself. The cover page of the disclosure document must "reference sources of additional background information that prospective franchisees can use in investigating the franchise," "include the e-mail and website for the franchisor," "contain various warnings about document holding periods and other matters," and disclose the investment needed to begin franchise operations and the amount that must be paid to the franchisor.[268] Within the document, the Amended Rule requires franchisors to reveal the name of their parent company and the address of their principal business.[269] Similarly, the franchisor is also required to reveal the names of a "broad range of people" that have "management responsibility" over the company, any actions involving affiliates, any action that is material when considering the number of franchises, and any settlements or litigation finding the company liable after the Amended Rule was enacted.[270]

The franchisor additionally has the responsibility of updating the franchisee on any actions that involved the franchisor as a plaintiff in the last fiscal year.[271] The Amended Rule requires that the franchisor inform the franchisee about how the franchisor will provide assistance in the process of maintaining the franchise, "including advertising assistance, training, operations manuals, and required computer systems."[272] However, the Amended Rule does not require the franchisor to submit financial performance information.[273] Instead, the franchisor must inform the franchisee in the preamble of the disclosure document that the

266. *See* 16 C.F.R. § 436.6(g) (2013).
267. *See* 16 C.F.R. § 436.6(h) (2013).
268. Wells & Wieczorek, *supra* note 258, at 107; *see also* 16 C.F.R. § 436.3 (2013).
269. *See* 16 C.F.R. § 436.5(a)(1) (2013). According to Wells & Wieczorek, the purpose of revealing the parent company is to "alert prospective franchisees of competing company-owned outlets." Wells & Wieczorek, *supra* note 258, at 107.
270. Wells & Wieczorek, *supra* note 258, at 107–08; *accord* 16 C.F.R. § 436.5(c)(1)(i)(B) (2013).
271. *See* 16 C.F.R. § 436.5(c)(1)(ii) (2013). According to Wells & Wieczorek, the "FTC's goal is to give a prospective franchisee more information on the nature and level of disputes within a franchise system." Wells & Wieczorek, *supra* note 258, at 108.
272. Wells & Wieczorek, *supra* note 258, at 108; *accord* 16 C.F.R. § 436.5(k) (2013).
273. *See* 16 C.F.R. § 436.5(s)(1)–(2) (2013).

franchisor chose not to disclose the financial performance information.[274] The Amended Rule updates the use of charts to summarize, in a more concise, reader-friendly manner, the number of outlets and transfers, as well as other information regarding the franchise system.[275] The franchisor also has the responsibility to inform the prospective franchisee of the existence of confidentiality agreements with current franchisees.[276] Franchise associations "created, sponsored, or endorsed" by the franchisor must also be revealed to the franchisee.[277] In regards to outlets, franchisors must reveal:

> [I]nformation for each previous owner of the outlet in the last five years, the ownership period for each previous owner required to be disclosed, the reason for each previous ownership change during the last five years, and the periods when the franchisor retained control of the outlet in the last five years.[278]

Additionally, the franchisor must include more information in the audited financial statements, including the financial statements of the parent company, in limited circumstances.[279] Meanwhile, the Amended Rule gives the franchisor more time to update its audited financial statements.[280] After the document has been submitted, the Amended Rule requires the franchisee to acknowledge receipt of the disclosure document.[281] Lastly, the Amended Rule prohibits waivers of franchisor liability for misrepresentations in the submitted disclosure document.[282]

Although the Amended Rule includes new requirements for disclosure, the Amended Rule does not affect a state's right to include additional requirements for disclosure.[283] For example, Maryland, New York, and Rhode Island kept an old FTC requirement that sets the deadline for disclosure at the date of the first meeting.[284] Many states also have a

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274. *See* 16 C.F.R. § 436.5(s)(2) (2013).
275. *See* 16 C.F.R. § 436.5(t)(1)–(3) (2013).
276. Wells & Wieczorek, *supra* note 258, at 109; *see also* 16 C.F.R. § 436.5(t)(7) (2013) (setting forth the requirement for disclosing confidentiality agreements).
277. Wells & Wieczorek, *supra* note 258, at 109*; accord* 16 C.F.R. § 436.5(t)(8) (2013).
278. Wells & Wieczorek, *supra* note 258, at 109; *accord* 16 C.F.R. § 436.5(u)(1) (2013).
279. *See* 16 C.F.R. § 436.5(u)(1)(v) (2013).
280. *See* 16 C.F.R. § 436.7(a) (2013).
281. *See* 16 C.F.R. § 436.5(w) (2013).
282. *See* Wells & Wieczorek, *supra* note 258, at 110.
283. *Id*. at 105 (quoting 16 C.F.R. § 436.10(b) (2013)).
284. *Id*. at 107.

franchise regulatory agency, which a franchisor must register with and obtain approval from before marketing a franchise business.[285] Furthermore, most states have enacted consumer fraud or deceptive trade practices acts, which allow for a private cause of action for violations of the FTC franchise rules.[286]

Nevertheless, some commentators still argue that more protection for franchisees may be needed. For example, some argue that franchisees should be given more disclosure, or put more bluntly, "straight talk," about the realities of what could happen when the franchisor-franchisee relationship terminates.[287] In contrast, others argue that state consumer protection legislation should expressly include the purchase of a franchise.[288] Additionally, these commentators propose that a private cause of action should be adopted at the state or federal level, which would allow a franchisee to sue its franchisor for misrepresentations or failure to comply with disclosure requirements.[289] This private cause of action would allow recovery of attorney's fees, in addition to damages, to lessen the economic burden of litigation on franchisees.[290]

Overall, the goal of the FTC's Amended Rule and other state law requirements for disclosure statements is to address the issue of unsophisticated franchisees.[291] The myriad of required presale disclosures serves to inform the franchisee of the franchise situation it is about to

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285. Manitoba Law Reform Comm'n, *Consultation Paper on Franchise Legislation*, 8 ASPER REV. INT'L BUS. & TRADE L. 181, 225 (2008) (detailing various differences between state and FTC disclosure laws); *see also* Debra Burke & E. Malcolm Abel II, *Franchising Fraud: The Continuing Need for Reform*, 40 AM. BUS. LJ. 355, 371 (2003) (citing Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1509–13 (1990)) (discussing how some state legislatures grant franchisees a private cause of action for any losses to the franchisee caused by the franchisor's failure to comply with certain state laws).

286. Bryan Schwartz et al., *Response to Consultation Paper on Franchise Law*, 8 ASPER REV. INT'L BUS. & TRADE L. 253, 299 (2008) (detailing ways in which states enforce the FTC franchise rules); *see also* Burke & Abel, *supra* note 285, at 371–73 (listing ways in which state laws enforce FTC franchise rules through private rights of action).

287. *See e.g.*, Am. Bar Ass'n, *Thirty Years of Franchising*, 27 FRANCHISE L.J. 85, 102 (2007) (reporting Rochelle Spandorf's response to an American Bar Association Forum on Franchising questionnaire).

288. *See e.g.*, Burke & Abel, *supra* note 285, at 383–84.

289. *See id.* at 384. Alternatively, these commentators suggest that if a state does not want to create a private cause of action for franchisees, the state should make any violation of federal disclosure laws a violation of the state's Deceptive Trade Practices Act. *See id.*

290. *See id.*

291. *See* Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444 (Mar. 30, 2007) (codified at 16 C.F.R. pt. 436).

sign into.[292] As the existence of such elaborate rules for the negotiation of franchise relationships suggests, unrepresented franchisees are a problem. Franchisees are not only a problem to themselves but also a problem to the system itself, as evidenced by the fact that even franchisors recognize the need for disclosure regulation.[293] By requiring franchisors to submit more information about the franchise, thereby making research into the franchise that much easier for the franchisee, the FTC and state legislators have attempted to protect franchisees from the pitfalls of signing a franchise agreement and franchisors from the economic impact of an unsuccessful franchise.[294]

Public policies supporting franchise disclosure rules ultimately aim to protect the interests of both parties to the contract but particularly those of the franchisee. These policies are not specific to franchise law, though. Consumer, real estate, and marriage laws all favor or mandate disclosures,

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292. James A. Meaney, *Choice of Law: A New Paradigm for Franchise Relationships*, 15 FRANCHISE L.J. 75, 78–79 (1996) (discussing, in part, the role of franchise regulation and disclosures in counteracting the effects of an "informational imbalance").

293. When the FTC surveyed public opinion on the Amended Rule in 2004, the Commission received many favorable comments about the Rule from franchisors. *See* FTC, DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING: STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED REVISED TRADE REGULATION RULE (16 CFR PART 436), at 5–6 (2004). Among the supporting franchisors was Cendant, a publicly traded company that owns several franchise systems, including Howard Johnson, Ramada, Century 21, Coldwell Banker, ERA, and Avis Rent-A-Car. *Id.* Clearly, the Amended Rule not only protects franchisees, but it can also confer broad benefits to honest, ethical franchisors who engage in fair sales practices and thus, continue to survive. That is, these honest franchisors engaging in only ethical practices find it easier to compete in franchisee recruitment when other franchisors play by the rules, too. Other franchisors supporting the Amended Rule included Better Homes & Gardens Real Estate Service, Re/Max Corporation, The Prudential Real Estate Affiliates, Inc., Snap-On, Inc., Little Caesars, The Southland Corporation (7-Eleven), Medicap Pharmacies, Forte Hotels, Atlantic Richfield Company, Papa John's Pizza, and PepsiCo Restaurants—Pizza Hut, Taco Bell, KFC, Inc. *Id.* at 6 n.16.

294. Some practitioners believe that under the current disclosure system, prospective franchisees still do not conduct thorough enough research on the franchises for which they are signing agreements. E-mail Interview by Jason Parnell, Assistant to the Author, with Rupert Barkoff, franchisor lawyer and Senior Counsel, Kilpatrick Townsend & Stockton LLP (May 12, 2012). In some cases, when the lawyer believes the prospective franchisee has performed insufficient research or is seeking counsel too early in the process, the lawyer will not accept the representation and will ask the prospective franchisee to do more research before seeking to hire the lawyer. Telephone Interview by Jason Parnell with Rochelle Spandorf, *supra* note 109. These lawyers recognize that legal representation is expensive and believe that prospective franchisees should do their homework before calling a law firm. *Id.*

perhaps going so far as to require a party to seek counsel.[295] As mentioned earlier, many states have consumer fraud and deceptive trade practice laws that require those who are selling a service or a product to disclose pertinent information to the consumer and not to misrepresent the information.[296]

State consumer protection laws may have implications in other areas of law as well. For example, one type of consumer fraud law can be seen in the Federal Truth in Lending Act, which attempts to shield consumers from misrepresentations by lenders and requires certain information to be disclosed to consumers before they take out a credit card or receive a loan.[297] Furthermore, various states, such as Illinois, have consumer and commercial protection acts that require disclosure of information regarding the purchase or sale of real estate and rentals.[298] Perhaps the strictest of all the protection laws is one that does not concern consumers—marital law. States such as New Jersey and California require not only that pertinent information be disclosed to a party but also that independent legal counsel represent the party or that the right to independent legal counsel be waived before signing various types of marital agreements.[299] If independent legal counsel does not represent a party, there may be a presumption that the contract was not signed "voluntarily" and is therefore unconscionable or void.[300] This same result can be found in the fiduciary context where a transaction between a trustee and a beneficiary may be presumed voidable if the beneficiary does not obtain independent legal

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295. *See, e.g.*, Johnston v. Weil, 946 N.E.2d 329, 335–38 (Ill. 2011) (discussing required disclosure for marriages in Illinois); 1 HOWARD J. ALPERIN & ROLAND F. CHASE, CONSUMER LAW: SALES PRACTICES AND CREDIT REGULATION § 1 (2013) (discussing consumer laws that require disclosure); 54B CAL. JUR. 3D *Real Estate* § 1258 (2013) (discussing real estate disclosure requirements in California).

296. *See supra* note 286 and accompanying text.

297. *See* Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199, 210–11 (2005).

298. *See* Robert W. Gray, *The Applicability of Constructive Eviction, Implied Warranty of Habitability, Common-Law Fraud, and the Consumer Fraud Act to Omissions of Material Facts in a Commercial Lease*, 38 J. MARSHALL L. REV. 1289, 1289–90 (2005) (discussing Illinois consumer real estate protection).

299. *See* CAL. FAM. CODE § 1615(c)(1) (West 2014) (discussing California's requirement that parties to a premarital agreement either retain independent counsel or voluntarily waive the right to do so); Andrew J. Kyreakakis, *Antenuptial Law in New Jersey*, 24 SETON HALL L. REV. 254, 282–83 (1993) (discussing the requirement of independent legal counsel for each spouse dealing with a prenuptial agreement in New Jersey).

300. *See* Judith T. Younger, *Lovers' Contracts in the Courts: Forsaking the Minimum Decencies*, 13 WM. & MARY J. WOMEN & L. 349, 360–61 (2007) (discussing, in part, California marital disclosure laws that require a party to have independent counsel or a waiver to be found voluntary).

counsel.[301] Under these circumstances, merely urging the beneficiary to obtain independent legal counsel will not be sufficient to avoid the presumption.[302]

Whether the Amended Rule has led to the intended effect of sufficiently informed and capable franchisees remains to be seen. In this Author's survey of franchise counsel, 51.1% of respondents claimed that the percentage of franchisees represented by lawyers at closing has stayed about the same in the past ten years.[303] Meanwhile, only 24.1% of respondents claimed the percentage has increased.[304] The change in the number of franchisees seeking knowledgeable counsel may not be enough to meet the public policy goals underlying disclosure laws. If the current disclosure laws are not enough to change the course of uncounseled franchisees, then changes to the number, substance, and enforcement of disclosure laws may need to be considered.

VI. SOLUTIONS TO THE UNREPRESENTED FRANCHISEE PROBLEM

One solution to the issue of unrepresented franchisees is to place liability on the franchisor's lawyer to inform the franchisee of the importance of seeking independent counsel. However, there are strong policy arguments to tread warily before imposing liability on franchisor lawyers for actions not taken with respect to their "opposite"—the *pro se* party buying a franchise.

A. Why Lawyers Should Not Be Liable to Nonclient Franchisees

An argument for imposing liability on the franchisor's lawyer for actions taken towards unrepresented franchisees is that it will encourage full disclosure to franchisees.[305] By requiring lawyers to fully disclose all material information to potential franchisees, it will equalize the discrepant bargaining power between franchisors and franchisees.[306] If

301. *See* GEORGE G. BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES § 544 (2d ed. rev. 2013).
302. *See id.*
303. *Infra* Appendix, Franchise Lawyer Survey, Question 11.
304. *Infra* Appendix, Franchise Lawyer Survey, Question 11.
305. *See* Alexander M. Meiklejohn, *UFOCs and Common Law Claims Against Franchise Counsel for Negligence*, 25 FRANCHISE L.J. 45, 63 (2005).
306. *See id.* This is important because many franchisees are not financially situated to deal with these potential losses. *Id.*

lawyers face the possibility of violating state or federal disclosure laws, then lawyers would likely be more forthcoming with information to potential investors.[307] Additionally, supporters of this policy decision argue that such disclosure will not threaten attorney-client confidentiality because the "lawyer-client privilege should not shield information that the franchisor is legally required to disclose. Nor should it have any application to misleading information contained in a document designed to be read and relied on by third parties."[308]

A second policy reason for imposing franchisor lawyer liability arises from the lawyer's role in the transaction as someone with "greater access to the franchisor and its records," and the amount of reliance placed on it by the franchisee.[309] Throughout the transaction, a franchisee relies on information communicated to it by the franchisor's lawyer and assumes that what the lawyer communicates is legally accurate because the lawyer is better situated to know the relevant and applicable laws regarding the transaction.[310] However, if information provided by the franchisor's lawyer is not legally accurate and the franchisee reasonably relies on it,

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307. *See* Meiklejohn, *supra* note 305, at 63; *supra* Part V. However, in light of the "FTC's limited enforcement resources and the lack of any private right of action under its rule, common law litigation is an important means of ensuring compliance." Meiklejohn, *supra* note 305, at 63.

308. Meiklejohn, *supra* note 305, at 63–64.

309. *Id.* Such reliance may arise simply because the nature of the impending franchisor-franchisee relationship is long term. For singular transactions with little or no continuing relationship, business lawyers may burn bridges to obtain the most profitable outcome for their clients; however, a franchisor attorney's best approach may not be to focus solely on maximizing the franchisor's share of the pie. Instead, for the relational franchise contract, both sides' long-term satisfaction with the arrangement is helpful, if not outright necessary, to meet the best interests of both parties, and franchisors may need to understand that when contracting with an unrepresented franchisee. *See* Andrew C. Selden & Victoria Blackwell, *Franchise Relationship Management*, *in* FRANCHISE LAW COMPLIANCE MANUAL 313, 318 (Jeffrey A. Brimer ed., 2d ed. 2011) (stating, among other things, "if the franchisor's lawyer adequately disclaims on paper an equipment warranty but does not ensure that the franchisee understands the existence or meaning of the disclaimer, the lawyer has done his client no good service when the equipment fails" and the franchisee feels "frustrated" and "aggrieved"). Selden and Blackwell note that franchisor-franchisee transactions are opportunities "to build trust and cooperation" between the parties, and they urge counsel "to remember at all times that the franchisor and franchisee will probably remain in business together at the conclusion of the transaction or dispute and that both share an overriding interest in a healthy and productive system." Selden & Blackwell, *supra*, at 318.

310. Meiklejohn, *supra* note 305, at 63; *see* Mark H. Miller, *Unintentional Franchising*, 36 ST. MARY'S L.J. 301, 389 (2005) (discussing various ways in which franchisor lawyers have a duty to inform both parties that they are participating in a franchise agreement. Miller argues, "The duty of the lawyer includes the obligation to exercise due diligence, including a reasonable inquiry, in connection with responsibilities he has voluntarily undertaken").

the franchisee could subsequently be liable for the actions it takes based upon the inaccurate information, unless the lawyer is held liable.[311]

Similarly, because counsel is closely connected to the franchisors, they are in a better position to advise the franchisors as to what information should be disclosed to the prospective franchisees, which, in turn, will result in more appropriate disclosure to the franchisees.[312] Those who support this position argue that "encourag[ing] collaboration between lawyers and franchisors" will position the lawyer to better "fulfill his or her professional obligation to the franchisor."[313]

On the other hand, many argue that lawyers should not be liable to nonclient franchisees. One reason for this argument is that liability will lead to defensive drafting, which would result in the disclosure of meaningless negative information regarding the franchise system to potential investors.[314] Thus, the more the lawyer has to disclose, the more likely potential investors will shy away from investing—a phenomena seen in other fields of law. This failure to invest is potentially to their detriment, as well as to the detriment of the franchisors and the franchise system in general.[315]

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311. *See* Meiklejohn, *supra* note 305, at 63.

312. *See id.* Arguably, the franchisor's counsel is also in a better position to assess his own liability for the franchisee's reliance on information he provided because of his legal knowledge. For example, the franchisor's attorney already knows that he can be liable for information that the franchisor reasonably relies on to his detriment. *See id.* Because an attorney is generally in a better position to gauge the risk of reliance than the reliant party, he can evaluate what information should be communicated to the franchisee. *See id.* The franchisee, in contrast, is unlikely to fully appreciate the negative impact of his reliance and may not be able to determine what information he needs to request. *See id.*

313. *Id.*

314. One practitioner notes that if more liability were imposed upon lawyers, it would not change his representation of his client. Telephone Interview with Robert T. Joseph, *supra* note 72. It would, however, prompt him to ask the unrepresented franchisee to sign a disclosure, making the franchisee acknowledge that he is not the franchisee's lawyer and that he agrees not to hold the lawyer liable. *Id.* In his opinion, more liability for lawyers would simply mean *more* paperwork for the franchisee to sign, which may, at least in the long run, not really make much of a difference. *Id.* Similarly, another attorney for franchisors says that more liability for lawyers would cause him to issue a *pro forma* statement to unrepresented franchisees informing them that he is not their lawyer. Telephone Interview with Lee J. Plave, *supra* note 92.

315. *See* Bradford Cornell & James C. Rutten, *Collateral Damage and Securities Litigation*, 2009 UTAH L. REV. 717, 719–20 (discussing the harmfulness of overdisclosure in securities law).

Although advocates for franchisor lawyer liability argue that it will result in more adequate disclosure, those opposing it argue that "liability for negligence will not necessarily produce more accurate and comprehensive disclosure[s]."[316] Instead, many lawyers argue that "the result may be simply that [the franchisor's lawyer] will devote substantial amounts of time to documenting their own efforts to ensure accuracy and comprehensiveness," rather than spending the time attending to duties pertaining to the actual client, the franchisor.[317] Indeed, lawyers who prepare disclosure statements in other areas of law, such as those preparing securities disclosures, are able "to reduce their exposure by delegating portions of the work to other professionals."[318]

Additionally, those who argue against liability claim that "[l]iability cannot be justified by reliance on the lawyer's role."[319] Although it is true that the franchisor's lawyer prepares the offering circulars distributed to potential franchisees and that the circulars must be in compliance with applicable investing laws, "the notion that [franchisees] somehow rely on counsel is simply unrealistic if the circular reveals no evidence of the lawyer's participation in the drafting process."[320] Without the franchisee knowing that the lawyer participated in drafting the circular,[321] there is no way to establish that the franchisee relied on the information the attorney supplied to be factually correct or legally accurate.[322]

Further, it is the duty of franchisors' lawyers, like any lawyer, to represent the interests of their clients and not the interests of another party, such as a prospective franchisee.[323] The franchisor's lawyer, therefore,

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316. Meiklejohn, *supra* note 305, at 64 (citing Erik B. Wulff, *Is Franchisor Counsel Subject to Due Diligence Obligations? An Analytical Response*, 4 FRANCHISE L.J. 3, 3 (1985)).

317. *Id.*

318. *Id.* (citing Wulff, *supra* note 316, at 27).

319. *Id.*

320. *Id.* This, of course, is a legal argument and does not take note of the often faulty reasoning of prospective franchisees. As many such people believe they need not consult an attorney or they are capable of representing themselves, it is no stretch to conclude that many prospective franchisees could wrongly assume that a lawyer prepared the circulars and that a franchisee can therefore rely on that lawyer's work—his assistance. *See supra* Part II.C.

321. For example, when there are stock or bond offerings in which the lawyer provides a signed opinion letter to accompany the offering. Meiklejohn, *supra* note 305, at 64.

322. *Id.* Despite these potential risks, countries abroad have also chosen to adopt similar disclosure schemes. France, for example, amplified its franchise regulation scheme in 1999 and requires franchisors to offer circulars to franchisees prior to the sale of a franchise. *See* David J. Kaufmann, *An Overview of the Law of Franchising*, *in* UNDERSTANDING FRANCHISING: BUSINESS AND LEGAL ISSUES 55, 119 (Practising Law Inst. ed., 2001).

323. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (2000) (discussing the duties owed by a lawyer to a client).

will create agreements that are favorable to the interests and objectives of the franchisor.[324] To the extent that such agreements are one-sided, a court will find them to be unenforceable.[325] Although franchisors' lawyers should advise their clients about the risk of such agreements and perhaps offer suggestions to reduce those risks, these efforts are still not aimed at protecting the prospective franchisee. Indeed, there may also be business reasons for avoiding a one-sided agreement, such as the inability to sell franchise opportunities because the franchise agreement is unduly oppressive or simply to foster a good franchisor-franchisee relationship—a relationship that the franchisor lawyer must respect.[326] Nevertheless, these matters are still designed to protect the interests of the franchisor, not the franchisee.

Rather than hold lawyers liable, the courts should encourage potential franchisees "to conduct their own investigations and assessments of franchise systems; to compare systems with one another and with other investments; and to seek expert advice from professionals, including accountants and lawyers with expertise in franchising."[327] If franchisees were able to fall back on holding the franchisor's lawyer liable, they might become less diligent and fail to properly research potential investments for themselves. Also, it would be difficult for courts to determine whether there exist grounds for imposing this liability. Ultimately, courts would be positioned to determine "whether or to what extent negligent drafting has caused a particular loss," and these "[a]fter-the-fact claims of reliance on particular items in a disclosure document will be easy to make and hard to refute, even if untrue."[328]

Another argument against liability is that it would be unfair to hold lawyers liable when the essential information that must be disclosed

324. *See* 62B AM. JUR. 2D, *supra* note 110, § 174 (stating that franchise agreements are written to be "highly favorable to the franchisor" (quoting Am. Nursing Care of Toledo, Inc. v. Leisure, 609 F. Supp. 419, 431 (N.D. Ohio 1984))).

325. *See, e.g.*, Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931, 939–40 (9th Cir. 2001) (finding an arbitration clause in a franchise agreement to be too one-sided and thus unenforceable).

326. *See* Fox & Su, *supra* note 39, at 284 (stating that a franchisee should not form a business relationship with a franchisor when the terms of the franchise agreement are oppressive); *see also* Cavico, *supra* note 235, at 103 (discussing the business benefits of a "rational, reasonable, fair, just, ethical, and honest" relationship between a franchisor and franchisee).

327. Meiklejohn, *supra* note 305, at 64.

328. *Id.*

comes from their clients, the franchisors.[329] If the franchisor fails to disclose information to his attorney, and the lawyer, in turn, fails to disclose the information to the potential investor, the lawyer could be held liable for his client's nondisclosure, even if the lawyer has taken all necessary steps to ensure disclosure of such information.[330] Further, the lawyer "may well lack the resources to ferret out information that the client fails to provide" or "other kinds of expertise necessary to recognize red flags in information that the franchisor provides, such as discrepancies in financial statements."[331]

Many opponents argue that "[l]iability will lead to disproportionately large damage awards."[332] At most, if the franchisor's attorney is liable, it should be under a theory of negligence, not fraud.[333] However, the damages the potential investor may be awarded are of a more punitive nature.[334] The awards are measured by "the difference between the value of a franchise as it was represented and its actual value."[335] Accordingly, if the franchisor does not properly disclose the requisite information to his attorney, and the attorney fails to either diligently pursue this information or spot the warning signs, he may face a substantial damages charge.[336] These damages can accrue not only during the period that the franchisor actively distributes the circular but also anytime the franchisor uses the circular.[337] Thus, the attorney is required "to continually monitor the timeliness and accuracy of the disclosure document's contents, changes in the franchisor's business condition, and the entire franchise program."[338] Failure to do so may result in the attorney's liability for massive damage awards to investors.

Those who oppose holding the franchisor's lawyer liable to the unrepresented franchisee also argue that lawyer liability will have a detrimental impact on the practice of law in general. For example, holding lawyers liable will detract from the loyalties owed to their clients

329. *See* Ronald E. Mallen, *Duty to Nonclients: Exploring the Boundaries*, 37 S. TEX. L. REV. 1147 (1996) (discussing the increase in lawyer liability laws and the hardships on lawyers who may not anticipate a duty arising from the representation of a client).

330. Meiklejohn, *supra* note 305, at 64.

331. *Id.*

332. *Id.*

333. *See id.*

334. *See id.*

335. *Id.*

336. *See id.*

337. *See id.* ("[T]here is no time limit on the franchisor's use of the circular.").

338. *Id.* (quoting Rochelle Buchsbaum Spandorf, *The Case Against* Courtney v. Waring*: An Analytical Response to Due Diligence Proponents*, 11 FRANCHISE L.J. 29, 48 (1991)).

because lawyers will be more likely to "consider their own interests in the disclosure process rather than provid[e] completely disinterested advice to the franchisor."[339] This will likely threaten a client's confidentiality in light of the attorney's "self-protective concerns."[340] Attorneys will be increasingly likely to disclose more information to potential investors for fear of liability, in contradiction of the duties owed to their clients.[341] Therefore, holding lawyers potentially liable to nonclients places them in a position at conflict with the duties owed to their clients.

Lawyer liability to nonclients may also result in an increase in the cost of franchise attorneys' services and the unavailability of legal services.[342] Lawyers facing potential liability may be unwilling to take on the representation of franchisors, or, if they are willing to represent franchisors, they may increase the cost of their services to offset the potential risk the representation poses.[343] Moreover, an increase in the standards of franchising may result in a decrease in the availability of franchise lawyers.[344] In order to avoid liability for nondisclosure, larger-franchised companies may increasingly engage these attorneys to produce disclosure documents,[345] which, in return, may decrease the smaller franchisors' abilities to obtain representation.[346] Further, risk-averse lawyers "may also decline to represent start-up franchisors whose business plans are truly innovative and potentially highly successful but that lack records of success to assure that they will not fail, leaving the lawyers to face angry franchisees."[347] As a result, some would-be franchisees may be deprived of a potential opportunity for success because of this lack of support for franchisor innovation.[348]

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339. *Id.* (citing Spandorf, *supra* note 338, at 51, 53). Such criticisms have long been voiced, particularly in the aftermath of the decision in *Courtney v. Waring*, 237 Cal. Rptr. 233, 239 (Ct. App. 1987), which held a franchisor's lawyer liable to a nonclient. *See* Spandorf, *supra* note 338, at 51–53.

340. Meiklejohn, *supra* note 305, at 64.

341. That would certainly be the case if, in a potential investor's action, the court decides such information might be deemed "material." *Id.*

342. *See id.*

343. *See id.*

344. *See id.*

345. That ultimately shifts the burden from the franchisor to the attorney. Even if the franchisor was liable, the franchisor could seek indemnification from the attorney via a malpractice claim. *See id.*

346. *See id.* at 65.

347. *Id.* (footnotes omitted).

348. *See id.*

B. Why Better Disclosure Requirements Should Be Adopted

Another possibility for addressing the uncounseled franchisee problem would be to create more robust disclosure requirements in franchise law. Rather than place liability on a franchisor's lawyer to inform the franchisee, a solution would be to include more explicit warnings in disclosure documents to impress upon the franchisee the importance of seeking counsel before signing a franchise agreement.[349] Currently, the FTC does not require the franchisor to provide recommendations to the nonclient franchisee to obtain counsel in its disclosure documents.[350] However, as in other areas of law, this type of disclosure could be the key to addressing and combating the various psychological reasons—overconfidence, overoptimism, and general incompetence—behind why franchisees do not obtain counsel, and thus limit the harmful effects of uncounseled franchisees.[351]

Although these personality traits—especially optimism and confidence—can positively affect business ventures, Dunning cautions there is "a dark side to our chronic optimism. It can lead to actual harm."[352] This caution is equally true in the area of franchise law and is a major argument for why better disclosures are needed to impress upon franchisees the need to seek counsel.

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349. One practitioner sees unrepresented franchisees as a less than desirable situation and would prefer to see more franchisees secure representation. Telephone Interview with Robert T. Joseph, *supra* note 72. He does not, however, feel it is his duty to tell the unrepresented franchisee to do so. *Id*. In his view, telling unrepresented franchisees to seek counsel would impose a legal duty upon him that, at least under the current law, does not exist. *Id.*

350. *See* 16 C.F.R. §§ 436–37 (2013). Internationally, however, this is not the case. In Australia, for example, the franchise agreement cannot be signed unless the franchisor receives signed statements from the franchisee stating that the franchisee received independent legal or business advice related to the franchise agreement or chose not to do so. *See Trade Practices (Industry Codes—Franchising) Regulations 1998* (Cth) s 11 pt 2 (Austl.); *see also* Stephen Giles & Rupert M. Barkoff, *Australian Franchise Law: How To Avoid Being a Shrimp on the Australian Franchising Barbecue*, 29 FRANCHISE L.J. 164, 171 (2010) (discussing how franchisors in Australia "must recommend that franchisees seek independent legal and business advice").

351. Even more disclosures may not limit these harmful effects if the franchisees simply fail to read the disclosures. When this occurs, some practitioners question how much the law should protect franchisees who do not read their own contracts. Telephone Interview with Rochelle Spandorf, *supra* note 109.

352. Spiegel, *supra* note 89. For example, Dunning explains, "Doctors, confident that they understand an illness, will fail to refer a patient to a specialist," or "elderly drivers who are brought in for an evaluation [often] say they are above average drivers" but "are four times more likely at the end of the evaluation to be labeled as unsafe as those who are more cautious about their skill." *Id.*

On the other hand, better disclosures for franchise agreements may not be helpful in convincing franchisees to obtain counsel. The same psychological reasons that underlie a franchisee's decision not to seek counsel—overconfidence and over-optimism—may negate the positive effects of better disclosures.[353] People tend to process information in "self-serving" ways, meaning that if an individual is biased towards one viewpoint, that individual may process information to lead to his "desired conclusion."[354] Thus, an overconfident and overly optimistic franchisee may only mentally process information that is favorable to signing the franchise agreement while mentally disregarding any warnings that indicate the contrary. If the public policy of better disclosure is to impress upon the franchisee the need to obtain counsel, but the franchisee does not heed the advice, then better disclosures would be an exercise in futility.[355]

As previously discussed, all parties may suffer from an inexperienced franchisee conducting the transaction without the assistance of counsel. The more obviously aggrieved party is the franchisee itself. Without knowing the business nor the intricacies and requirements of enfranchising a business, it may be venturing down a slippery slope. However, the franchisee is not the only party who may be injured by its actions. Both the franchisor and the franchisor's attorney may suffer from the franchisee's inexperience. If a court decides to protect the franchisee from his inexperience, the entire franchise agreement may be voidable. If the contract is voided, the franchisor's attorney could face repercussions from their client, as well as from the franchisee as a third-party beneficiary to the attorney's services. Essentially, the franchisee's decision to represent itself can produce injurious consequences for all parties involved.

353. *See* Williams, *supra* note 82, at 734–35.

354. *See id.* at 746–47.

355. At least one leading franchise law practitioner agrees. Because franchises are business arrangements with no fiduciary duty, more disclosure may not be effective if the franchisee does not read and, more importantly, understand the disclosure documents. Telephone Interview with Robert T. Joseph, *supra* note 72. According to the practitioner, if the franchisee fails either to read and understand the documents or to obtain a lawyer to assist him in doing so, and later the franchisee sues the franchisor, at the franchisee's deposition the first question the franchisee will be asked is whether or not he received the disclosure documents. *Id.* If the answer is "yes," then he will be asked two questions: whether he read the disclosure documents and, if so, whether he understood them. *Id.* Depending on how the franchisee answers these two questions, he will appear either uninformed or unintelligent, with neither outcome playing in his favor at trial. *Id.*

Furthermore, although requiring better disclosures for franchisees generally favors the plight of the franchisee, it may lead to unintended results, such as harmful market effects to the franchise system. Franchisor lawyer William Killion argues against an interpretation of franchise laws that favors the franchisee.[356] Killion notes that the disparity between franchisors and franchisees may not be a problem but simply market competition.[357] Increasing the regulation of franchises, when current regulation is expansive in its disclosures and franchisees are arguably more sophisticated than ever before, would favor the franchisee by potentially "bail[ing] franchisees out of bad business decisions."[358] Furthermore, Killion believes that expanding regulation of the franchise market will lead to harmful economic results for franchisors, franchisees, and the millions of people who rely upon the franchise system.[359] Often, the actions of the franchisor, which may be harmful to the franchisee, are beneficial to the public, such as the franchisor's bargaining for terms that keep the cost of the franchise's "product" down.[360] In other words, the effects of more franchise regulation, including disclosures, could leave the economy, on balance, in a worse position than before.[361] If public policy is to protect the franchisee, franchisor, and economy from the negative effects of an uneven agreement,[362] and if more regulation will serve to exacerbate the problem in other ways, then perhaps more regulation is not the answer.[363]

Nevertheless, considering the current negative impact of uncounseled franchisees, commentators agree that prospective franchisees need better protection through amendments to franchise laws, by either creating a private right of action or requiring better disclosures.[364] For example,

356. *See* Killion, *supra* note 10, at 24.

357. *See id.*

358. *See id.* at 31.

359. *See id.* at 29.

360. *See id.*

361. However, disclosure can be "conducive to economic efficiency," by ensuring that those who invest in potential franchises are best suited and completely informed of the requirements for franchising. *See* Meiklejohn, *supra* note 305, at 63.

362. *See supra* notes 233–36 and accompanying text.

363. One leading franchise lawyer argues that franchisees are not nearly as unsophisticated as they were forty years ago, and that current laws requiring a franchise disclosure document notifying the prospective franchisee to seek counsel, along with a mandatory cooling off period, are more than sufficient to protect prospective franchisees and prevent overreaching. Telephone Interview with Rochelle Spandorf, *supra* note 109. Thus, if a prospective franchisee is uninformed or without counsel, it is by choice and not some flaw in the current regulations. *Id.* Rules should not automatically place a lawyer at the hip of every businessman or woman. *Id.*

364. Such a proposal is already enforced abroad. For example, in Ontario, Canada, the franchise laws require franchisors to disseminate disclosures to prospective franchisees

Peter C. Lagarias and Robert S. Boulter, partners in Lagarias & Boulter, argue that some form of better franchisee protection is needed, considering the "abuses of the free market economy."[365] Similarly, according to Paul Steinberg and Gerald Lescatre, both involved in franchising operations with Subway Sandwiches and Salads, "[f]ranchise regulation will never serve as a panacea for postsale abusive practices by franchisors."[366] Professors Debra Burke and E. Malcolm Abel II suggest a private right of action explicitly for franchisees who have been misled by a franchisor's misleading statements or failure to disclose; an action that may be both remedial for the franchisee and a deterrent for the franchisor in future franchise negotiations.[367]

Additionally, the argument to increase the number or degree of disclosures to a contracting party is not novel considering the prevalence of disclosure requirements in other areas of law.[368] Based on the rampant use of disclosure rules in consumer, real estate, and marriage law, it may be argued that the best method for dealing with uncounseled franchisees, in conformity with a regulatory framework suitable to providing additional protections, is to require more from the franchisor, such as disclosing more information to prospective franchisees about the importance of seeking independent counsel.[369] New disclosures could take the form of an acknowledgement that the franchisee is fully aware of the potential issues that could arise from not seeking counsel in the franchise negotiation process and the signing of the agreement. The acknowledgement need not constitute the waiver of a franchisee's right to sue the franchisor for misrepresentations or otherwise but should emphasize the need to have lawyers review the documents and thereby negate the current impact of uncounseled franchisees on franchised networks and the courts. The notice would explicitly remind would-be franchisees that what they are

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and also to afford franchisees a private right of action against franchisors for misrepresentation or statutory noncompliance. *See* Arthur Wishart (Franchise Disclosure) Act, R.S.O. 2000, c. P.3 §§ 5(1), 7(1) (Can.); *see also* Kaufmann, *supra* note 322, at 117–18 (discussing Canadian franchise laws).

365. 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, 139 (2010).

366. Steinberg & Lescatre, *supra* note 20, at 313.

367. *See* Burke & Abel, *supra* note 285, at 384.

368. *See supra* notes 295–302 and accompanying text.

369. *See supra* notes 295–302 and accompanying text.

about to sign merits the expert guidance of a franchise attorney.[370] For example, the warning could say:

> Before agreeing to become a franchisee, you should consult with an experienced franchise lawyer. As a practical matter, including a long-term savings of time and money, your hiring that lawyer at the outset is almost always a "must."
>
> Do not trust in your ability, or the ability of others, to decide whether you need a lawyer's assistance for something this important. Just as a new but persistent physical ailment should lead you, as a matter of personal health, to do more than just treat it yourself but to see a medical doctor, so you, when buying a franchise, should not "go it alone." To proceed without a lawyer, you simply do not know enough about this franchise, the legal nature of the franchise documents, and the many relevant laws.
>
> The nature of professional expertise (medicine, law, etc.) is that even an otherwise very smart and experienced individual, if not a professional in that field, needs professional assistance. Also, your lack of training and experience in law likely makes you unable to assess whether and how a legal expert (a franchise lawyer) could help you. So, no matter how smart or experienced you may be generally or even for this particular type of business, you probably cannot accurately weigh the costs of "going it alone" versus paying for legal counsel. Very often in hindsight, a franchisee who failed to hire a lawyer deeply regrets that he or she did not hire a lawyer at the outset.

If properly formulated and distributed, such a warning could operate quite well. Franchisees would not just be better advised; the result would include the beneficial side effects of fairer franchise agreements and reduced litigation.[371]

VII. CONCLUSION

In certain limited instances, the franchisor and its attorney owe an unrepresented franchisee a duty of care during the negotiations of a new franchise.[372] While still owing a duty of zealous representation to his own client, the franchisor's attorney need not myopically fix his gaze upon just his clients. Rather, the attorney must not overlook any unfair consequences of the transaction for an unrepresented franchisee.

370. Australia mandates even more from franchisors in that not only must warnings be given, but prospective franchisees must also, with a signed writing, indicate that they retained independent legal advice or knowingly rejected it. Giles & Barkoff, *supra* note 350, at 169.

371. *See* Giles & Barkoff, *supra* note 350, at 171 (stating that Australia's required warning and acknowledgement by franchisees "may sound unwieldy, or perhaps paternalistic, to U.S. lawyers, but it operates well in practice"). For example, this admonition could be displayed on the cover page of any disclosure document furnished to prospective franchisees.

372. *See* Courtney v. Waring, 237 Cal. Rptr. 233, 239 (Ct. App. 1987).

However, to place the burden of disclosure squarely upon a franchisor's attorney is a drastic, and likely legally inconsistent, conclusion. Considering the conflicts that would arise in holding lawyers liable for failing to inform the franchisee, or, conversely, informing it of too much, such as the franchisor-client's confidential, proprietary information, the solution to the uncounseled franchisee problem comes in the form of a written warning or acknowledgement in the disclosure documents submitted by franchisors to potential franchisees. In this way, a franchisee can be forewarned or put on notice of the importance of obtaining counsel without imposing any substantial duty on a party. Indeed, this method for dealing with uncounseled franchisees conforms to a regulatory framework already emphasizing disclosure between the franchisor and franchisee. More disclosure is a relatively burden-free imposition on franchisors to counter the foibles of falsely confident prospective franchisees ready to make long-term, irrevocable commitments.

Common law contract principles, as evidenced in the *Restatement (Second) of Contracts*, set forth several reasons why a franchisee's lack of counsel often should void an agreement. These reasons include incapacity, undue influence, duress, fraud, and unconscionability.[373] A franchisor should not be permitted to obtain a windfall from dealing with unrepresented franchisees.

Most franchisees cannot rightly be considered sophisticated investors who have knowingly entered into a franchise agreement. Ordinarily, franchisees ought *not* to be bound by the agreement. Indeed, many courts have ruled that when the franchisee has no business experience and reasonably relies on the franchisor's statements to his detriment, the franchise agreement may be voided as if the franchisor intended the mischief to take advantage of the franchisee's inexperience.[374] In these cases, as a practical matter, courts already hold franchisees with business experience to a higher standard than franchisees without that background or knowledge.[375]

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373. *See supra* notes 198–202 and accompanying text.

374. In other words, a court may void the contract, even if there was no wrongful intent on the franchisor's part, only harmful consequences to the franchisee. *See supra* note 300 and accompanying text.

375. *Compare* Payne v. McDonald's Corp., 957 F. Supp. 749, 761 (D. Md. 1997) (noting that reliance on the franchisor's statements was unreasonable due to the franchisee's knowledge of the restaurant business), *with* Fisher v. Mr. Harold's Hair Lab, Inc., 527 P.2d 1026, 1034 (Kan. 1974) (holding that an investor with no background in

The would-be franchisee's need for an attorney is critical. During a franchise's formative stages, however, many franchise applicants simply "go bare," that is, proceed without counsel. Lawyers for the franchisor recognize that this is extremely problematic for the potential franchisee, and that it often impairs the franchise relationship and even the long-term interests of the franchisor. There are psychological reasons behind a franchisee's failure to consult an attorney before proceeding to the bargaining process and investing time and money in a franchise. Many franchisees believe themselves capable of self-representation. If a franchisee thinks it can represent itself, should additional protections be implemented to protect it from its own inexperience? The particularly confounding aspect of this state of affairs is that the investors who most need the assistance of a legal expert are the ones whose limited skills and self-awareness make them the least likely to realize that fact. They misjudge the situation and—much more so than a comparatively sophisticated businessperson—overestimate their ability to understand legal concepts and to negotiate terms. These self-inflicted injuries cannot be remedied without any side effects. Indeed, a cure for such a deep-rooted, psychologically based quandary may be worse than the "disease."[376]

Still, the absence of an obvious systemic solution does not make the predicament any less real; the wisest, most experienced people in franchising—typically franchisors and legal counsel—should openly acknowledge the problem.[377] In some circles, the fact that many new franchisees are unschooled and, in a sense, their own worst enemy is apparently an open secret known to everyone but the franchisees themselves. They, of course, may learn this fact later, but only after they become ensnared in a business or legal dilemma. At this point, however, the damage is already done. Although the franchisees cannot evade responsibility for these problems, which are certainly, in part, their own making, the resultant difficulties often spill over into problems for the system as a whole—the other franchisees and the franchisor itself. Hence, there is, at the very least, the need for more effective notification about the franchisee's need for counsel. Forewarned is, indeed, forearmed.

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business reasonably relied on the franchisor's statements). These cases and principles are discussed in Parts III.A and III.B., *supra*.

376. On the individual level, there is no miraculous balm to treat the injuries incurred due to ignorance. As for a universal perspective, there is no overall solution; for example, one cannot increase the franchisee's opportunity to use her ignorance as an excuse to thereby evade otherwise binding contractual duties without decreasing the ability of franchisors and others to rely on the deals they make with franchisees.

377. More so than potential or new franchisees, these persons are most likely to have superior knowledge and experience.

VIII. APPENDIX – COPY OF SURVEY INSTRUMENT

Figures derived in response are in **bold.**

Dear ___________,

Information and Consent to Survey

My name is _______. I am a business law professor at _______. I am studying the degree to which franchise parties are represented by counsel in the franchise agreement negotiation and signing process. To that end, I have developed a short survey (16 questions), which should take about five to ten minutes for you to complete.

. . . .

The Survey

I understand that you are a lawyer who practices law on behalf of one or more franchisors. You are, I am sure, a very busy professional. As a former litigator, I am quite aware of the pressing demands on a lawyer's time. So, I just want you to know how much I appreciate your time and help. The information you and others provide will, I believe, be most useful.

Please just respond to this e-mail by pressing "Reply," typing your answers directly herein, and then sending your letter back to me at ___________. Again, thank you!

1. In the past two years, while acting on behalf of a franchisor, how many franchise "closings" did you attend or otherwise participate in, supervise, or review? **1607**

By closing, I mean the process in which the franchisor and franchisee, perhaps at a meeting (but not necessarily in such a face-to-face conference), sign the franchise agreement and perhaps related documents. NOTE: If you did not personally attend one or more of the closings but know about those closings in your role as a supervisor of another person acting on behalf of the franchisor, or otherwise in your

role as counsel, please indicate such information (discuss those closings/ transactions) in your answers. Thank you.

2. For how many of these closings from Question 1 was the franchisee represented by counsel? **419 (26.07%)**

The Questions 3-10 now deal with these closings—the number answered for Question 2—in which a lawyer represented the franchisee.

3. How many franchisees had, in your estimate, lawyers who engaged in negotiation of the franchise terms, seeking more favorable terms for the franchisee? **310 — 73.99% of those times (419, answer 2, above) where the franchisee had a lawyer**

4. How many franchisees instead had, in your estimate, lawyers who simply advised the franchisee, but did not negotiate with the franchisor? **104 —24.82% of the times (419, answer 2, above) where the franchisee had a lawyer**

5. If there were one or more franchise lawyers for whom you simply cannot recall their role, between Question 3 and Question 4, please give that number here. **5 (re: franchisees with a lawyer, 1.19% unsure/cannot recall as to whether the lawyer engaged in negotiations or simply advised the franchisee)**

The answers to Questions 3 and 4 and 5 should add up to the number given in response to Question 2.

6. In your estimate, how many franchisees had a lawyer whose quality of representation was (state a number for each of the six answers immediately below)?

Excellent	41 (9.79%)
Very Good	167 (39.86%)
Good	108 (25.78%)
Fair	87 (20.76%)
Poor	16 (3.82%)

The total of the numbers given should add up to the number given in response to Question 2.

7. If you can, for each time period below, state how many of the franchisees had a lawyer who had been their counsel, before the closing, for about that amount of time:

Less than a week	30 (7.16%)
1 to 4 weeks	48 (11.46%)
1 to 6 months	10 (2.39%)
Over 6 months	88 (21.0%)
DID NOT KNOW	243 (58.0%)

The answers to Question 7 should add up to no more than the number given in response to Question 2. If it is less than the answer given to Question 2, the assumption will be that the difference represents those franchisees for which you have no idea about how long their lawyer had represented them. **That is what the 243, above, is.**

8. Concerning the franchisee lawyers' experience with franchising, please give the number of such lawyers with:

A very high level of experience, with many previous times advising prospective franchisees **40 (9.55%)**

Some experience—having represented at least a few other prospective franchisees **53 (12.65%)**

Little experience in franchising, having counseled just one or two franchisees previously **37 (8.83%)**

No such experience before that franchisee **48 (11.46%)**
DID NOT KNOW **241 (57.52%)**

Again, the answers to Question 8 should add up to no more than the number given in response to Question 2. If it is less than the answer given to Question 2, the assumption will be that the difference represents those lawyers for whom you have no idea about their experience with franchising. **That is what the 241, above, is.**

9. Concerning the franchisee lawyers' experience with your particular industry (e.g., hotels, restaurants, hair care, retail stores, real estate, travel), please give the number where the franchisee counsel's level of experience was:

Very high, with many previous times advising clients about matters involving the industry **117 (27.92%)**

Some, having at least 3 or 4 previous clients involved in my industry **61 (14.56%)**

Little, having just 1 or 2 previous clients in my industry **92 (21.96%)**

None before that franchisee **34 (8.11%)**

DID NOT KNOW **115 (27.45%)**

Again, the answers to Question 9 should add up to no more than the number given in response to Question 2. If it is less than the answer given to Question 2, the assumption will be that the difference represents those lawyers for whom you have no idea about their experience with clients in your industry. **That is what the 115, above, is.**

10. For how many years have you practiced law concerning franchised enterprises? **16 years mean; 15 years median**

Questions 11–13 ask for your impressions about the percentage of represented franchisees and the sophistication of that representation?

11. In the past ten years (or however long you have practiced franchise law, if that period is shorter), the percentage of franchisees represented by lawyers at closings has:

Increased **24.1% of respondents (representing 32.05% of franchised units for which there was a response)**

Stayed about the same **51.1% of respondents (representing 67.95% of franchised units for which there was a response)**

Decreased **None of the respondents**

12. In the past ten years (or however long you have practiced franchise law, if that period is shorter), would you estimate that the franchise law sophistication of franchisee lawyers has:

Increased **43.44% of respondents (representing 57.41% of franchised units for which there was a response)**

Stayed about the same **32.22% of respondents (representing 42.59% of franchised units for which there was a response)**

Decreased **None of the respondents**

13. In the past ten years (or however long you have practiced franchise law, if that period is shorter), the business sophistication of franchisees has:

    Increased **53.22% of respondents (representing 70.79% of franchised units for which there was a response)**

    Stayed about the same **21.96% of respondents (representing 29.2% of franchised units for which there was a response)**

    Decreased **None of the respondents**

14. For the closings from Question 1, were any franchisees-to-be the beneficiaries of a standard form contract negotiated by the franchisor and a franchisee association?

    Yes **______ 28.16% of respondents (representing 37.69% of franchised units for which there was a response)**

    No**______46.54% of respondents (representing 62.3% of franchised units for which there was a response)**

15. Do you have any other information you would like to impart? Please write starting here, using as much space as you would like.

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16. Would you like me (the professor) to call or write to you?

I very much appreciate your assistance.