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ABSTRACT

Franchisors sell the American Dream to franchisees, marketing it as an opportunity to effectively "own your own business," while minimizing initial investment. Despite this, franchise agreements often unfairly favor the franchisor—this makes sense considering the need for franchisors to set standards of performance and consistency for the brand; however, this leaves franchisees exposed to unfair and deceitful practices that often are typical of the franchising system. When Franchisors base their corporate franchise model on serving their franchisees and increasing system-wide profitability, franchise systems thrive; however, when franchisors obsess over their own bottom-line, rather than that of the franchisee, it can be detrimental to both parties. The dissonance in the interests of franchisees and franchisors has become more prominent as contemporary advancements are made in the industry. The best franchise systems find a balance between the interests of the franchisor and the franchisee to contribute to overall success. Increasing regulation on the franchise industry and incentivizing franchisors to become more focused on franchisee profitability will allow for greater mutual success and increase the likelihood of long-term sustainability of the franchise model.

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I. INTRODUCTION

Many Americans love nothing more than the combination of a milkshake and a hamburger, and, because of this, most are familiar with the Steak 'n Shake franchise. Steak 'n Shake has become a fan favorite for the value of its offerings under $4.00. Globex was a year-and-a-half-old Steak 'n Shake franchisee with two units and an agreement to build an additional eleven when the franchise owner got into a disagreement with Steak 'n Shake corporate (franchisor).[1] Globex claimed the operating cost to run its Denver-based stores exceeded the costs of other franchisees.[2] Globex alleged these cost pressures required it to charge more than the $3.99 franchisor-mandated maximum pricing to turn a profit. Despite the insistence of Globex, Steak 'n Shake required the franchisee to comply with the $3.99 maximum-pricing menu.[3] When Globex refused to comply, Steak 'n Shake terminated its franchise agreement immediately.[4]

A franchise relationship involves a contract binding two parties: the franchisor and the franchisee. The franchisor establishes the brand, holds trademarks, creates marketing initiatives, etc., while the franchisee pays an initial fee plus royalties to obtain the right to operate under the franchisor's brand name.[5] The franchise model can be divided into two subgroups of relationships: Business Format and Traditional or Product Distribution franchising.[6] The Business Format is the most common – a franchisor provides not only the name and products but with it a complete operating system for the business.[7] In a typical fast-food franchise, the brand provides the franchisee with support in selecting the location, operating manuals, training, brand standards, marketing and business strategy, and more.[8] Traditional or Product Distribution franchising is seen most commonly in manufacturing industries like gasoline and automotive.[9] This paper will focus mainly on Business Format franchising. Approximately 1,500 franchise companies operate in the United States with more than 320,000 retail units.[10] The franchise system in the United States, as well as internationally, is massive.[11] Globally there are approximately thirty-six countries that have laws explicitly regulating franchising, and many other countries have laws indirectly implicating the franchise relationship.[12]

Whether the franchise system is an equal "partnership" remains questionable due to the legal advantages the franchisor often has over the franchisee; however, the relationship is designed to be mutually beneficial.[13] The franchisor benefits from

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1. Steak N Shake Enters. v. Globex Co., LLC, 659 Fed. Appx. 506, 507-08, (10th Cir. 2016).
2. *Id.* at 511.
3. *Id.* at 509.
4. *Id.* at 510.
5. *What is a Franchise?*, INT'L FRANCHISE ASS'N., https://www.franchise.org/faqs/basics/what-is-a-franchise (last visited Sept. 28, 2021).
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. Marc Ballon, *Franchisees Organize to Counter Company Power*, L.A. TIMES (Feb. 23, 2000), https://www.latimes.com/archives/la-xpm-2000-feb-23-fi-1625-story.html.
11. *Id.*
12. *Executive Summary of Franchise Laws Around the World*, DLA PIPER, (2009), https://www.franchise.org/sites/default/files/ek-pdfs/html_page/Executive_Summary_Franchise_Laws_World_1.pdf.
13. Mark Siebert, *The Franchisor/Franchisee Relationship*, ENTREPRENEUR (Apr. 25, 2005), https://www.entrepreneur.com/article/77374.

the franchise model as it minimizes the capital investment to increase their locations and, subsequently, reduces their liability risk for operations within the store.[14] Conversely, the franchisee operates as an independent business owner of sorts who, using the comparatively low entry barrier, benefits from the goodwill the brand has already established.[15] With the global reach of franchising, it would make sense for franchising and the franchisor/franchisee relationship in the United States to be highly regulated; however, outside of pre-contractual disclosure laws, franchising is largely unregulated.[16] This lack of oversight may be partly due to the fact that it would be impossible to contemplate every situation that may occur between the two parties during the term of their agreement, which commonly is an initial term of 10-20 years.[17] Further, courts have ruled that there is no fiduciary relationship between the franchisor and its franchisee; thus, the covenant of good faith and fair dealing becomes the primary way to measure contract performance.[18] Additionally, the franchisor and franchisee may individually have different definitions of reasonableness. In order to decide whether the franchisor acted with good faith and reasonableness, a judge, jury, or arbitrator must make that decision with no real strict guidelines beyond the common law subjective opinion of good faith and reasonableness.[19] In fact, some franchise agreements draft around the implied covenant of good faith and fair dealing and instead look to the business judgment rule.[20] This rule allows the franchisor to ignore the good faith interests of the franchisee and exercise its own discretion on the basis of making a reasonable "business judgment."[21] Due to the widespread enforcement of private arbitration agreements, there is little case law surrounding this rule which leaves franchisees vulnerable to abuse.[22]

Franchisees invest their savings, leverage their personal assets, and risk their families' livelihood when entering these long-term, often one-sided agreements, where franchisors frequently make unilateral decisions based on their own business judgment.[23] Considering these factors, the Franchise Disclosure Document, which provides information to the franchisee about the franchisor, may more aptly be referred to as the Franchise *Disclaimer* Document—suggesting that as long as the

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14. *Franchising*, LUMEN LEARNING, https://courses.lumenlearning.com/boundless-business/chapter/franchising/ (last visited Oct. 24, 2021).

15. *Id.*

16. Mark Abell, *The Franchise Law Review: The Regulation of Franchising Around the World*, THE L. REVS. (Feb 1, 2022), https://thelawreviews.co.uk/title/the-franchise-law-review/the-regulation-of-franchising-around-the-world.

17. Jeff Elgin, *10 Things About Franchise Contracts—Part* 2, ENTREPRENEUR (May 28, 2009), https://www.entrepreneur.com/article/201914.

18. 62B AM. JUR. 2D *Private Franchise Contracts* § 20 (2022).

19. Brian B. Schnell & Ronald K. Gardner, Jr., *Battle Over the Franchisor Business Judgment Rule and the Path to Peace*, DADY GARDNER (Nov. 19, 2015), https://www.dadygardner.com/blog/2015/11/battle-franchisor-business-judgment-rule-path-peace/.

20. *Id.*

21. *Id.* (allowing a franchisor to meet the standard under these provisions, even if other preferable alternatives are available).

22. *Id.*

23. Timothy Noah, *Disenfranchised: Why are Americans Still Buying Into the Franchise Dream?*, PAC. STANDARD, https://psmag.com/economics/disenfranchised-fast-food-workers-quiznos-73967 (last updated Jun. 14, 2017).

franchisor discloses what they may do, they can do, by-in-large, whatever they want.[24]

Improving both government regulation of the franchise relationship and incentivizing good franchisor behavior could address historic and contemporary issues facing all parties to the franchise system. This approach would also help foster the trust and cooperation needed for franchisors and franchisees to fulfill the obligations of their contract and to benefit both parties, while improving the viability of the franchise industry overall.

This article begins with a discussion of current regulations that govern the franchise relationship and then proceeds to address historic and contemporary issues that plague the relationship and franchise system as a whole. Lastly, this article will conclude with suggested remedies to mend the broken relationship between franchisor and franchisee, including government regulation and incentives for franchisors to keep franchisee profitability top of mind.

II. Regulation Of the Relationship

There is a widespread assumption that franchising is heavily regulated.[25] This likely stems from franchisors perpetuating this misconception by promoting the various ways that federal and state governments support franchising. The Federal Trade Commission ("FTC") is considered to be the agency that oversees franchising, while the Small Business Administration provides loan guarantees and programming.[26] The involvement of these groups can lead prospective franchisees to believe there is much regulation and support in the franchising community when, in fact, the relationship is essentially unregulated.[27]

A. Federal Regulation

In the United States, the only federal rule governing franchising is the FTC Franchise Rule governing pre-sale disclosure.[28] This rule requires that franchisors provide prospective franchisees with the information they need to assess the risks and benefits of investing in a franchise.[29] This takes the form of a Franchise Disclosure Document ("FDD"), which must include 23 specific items of information about the franchise and its performance.[30] The rule also prohibits unfair or deceptive trade practices, though it is important to note that the FTC Rule does not include a private right of action.[31] Thus, only the federal government has the authority to enforce the

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24. William L. Killion, *The Modern Myth of the Vulnerable Franchise: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 28 (2008).
25. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, OFF. OF SEN. CORTEZ MASTO, at 8 (Apr. 2021), https://www.cortezmasto.senate.gov/imo/media/doc/Franchise%20Report%20from%20the%20Office%20of%20Senator%20Cortez%20Masto.pdf.
26. *Id.*
27. *Id.*
28. 16 C.F.R. § 436 (2007).
29. *Id.*
30. *Id.*
31. Nixon Peabody LLP, *Key Franchise Laws in USA*, LEXOLOGY (Feb. 8, 2019), https://www.lexology.com/library/detail.aspx?g=61f1312e-970d-434b-9f6b-a83cc621a636.

rule.[32] Further, there is no federal requirement for franchise registration or for post-sale franchise relationship regulation.[33] These vary from state to state.[34]

B. State Regulation

Approximately fifteen states have additional laws that regulate various aspects of the franchise relationship.[35] This complicates the lives of franchisees and franchisors wanting to open stores in multiple states -- for example, while Missouri does not require franchise registration, neighboring Illinois does.[36] Similarly affecting multi-state brands, federal and state definitions of franchise differ.[37] Thus, these franchisors must be aware of each state's franchise act, as the franchise acts of multiple states may apply to a single franchise depending on where the franchise is to be located, the domicile of the prospective franchisee, and the location of the offer and acceptance.[38]

Some states have tried to impose regulatory protections for franchisees, but most of these protections are vague. For example, New Jersey's Franchise Practices Act forbids "unreasonable standards of performance upon a franchisee"; however, the Act does not specify what "unreasonable standards" are.[39] Because of the vague and half-hearted nature of the attempts to regulate the franchise relationship, the relationship goes largely unregulated and relies solely upon the duty of good faith and fair dealing.[40]

III. FRANCHISING: AN INDUSTRY OR A BUSINESS MODEL?

It has long been argued that franchising is not an industry, but rather a way of doing business and that, consequently, increased regulation of franchising would be impracticable.[41] However, as the government has created restraints on private contracts between consenting parties through minimum wage and maximum hour laws, it would be entirely feasible to extend a similar level of protection to franchisees.[42]

Historically, franchising has been based on the development of trust and long-term relationships between two parties.[43] Franchisees were mostly individuals or entrepreneurial couples looking for an opportunity to start their own company and build a generational family business.[44] Successful franchisees began to realize the benefits of investing their assets into multiple locations or even multiple concepts.[45]

32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. Noah, *supra* note 23.
40. *See id.*
41. Donald P. Horwitz & Walter M. Volpi, *Regulating the Franchise Relationship*, 54 ST. JOHN'S L. REV., 217, 220 (1980).
42. *Id.*
43. Dr. Benjamin C. Litalien, *How Franchising Transformed Itself*, INT'L FRANCHISE ASS'N, (Oct. 4, 2019), https://www.franchise.org/franchise-information/franchise-development/how-franchising-transformed-itself.
44. *Id.*
45. *Id.*

As franchisee portfolios began to change, Wall Street recognized the opportunity to invest in franchising.[46] This change in corporate ownership structure resulted in founders leaving brands to be replaced by corporate managers, and significantly affected the way franchisees were courted by franchisors, which morphed into brokers recruiting potential franchisees and educating them through the sales process.[47]

A. The Disadvantage of Franchisees

Concepts that follow a franchise model tend not to have many company-owned locations. McDonald's, for example, owns around seven percent of its stores, while the remaining ninety-three percent.[48] As a result, franchisors often make decisions that, if made by someone with daily operating exposure to the restaurant, likely might have been made differently.[49] Franchising is, at its core, a relationship between franchisors and franchisees of mutual interdependence and reliance.[50] For this mutual interdependence and reliance to thrive, there must exist a cooperative relationship.[51]

Under common law, a court would find little basis for overturning a franchisor's decision to terminate a franchise relationship without cause at the end of one year.[52] Thus, in many situations, a franchisee contributes their sweat equity to building up a brand in their market, only to find their rights to enjoy the fruits of their capital and labor have been unilaterally severed and taken over by the franchisor or a franchisor-appointed substitute at a moment's notice.[53]

Franchisors may selectively choose when to enforce provisions within their Agreements.[54] For example, if a franchisee chooses not to run a promotion that is unprofitable in its region, as in *Steak 'n Shake v. Globex*, or does not meet the speed of service times, it may be stalled from building more locations.[55] In addition, typical franchise agreements allow franchisors ample discretion to require franchisees to participate in any programming they choose, even when the programming adversely affects the franchisee's profitability.[56]

Despite the anecdotal evidence of individual franchisees like Globex, many Americans still see franchising as a gateway to the "American Dream."[57] A study from 2007 found that franchisees had a higher failure rate than non-franchisees on Small Business Administration loans.[58] Though many Americans look at their local Burger King and see a large corporation, it is often (ninety-five percent of the time)

46. *Id.*
47. *Id.*
48. *Franchising* Overview, MCDONALD'S, (Nov. 2021), https://corporate.mcdonalds.com/corpmcd/franchising-overview.html.
49. AJ Beltis, *7 Issues That Harm Franchisor, Franchisee* Relationships, 7 SHIFTS, (Dec. 2019), https://www.7shifts.com/blog/franchisor-franchisee-relationship/.
50. What Is A Franchise*?*, *supra* note 5.
51. *Id.*
52. Rupert M. Barkoff, *Franchise Relationship Regulation: Can Federal Preemption Cure Today's* Inefficiencies, FRANCHISING.COM, (Nov. 2021), https://www.franchising.com/articles/franchise_relationship_regulation_can_federal_preemption_cure_todays_ineffi.html.
53. *Id.*
54. *Id.*
55. Steak N Shake Enters., 659 Fed. Appx. at 506.
56. *Id.*
57. *See* Noah, *supra* note 23.
58. *Id.*

a franchisee owner who is making a single-digit profit margin, while their franchisor counterpart is making upwards of twenty percent.[59]

B. Contemporary Issues in Franchise Relationships

With the emergence of delivery sales, made possible through third-party delivery aggregators, franchisors have made special franchise license agreements for non-traditional units, such as ghost kitchens, presenting new hurdles for franchisees. [60] These often short-term, non-traditional agreements may not require the franchisor to notify nearby franchisees so that they can request an impact study, nor for the ghost kitchen operator contribute to the national advertising fund and run unprofitable price-point promotions.[61] Delivery aggregators may also choose to distribute the order to the ghost kitchen due to longer wait, traffic patterns, or other factors determined by third-party algorithms, even if the traditional restaurant is physically closer.[62] These are all examples of a whole host of contemporary elements that may affect franchisees' ability to honor their trade area agreements and the sales they expected to achieve when they originally built their restaurant. Underperforming sales and the introduction of additional competition into the market can also affect the franchisees' ability to honor trade area agreements, which results in penalties associated with non-performance—many critics agree that some form of regulation needs to come to fruition.[63]

Franchisees expect their trade area to be protected by the franchisor.[64] Historically, this meant that a franchisee would not have another unit open within a certain distance from his existing restaurant, dependent upon specific demographic factors outlined in a franchisors' development or impact policy.[65] Impact policies and studies exist to investigate these potential effects and provide remuneration to the parties affected.[66] When COVID hit, and third-party delivery boomed overnight, many franchisees saw unit sales increase due to the radius and customer access expanding.[67] With delivery being added to the equation, the definition of impact is greatly changing, though these changes are not likely considered in the franchise agreements or development policies.[68] This brings in concerns with cannibalization of gross sales and delivery vicinity—increased revenue will decrease if another restaurant is put in within the delivery radius, as well as delivery aggregators' using complicated algorithms to determine which restaurant should fill the delivery order.[69]

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59. *Id.*
60. Anne Caiola, Brittany Johnson & Andra Terrell, *ABA 43rd Annual Forum on Franchising: W-20 Age of Distribution: Current Issues For Restaurant Franchising*, AM. BAR. ASS'N 11-12 (2020), https://www.americanbar.org/content/dam/aba/events/franchising/2020/w20.pdf.
61. *See generally id.* at 10-11.
62. *See generally id.* at 12.
63. *See generally id.*
64. Michael H. Seid & Joyce Mazero, *Protected and Exclusive Areas in Franchising*, DUMMIES, (Nov. 2021), https://www.dummies.com/business/start-a-business/protected-exclusive-areas-franchising/.
65. *See* Caiola, Johnson & Terrell, *supra* note 60, at 10-11.
66. *See id.*
67. *Id.* at 2.
68. *See generally id.* at 3-4.
69. Caiola, Johnson & Terrell, *supra* note 60, at 3, 11.

Delivery sales have added to the top line, but franchisors and franchisees have not yet ironed out how to mitigate their effect on the bottom line.[70] The fees to delivery companies initially made making a profitable sale difficult.[71] Learnings indicate that the market has been able to bear customers paying more for the convenience of delivery, and so delivery pricing can be increased from regular menu board pricing to make up for the fees paid to the delivery aggregator.[72] Franchisors, however, who control many of these agreements with POS vendors and third-party aggregators, may deny or cap the amount of the increase, thus affecting franchisee profitability.[73]

Also, relative to the increase in third-party delivery, franchisees are subject to many other seemingly arbitrary requirements by their franchisors daily.[74] Franchisees may be required to participate in value or discount and loyalty programs or mandated operating hours that can significantly affect their profitability.[75] They may also be forced to make significant investments in their business without proof of ROI.[76] These often come in the form of mandated equipment and technology packages and facility reimage programs.[77] Franchisors may also mandate training for employees at the franchisee's expense; they may amend their Operations Manual to include new fees or equipment not included in the Agreement, and much more.[78]

C. The One-Sided Nature of Franchise Agreements

Franchise agreements typically contain a variety of provisions that favor the franchisor. Consider the indemnity provision typically included in the average form franchise agreement.[79] It is rare the franchisor will allow for the modification of the form provision.[80] Because franchise agreements often limit available legal recourse, there is little protection offered to franchisees.[81] These limitations may include venue and governing law provisions, arbitration provisions, or provisions barring class-action suits.[82]

70. *See generally id.* at 3.
71. *See id.* at 5-6.
72. *See* Julie Littman, *How Restaurants Are Taking Control of Delivery in 2020*, RESTAURANT DIVE (Jan. 31, 2020), https://www.restaurantdive.com/news/how-restaurants-are-taking-control-of-delivery-in-2020/571489/.
73. *See generally* Caiola, Johnson & Terrell, *supra* note 60, at 5.
74. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, supra note 25, at 7.
75. *Legal Problems with Loyalty* Programs, HILFER LAW (Dec. 7, 2018), https://kbhilferlaw.com/legal-problems-loyalty-programs.
76. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, supra note 25, at 64-65, 68 (listing examples in several states where franchisees were forced to make investments without any proof of ROI).
77. *Id.* at 7.
78. *Id.* at 30, 33.
79. Bryan Dillon & Dean Fournaris, *Indemnification Provisions in Franchise Agreements: How to Draft Them and How to Enforce* Them, AM. BAR ASS'N, (Oct. 2018), https://www.americanbar.org/content/dam/aba/events/franchising/2018/fr_14_paper.pdf.
80. *Id.* at 20.
81. *See generally* Jeffery M. Goldstein, *Top Ten Worst Provisions in a Franchise Agreement*, GOLDSTEIN LAW GROUP, (June 2016), https://www.goldlawgroup.com/top-ten-worst-provisions-franchise-agreement/.
82. *Id.*

Franchisors have the authority to identify approved vendors for food, equipment, packaging, technology, and beverage in order to protect brand integrity and address supply chain issues, particularly for food safety tracking.[83] However, in the process of supplier approvals, there are commonly master agreements entered between approved suppliers and the franchisor, the terms of which are unknown to franchisees, yet may be referenced in individual agreements signed by franchisees.[84] These master agreements may include rebates or special purchasing arrangements from which the brand may benefit based on purchases by its franchisees.[85]

There are several policies referenced in the Franchise Agreement but not explicitly included in the Franchise Agreement.[86] This common practice allows the franchisor to change these types of policies easily and often without filing amendments.[87] These documents might include Operations Manuals or Development and Impact Policies, where compliance can determine a franchisee's status of good standing.[88] If a franchisee is not in compliance with any item in the Operations Manual, which could be the addition of expensive equipment or technology, operating hours, or training requirements, it could be a window of opportunity for a franchisor to default an unwanted franchisee.[89] Also included might be franchisor metrics by which consideration for development is dependent upon the speed of service, customer surveys, or even participation in national marketing programs.[90] Amendments to Development or Impact policies could affect the term or cost of building new restaurants, or even the protected territory area, cost, or findings of a study.[91]

During the summer of 2021, a KFC franchisee, Kazi, won a six-figure jury verdict against the franchisor.[92] The *Kazi v. KFC* case began when Kazi applied to open another store in Pueblo, Colorado, on the north side of town where development was ongoing—his existing store was on the south side.[93] KFC turned him down, saying he did not meet their standard of "growth readiness;" however, shortly after, KFC allowed a different franchisee to open up on the north side.[94] When Kazi received the results of the impact study, facilitated by the franchisor but paid for by Kazi, the results were 13.5 percent.[95] The standard guidelines state that an impact finding of 10-15 percent allows KFC to open the store in the nearby area, while a finding greater than 15 percent would disallow KFC from opening the new store.[96]

83. *See* Chelsey K. Culp III & Rochelle B. Spandorf, *Sourcing Products And Services For The System: Efficiencies And Traps In Supply Chain Management*, AM. BAR ASS'N 10, 22-23, (Oct. 2009).
84. *Id.* at 35-36 (highlighting that franchisees agree to many one-sided terms but are still not fully made aware of all they will be getting into considering these master agreements they are not a party to).
85. *Id.* at 12-13.
86. *See id.* at 13.
87. *Id.* at 14.
88. *See id* at 3.
89. *See id.* at 3-4.
90. *Id.* at 6.
91. *See id.* at 16.
92. Beth Ewen, *Franchisee Kazi Foods Wins Jury Verdict Against KFC*, FRANCHISE TIMES, (July 20, 2021), https://www.franchisetimes.com/franchise_news/franchisee-kazi-foods-wins-jury-verdict-against-kfc/article_e5bc5196-e994-11eb-b1b8-63680f3fcf19.html.
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*

Conducting an additional study independent from KFC, the finding was between 25-30 percent impact.[97] Bruce Rohde, attorney for Kazi, noted that KFC never finds an impact percentage higher than fifteen, a strategy that benefits the franchisor but often hurts franchisees in the impact area.[98]

The jury awarded Kazi $792,239.[99] Rohde, reflecting back on the case, asserted, "I was surprised this one didn't settle. Kazi still has 50 outlets with KFC, so an important relationship that's going to have to endure for a period of years.[100] But mainly, I thought KFC would not want what I'm telling you to come to light. Now the jig is up."[101]

The unfair and deceptive practices demonstrated in *Kazi* are products of one-sided contracts imposed on franchisees who sign a uniform agreement that does not allow them to negotiate terms. Regulation of these types of provisions could bring to light franchise agreements that do not consider the legitimate business interests of the franchisee, nor the importance of the relationship.

D. Franchisee Associations as the "Unionizing" of Franchisees

Franchisee associations are groups independent from the franchisor made up of franchisees that try to represent the system's concerns to the franchisor in a united and organized way.[102] In a system where a franchisee association is welcomed, it can become a brand's most trusted advisor.[103] Franchisee associations can become mutually beneficial by collaborating and negotiating the terms of programs in operations, marketing, technology, development, or menu before they are rolled out to the system.[104] This is a way to vet ideas developed from a desk at a Corporate Headquarters through franchise operators who know what reality is like in the field. Franchisors, historically, were wary of franchisees that joined these associations, seeing it as a "unionizing" of sorts. [105]

Testifying before the House Judiciary Committee's commercial and administrative law subcommittee, former Taco Bell franchisee Darrell Dunafon claimed he "[w]as driven from the system and had [his] livelihood taken from [him]."[106] Dunafon said the franchisor punished him for becoming the president of the restaurant's independent franchisee association.[107] He alleged that Taco Bell denied him the right to open new restaurants to discourage his role in the association.[108]

97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. Rupert M. Barkoff, *Franchise Associations: Nothing to Fear but Fear Itself Usually*, INT'L FRANCHISE ASS'N, (Dec. 12, 2018), https://www.franchise.org/franchise-information/franchisee-associations-nothing-to-fear-but-fear-itself-usually.
103. *See generally id.* (giving the example of YUM! Brands as an instance where the cooperation with a franchisee association led to lower food costs for the brand).
104. *See id.*
105. *Id.*
106. Ballon, *supra* note 10.
107. *Id.*
108. *Id.*

Dunafon sold his stores and subsequently sued Taco Bell, reaching a settlement in 1998.[109]

Many franchisors, like Taco Bell in Dunafon's case, find ways to punish franchisees who join these organizations.[110] Since Dunafon's settlement, Taco Bell, and other franchisors, have become more willing to work with their franchisee organizations.[111] These organizations, when franchisors and franchisees cooperate with one another, can lead to extreme system-wide success and help lead to franchisee and franchisor satisfaction.[112] In fact, the franchisee association for Holiday Inn was guaranteed by the franchisor to have the right to vet all material changes to the system's operations before implementation.[113] When these parties work together, it leads to mutually beneficial solutions.

IV. Remedying The Relationship For Mutual Success

In a memo to commission staff and commissioners in September of 2021, Lina M. Kahn, Chair of the FTC, spoke about two policy priorities for the coming year that will affect the franchisee/franchisor relationship tremendously.[114] The first was regulating business models that "centralize control and profits while outsourcing risk, liability, and costs," considering the "deeply asymmetric relationships between the controlling firm and dependent entities" that can create a dynamic of abuse.[115] The second area is focused on looking at the ways specific contract terms, especially in adhesion-type contracts, may justify unfair or deceptive practices.[116] This "take-it-or-leave-it" type of contract is typical of a form franchise agreement.[117] Franchisors are not keen on changing terms in their agreements and often will not, as they usually have plenty of potential franchisees at any given moment who will be more than willing to sign up to be a part of these agreement terms.[118] Seeing the FTC express commitment to focusing on remedying the issues created by these unfair practices brings franchisees some hope; however, without a formal action plan in place, how the FTC will take on this challenge remains unknown.[119]

A. Roles in the Remedy

1. Congress

Congress could be part of the solution to the franchisor/franchisee issue. By strengthening the laws regulating the franchising process, Congress could substantially improve it from inception to the end of the contract term and provide adequate

109. *Id.*
110. *Id.*
111. *Id.*
112. Barkoff, *supra* note 102.
113. *Id.*
114. *See* Memorandum from Linda Kahn, FYC Chair, to Comm'n Staff and Comm'rs (Sept. 22, 2021) (available at https://www.ftc.gov/system/files/documents/public_statements/1596664/agency_priorities_memo_from_chair_lina_m_khan_9-22-21.pdf).
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*

funding for agencies that ensure fair treatment.[120] In April of 2021, Senator Catherine Cortez Masto (D-Nev.) re-introduced legislation intended to protect franchisees from bad actors in the franchise industry who use these "deceptive" practices when sharing financial information with prospective franchisees.[121] In an effort to sell underperforming or unprofitable businesses, franchisors may conflate or exaggerate their performance in a way that may be misleading to prospective franchisees.[122] The SBA Franchise Loan Transparency Act would require franchisors to provide prospective franchisees with accurate historical revenue and store closure information prior to Small Business Administration (SBA) approval of any loan to the franchisee.[123] This legislation arose out of a report compiled by Cortez Masto, which highlighted the four most problematic areas for franchisee complaints—the areas being unfair and deceptive contracts that give the majority of control to franchisors, lack of transparency in the FDD, overpriced goods and costly kickbacks, and fees charged with little to no benefit.[124]

2. *Federal Trade Commission*

The FTC can support the intentions set forth in their September memo by improving the Franchise Rule and ensuring the accuracy of financial representations in the FDD.[125] They can do this by requiring that the Financial Performance section (Item 19) include disclosures on revenues, costs, and other data for first-year units and more mature units.[126] To demonstrate the lack of federal oversight that currently exists in the franchisor/franchisee relationship, the FTC's enforcement of the franchise rule and the manner in which complaints by franchisees are handled should be revisited and revised.[127] Analysis of these complaints would help identify issue patterns and trends in the relationship so that bad actors can be revealed and reprimanded accordingly. As mentioned earlier, there is no private right of action under the Franchise Rule.[128] Adding a private right of action would supplement the FTC's ability to enforce the Rule, as they currently lack adequate resources.[129] Adding a private right of action to the Franchise Rule would provide franchise owners the right to sue franchise corporations for Franchise Rule violations.[130]

3. *State Governments and the Small Business Administration*

There are, additionally, roles that state governments and the Small Business Administration ("SBA") accurate historical financial data be provided by

120. *Id.*
121. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, supra note 25, at 4.
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* at 37.
126. *Id.*
127. *Id.*
128. Nixon Peabody LLP, *supra* note 31.
129. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, supra note 25, at 36.
130. *Id.* at 5.

franchisors prior to loaning money to prospective franchisees.[131] They could publish loan performance information and refuse to loan to franchisees of franchise corporations that include unfair and deceptive provisions within their agreements.[132] Additionally, state governments can enact state statutes to regulate franchising.[133] Some states, like California, already have strong regulations.[134]

4. Franchisors

The biggest party to remedying the relationship should, realistically, be the franchisors. The franchise corporations are truly in the best position to create change; however, they are not the most motivated.[135] The Coalition of Franchisee Associations (CFA) points to thirteen specific recommendations for franchisors such as freely allowing membership in a franchisee association, ensuring fair dealing, offering a right to earn equity in a business, right to price, and right to transfer.[136] In her report, Cortez Masto notes franchisors should intend to profit from selling franchises rather than relying on the long-term success of franchisees. By treating franchisees as "critical customers," the franchisor is better suited to preserve their business and improve economic resiliency long-term.[137]

There are examples of franchise models where mutually beneficial business decisions have led to great successes for both parties.[138] Cheryl Bachelder, former CEO of Popeyes Louisiana Kitchen, held a policy of treating franchisees as the most important customers of the franchisor.[139] Prior to Bachelder taking on the job, Popeyes had gone through four different CEOs in just seven years.[140] In her first meeting with the franchisees, Bachelder recalled one specific conversation that gave her insight into the strained relationship between Popeyes and its franchisees.[141] A veteran franchisee from Texas said to Bachelder, "Miss Cheryl, don't expect us to trust you anytime soon. We're like abused foster children, and you're just a new foster parent."[142] Through conversations with her franchisees, Bachelder learned that if she wanted to reach guests and increase profitability, she needed to create trust between the brand and the franchisees who have direct access to their front-line workers.[143]

To put this intention into action, she created a ground-breaking policy where her leadership team was bonused on the profitability of franchisees.[144] From 2011 to 2015, Bachelder led Popeyes to a $105 million growth in revenues.[145]

131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.* at 35.
137. *Id.*
138. *Id.* at 18.
139. Cheryl Bachedler, *The CEO of Popeyes on Treating Franchisees as the Most Important* Customers, HARV. BUS. REV., (Oct. 2016), https://hbr.org/2016/10/the-ceo-of-popeyes-on-treating-franchisees-as-the-most-important-customers.
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*

Approximately $24 to $44 million of the net profits went to the franchisor, while the other $60 to $80 million went directly to the franchisees.[146] This increase in profits surely should be enough incentive for franchisors to act with franchisees in mind. As Senator Cortez Masto points out, franchisors make money by selling more franchises, and financially healthy and content franchisees build more units.[147] The franchise system depends on scalability and local management, which yield faster growth and increased profitability and, ultimately, sell for more money.[148] Having successful franchisees that will continue to invest their capital in the right franchise model can be a very successful and powerful expansion proposition for a franchisor.[149]

No matter the role each party plays, the franchise industry needs a better way to ensure franchisees are purchasing viable businesses with provisions that respect the duty of good faith and fair dealing.[150] Franchisors need to shift focus to align their interests with those of the franchisees. Once this is done, the franchisors will be more successful in selling franchises, and the franchisees will benefit from the ongoing profitability of investing in a business that is built on a system of good faith and mutually beneficial business practices. It is important to note that ultimately it is still the responsibility of the franchisee to do its own due diligence before signing a franchise agreement. This due diligence should include talking to current franchisees about the relationship and asking for data to indicate terminations, defaults, renewals, etc. However, franchisees should also be able to trust that the data included in the FDD is accurate and achievable. Because franchising amounts for a massive part of the American economy, enforcing existing and future regulations against deceptive trade practices should be a priority for local and federal governments.[151]

V. Conclusion

In 1998, Bhupinder Baber spent his life savings to open two Quiznos in California.[152] After the franchisor broke an alleged promise to build another store nearby, his sales dropped substantially, and he claimed he was unable to get help from Quiznos.[153] To look for support, Baber formed the Quiznos Franchisee Association for California franchisees to advocate for change within the company.[154] Subsequently, Quiznos terminated both of Baber's franchises, claiming that there were customer complaints and failed inspections.[155] Believing his termination was the result of retaliation, Baber sued.[156] This suit drained Baber of over $100,000 in

146. *Id.*
147. *See Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, *supra* note 25, at 35.
148. *Id.*
149. *See id.* at 41.
150. *See id.*
151. *See id.* at 40.
152. *See also* Noah, *supra* note 23; Sarah Bennett, *Quiznos Bankruptcy May Have Roots in Long Beach Franchisee's Suicide*, LONG BEACH POST, (Mar. 28, 2014), https://lbpost.com/news/quiznos-bankruptcy-may-have-roots-in-long-beach-franchisee-s-suicide.
153. Bennett, *supra* note 151.
154. *Id.*
155. *Id.*
156. *Id.*

legal fees before the arbitration even occurred.[157] Fearing losing whatever little money he had left, Baber walked into the bathroom of a Quiznos and shot himself in the chest in November of 2006.[158] His suicide note, which was made public shortly after, read, "Someone must do something about what Quiznos is doing to the trapped franchisees. I deeply regret getting into Quiznos. I wish I had never heard of them."[159]

Between 2007 and 2017, Quiznos went from having 4,700 U.S. locations to less than 400.[160] This is an unprecedented shrinkage that stemmed from a variety of poor business decisions, namely the low profitability of stores due to volume.[161] Because Quiznos cared more for their own growth than the franchisees' profitability and stability, they sabotaged both.

A franchise relationship involves a contract binding two parties: the franchisor and the franchisee. The franchisor establishes the brand, holds trademarks, creates marketing initiatives, etc., while the franchisee pays an initial fee plus royalties to obtain the right to operate under the franchisor's brand name. At face value, this relationship is a give and take; however, in reality, franchisors have used adhesive, one-sided contracts to take way more than they give. The duty of good faith and fair dealing has for too long been ignored. Franchisors should heed the story of Quiznos and others like it. When franchisors and franchisees align their goals and work toward total concept profitability, a great success for both parties can follow. When the reverse happens, franchisees like Globex, Kazi, and Baber are the ones who suffer the most.

Franchisors sell the American Dream to franchisees, alleging it is the opportunity to "own your own business." Despite this, franchise agreements often unfairly favor the franchisor—this makes sense considering the need for franchisors to set standards of performance and consistency for the brand; however, this leaves franchisees vulnerable to unfair and deceitful practices that often are typical of the franchising system. Franchisees are not all equity corporations—they are Americans trying to succeed as entrepreneurs. One in seven franchisees is a veteran, and approximately 30 percent of franchisees are Black Americans, Latinos, or Asian Pacific Americans.[162] The franchise industry must find a way to guarantee franchisees are sold viable businesses with just contract provisions and a reasonable expectation of success. Both federal and state governments need to address this critical part of the American economy by enforcing their current regulations against these unfair and deceptive trade practices, and where these current regulations do not remedy the issues, they must strengthen them. Without efficient and thorough regulation, franchisees may continue to spend their life savings on a brand that will leave them with nothing, discouraging further investment and leaving the franchise industry barren.

157. *Id.*
158. *Id.*
159. *Id.*
160. Johnathan Maze, *A Brief History of Quiznos'* Collapse, RESTAURANT BUSINESS ONLINE (June 13, 2018), https://www.restaurantbusinessonline.com/financing/brief-history-quiznos-collapse.
161. *Id.*
162. *Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices*, *supra* note 25, at 6.

