

FRANCHISEES' OPTIMISM BIAS AND THE INEFFICIENCY OF THE FTC FRANCHISE RULE

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**This article is to be published in Volume 13, Issue 3 of the DePaul Business & Commercial
Law Journal**

Presented at the 29th Annual
International Society of Franchising Conference
Historical Building
University of Oviedo
Oviedo, SPAIN
June 18-20, 2015

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ABSTRACT

A seminal assumption that underlies current franchise law is that franchisees are intrinsically rational. As such, franchisees are presumed to be able to rationally assess the risks involved in the franchise contract and avoid those risks. Based on this rationality assumption, current law is predominantly based on the FTC Franchise Rule, in which franchisors are obliged to disclose to franchisees information regarding future risks. Equipped with this information, franchisees, as rational actors, are assumed to be capable of protecting themselves against the franchise risks.

This paper questions the validity of the assumption that franchisees are rational actors. Based on a significant body of existing empirical research, which has thus far been overlooked in the legal debate over the FTC Franchise Rule, this article presents the following arguments: First, although franchisees are often perceived as sophisticated business people, they systematically suffer from a common psychological bias: over-optimism about the future. Second, franchisees, being optimistically biased about the future, repeatedly avoid reading disclosure documents, which contain informative data about future risks. The conclusion therefore is that the efficiency of the Franchise Rule in protecting franchisees is dubious.

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