Mobility-Restricting Covenants in Business Contracts: The Case of Franchising

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Abstract:

Several studies show that restrictive covenants in employment contracts, such as noncompete agreements, may affect employees in detrimental ways, including by reducing mobility and suppressing wages. While such concerns are real, these clauses also have the potential to serve legitimate business purposes by helping companies protect valuable information, which can encourage investment and training and enhance social welfare. This paper explores the use of several types of covenants, including noncompetes but also confidentiality and non-recruitment clauses, in franchise contracts, which are an important and accessible category of business contracts. Many of these contracts impose restrictive covenants on franchisees but also on other individuals, notably franchisees' business partners and family members, and in some cases, their managers and employees. Patterns in the use of these covenants across these individuals is telling, suggesting that in business contracts, the information-protection role of these clauses is particularly salient.

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1. INTRODUCTION

Firms use contracts for a wide variety of socially beneficial purposes, including conveying information and encouraging exchange, inducing effort by resolving holdup problems, addressing market failures and clarifying responsibilities, and ensuring specific performance along various dimensions. Some contracts and clauses, however, also raise anticompetitive concerns. For example, exclusive dealing and other clauses that reference competitors or affect the competitive playing field have long attracted attention from antitrust authorities (e.g., Scott Morton, 2012). More recently, scholars and policymakers have underscored the risks that noncompetes and other restrictive covenants in employment contracts may pose to labor mobility and new business creation (see, e.g., Starr et al., 2021; Marx, 2022; Johnson & Lipsitz, 2022; Johnson et al., 2023). Understanding how economic agents use contracts and specific contractual clauses for good and ill—perhaps often at the same time—is a pressing research goal. However, for understandable reasons, the usage patterns and consequences of various clauses are likely to depend on party contractual goals and the surrounding business context.

In this paper, we describe the extent to which noncompetes but also a number of related clauses, including confidentiality and non-recruitment clauses, appear not in employment but instead in a specific type of business contract, namely business-format franchise contracts. These clauses may have anticompetitive effects, as emphasized by Callaci et al. (2024b) and Norlander (2024), but they may also serve welfare-enhancing roles, including encouraging optimal effort and protecting valuable information to stimulate efficient investment in research and training. As a result, the impact of these restrictive covenants on welfare is ambiguous. Our primary goal throughout this paper is to document how and how often contracting parties deploy these restrictive clauses in franchise contracts. However, we also seek to develop evidence and identify patterns that may help differentiate among various explanations for the use of these clauses and, ultimately, inform the debate about the social value of the use of these clauses in business contracts.

Business-format franchise relationships are a particularly fruitful context in which to consider the potential roles of restrictive covenants in business contracts that deal with the rights and obligations of individuals. In the first place, business-format franchising is very important economically, affecting a wide-swath of the U.S. economy and its labor force.[1] Not surprisingly, and perhaps for this reason, noncompetes and non-recruitment covenants in business-format franchise contracts have attracted the attention of policy makers nationwide. Moreover, as a result of both state and federal regulations, and

[1] Business-format franchising is one of two main forms of franchising. The other, according to the Department of Commerce, is "traditional" or product and tradename franchising. The regulation that requires business-format franchisors to share their franchise contract terms with potential franchisees does not apply to traditional franchises, so these contracts are not available through the same means. For a more detailed explanation, consult the FTC's Franchise Rule.

with the advent of new information brokers, researchers can now access the full text of these contracts—as well as other relevant information about the franchisor and the franchised chain—for large numbers of business-format franchises. This allows us to examine the details of restrictive clauses, including who is subject to them, and explore the relationship between certain franchise characteristics and covenant use. Finally, from the perspective of conducting rigorous empirical research, it is helpful that U.S. business format-franchise contracts are uniform across franchisees, making it feasible to describe their content in succinct ways and to dispense with certain interpretative concerns that might arise if these contracts were individually negotiated.

We find that franchise contracts impose or require restrictive covenants on different individuals in ways that appear most consistent with the need to protect the franchisor's intellectual property and prevent information leakage. Particularly informative is the common use of certain constraints on individuals, such as franchisees and their business partners, who earn profits from operating the franchised business—i.e., individuals who do not earn wages and thus do not contribute to labor costs locally. The standard monopsonistic wage-suppression theory cannot explain the use of these restrictive covenants for these individuals. Moreover, in these contracts, franchisors show a degree of intentionality in selecting who is bound and by which type of covenant. We find that the usage of the restrictive clauses varies across types of businesses, and with other characteristics of the franchised chains, in ways consistent with the role of enticing franchisee effort while also preventing copycats.

This paper contributes to three main strands of literature. First, it contributes to our understanding of franchising and other types of contractual relationships by documenting how franchisors can use restrictive covenants to encourage optimal effort among its franchisees. The literature on the economics of franchising provides ample evidence that franchisee effort is central to achieving success in franchised businesses. Franchise contracts clarify the status of franchisees as residual claimants and include certain constraints to curb the potential free-riding incentives that result from franchisee profit motives. However, existing work privileges the financial terms of franchise contracts and traditional vertical constraints such as territorial restrictions or pricing constraints as the important solutions to this agency problem. (See, for example, Lafontaine (1992) and Kaufmann & Lafontaine (1994); Blair & Lafontaine (2004) provide a useful overview of this literature.) How the desire to induce franchisee effort likely translates into contract clauses that constrain what the franchisee can do during and after the franchise relationship has not been an emphasis of this literature. We believe this efficiency motive for imposing constraints on franchisees deserves considerably more attention.[2]

[2] Callaci et al. (2024b) and Norlander (2024) do not consider the potential efficiency role of the covenants, focusing instead on anticompetitive explanations. Norlander (2024) also emphasizes the potential value of machine learning tools in extracting information from franchise disclosure documents.

Second, we provide new evidence on how firms use and protect valuable information and related investments through formal (e.g., statutory) and informal (e.g., contract and management) mechanisms (Hall et al., 2014). Business-format franchising, as an enterprise, entails the development and exploitation of intellectual property (IP), mostly via transfer to franchisees who then use the proprietary information to replicate a specific business in a new location. Beyond franchisors' ability to use trademarks, which are universal in these types of businesses, formal IP protection like patent or copyright is not generally considered to be of much use as a way to encourage investment.[3] Instead, valuable trade secrets, know-how, training, and other information become embedded in documents, practices, and individuals (Kitch, 1980; Becker, 2009). As a result, the IP protection role of restrictive clauses that affect the opportunities and mobility of individuals may be of more importance in business-format franchise relationships, as in other contexts where the goal is to protect process information rather than newly invented products (Levin et al., 1987). [4]

Finally, the current academic and policy debate on post-employment restrictive covenants has focused almost exclusively on the employer/employee relationship (FTC, 2023a; for a literature review see generally, Starr, 2023). Our analysis shows that in the context of business contracts such as franchising, but also potentially joint ventures, alliances, and so on, business entities that are related to the employer by virtue of a commercial contract can have an interest in the use of clauses that limit what employees can do. In other words, separate business contracts and the motivations behind the covenants they contain may be an important driver of restrictive covenants in employment contracts. Our analysis also highlights the importance of examining who is bound by a constraint (and who is not) to better understand the goals of the covenant in question.

We organize the paper as follows. In the next section, we introduce business-format franchising, the institutional setting, and some of the most relevant literature. In Section 3, we develop the conceptual framework and empirical predictions. In Section 4, we describe our data and empirical strategy, and in Section 5, we present and discuss our results. We conclude in Section 6.

2. INSTITUTIONAL SETTING AND RELEVANT LITERATURE

In this section, we discuss key features of business-format franchising. We include a brief overview of the literature on the economics of franchise relationships, much of which explores the importance of aligning franchisee incentives and the effort they produce in ways that are consistent with the needs of the franchise system as a whole. We also describe the nature of the IP that franchisors want to protect, why its protection is central to the business model, and the strategies franchisors use to ensure

[3] See, for example, Kelly & Frantz (2019); Blumstein & Maisa (2021).

[4] Business transactions and departing employees are key channels through which the spillover of competitively sensitive information occurs (Lemley, 2008; Almeling et al., 2009).

and enhance such protection—including the potential use of clauses (e.g., noncompetes, confidentiality covenants, and non-recruitment covenants) that constrain what franchisees and others with relevant relationships are free to do both during the franchise relationship and after it ends. In Appendix (1), we provide details about the nature of the covenants as they appear in business-format franchise contracts, and the legal standards governing their use. Finally, we discuss the current policy debate regarding the operation and welfare effects of restrictive covenants more generally.

2.1. Business-Format Franchising

In the U.S., the Department of Commerce distinguishes between two types of franchising: traditional (or product and tradename) franchising and business-format franchising. The former refers to product-distribution franchises, where the franchisor makes a product available for resale by the franchisee, often under an exclusive dealing arrangement that allows the franchisee to identify its business with the franchisor's tradename. Examples include gas stations, car dealerships, and soft-drink vendors. Business-format franchising, on the other hand, is what most people associate with the term "franchising" today. It involves the creation of a business model and associated training programs and materials—including the development of products, trademarks, and business (e.g., supplier) relationships—that allows franchisees to *replicate* the business in different local markets and provide a consistent experience to customers, with an eye toward enhancing the value of the business model and brand. As examples, consider restaurant chains, hotel and cleaning-services franchises, and auto maintenance and health-and-fitness businesses.

It is only with respect to business-format franchises that, according to the FTC Franchise Rule, the franchisor must make available to potential franchisees a 300- to 500 page document, known as a Franchise Disclosure Document or FDD, which provides details regarding 23 specific items about the offered franchise, its officers, and other franchisees. The FDD includes the franchise contract among the set of exhibits.[5] Some states require that franchisors operating in the state file the FDD with a state agency and, in recent years, data vendors have started making these documents available on the web, allowing researchers to access those detailed documents as well.[6]

Business-format franchisors as a group account for an important volume of economic activity. The most recent Economic Census report on business-format franchising documents that these franchisors operated nearly 500,000 establishments in the U.S. in 2017, employing nearly 10 million people (U.S. Census, 2021). Recent reports produced by Frandata for the International Franchise Association, the main trade association for franchising, puts this number even higher (IFA, 2024). For context, the

[5] See Appendix (2) for a sample table of content provided by the FTC.

[6] See, for example, Arbel (2024) and Norlander (2024) who mention accessing a corpus of 12,602 and 14,870 franchise-related documents, respectively.

same 2017 census reported that there were 11.5 million jobs in manufacturing in the U.S. The nature of franchise contracts and the covenants these contracts include thus have the potential to affect the livelihood, mobility, and other outcomes of a large number of franchise owners as well as millions of workers who fall into a wide variety of occupations and industries, work under a range of conditions, and vary in how and how much they are compensated by the hour, fixed salary, or otherwise.

For our purposes, it is important to note that business-format franchise contracts can be accessed and analyzed in detail and with relative ease not only because they are published but because they are *not* tailored to the specific circumstances of each franchisee or its local market. Instead, franchise contracts are boilerplate (Scott et al., 2024), with the same contract offered to all potential franchisees.[7] It is perhaps in part because of FTC regulation, which requires that franchisors make their contract available as part of a set of standardized documents, i.e., FDDs, that franchisors use a uniform contract for all franchisees. However, as Blair & Lafontaine (2005) report, when asked about reasons for contract uniformity in a survey, most franchisors (73 percent) mention that uniformity is desirable for consistency and fairness toward franchisees, while 27 percent indicate that such uniformity facilitates the administration and enforcement of their contracts. Moreover, in their survey responses, only about half of franchisors mention any drawback to uniformity. When they do, they principally refer to potentially losing franchise sales given the lack of flexibility (pp. 53–54).[8]

A few other important facts about franchising inform our analysis. First, most business-format franchisors develop a business and operate some establishments on their own account before they start franchising. Thus, as Lafontaine & Shaw (2005) describe, when a business first begins to franchise, its proportion of "company stores" or franchisor-owned outlets is relatively high, and this statistic diminishes often rapidly as they open franchised units. However, most established franchisors continue to own and operate at least some of their units directly, and their proportion of company-owned and operated outlets tends to be stable over time. Blair & Lafontaine (2005, tables 4 and 5) find that about 20–25 percent of franchisors that have been involved in franchising for eight or more years operate none of their outlets on their own, while another nearly 40 percent of them operate some but fewer than 15 percent of their total number of establishments directly. At the other extreme, about 10 percent of them operate more than half of their establishments directly, even after eight or more years in franchising.

[7] In other words, when they join, potential franchisees are offered the then-current standardized contract. However, franchise contracts typically last for 10 or 20 years. This means that, unless otherwise specified, changes can be made in new contracts whereas incumbent franchisees' relationships adjust to the "then current" contract only upon renewal. Moreover, franchisors often use so-called "state addenda" in FDDs to partially adapt for specific requirements imposed by some states.

[8] See also McAfee & Schwartz (1994) and Bhattacharyya & Lafontaine (1995) for models explaining uniformity based on potential franchisor opportunism, on the one hand, and based on the benefits of customization being inadequate to justify the cost and effort on the other hand.

Why different franchisors choose very different levels of corporate ownership has been the subject of several empirical studies in the franchising literature.[9] The evidence suggests that franchisors are attracted to franchising because, as we discuss further below, relative to managers of corporate establishments, franchisees have strong incentives to develop the local market and operate their businesses efficiently. But franchisees are investors and owner-operators, not employees. A major drawback for franchisors of using franchising is that franchisees cannot be treated like employees. For example, a franchisee might (understandably) object if another establishment is set up nearby, whereas a manager who is typically a salaried employee will not.[10] The manager will readily adopt new processes and products if directed to do so, but the franchisee will need to be convinced that these will be good for their business. In other words, franchisors relinquish some amount of control by choosing to work with franchisees relative to what a corporately owned chain can do. Lafontaine & Shaw (2005) show that this trade-off between control and high-powered incentives, moreover, influences the proportion of company ownership of outlets that chains end up selecting.

A second important fact about business-format franchising is that franchisors earn profits from franchised outlets by collecting fixed upfront franchise fees at the beginning of the franchise relationship as well as ongoing royalties and advertising fees from their franchisees. Typically, royalty rates and advertising fees are set as a percentage of the franchised establishments' *revenues*, not their profits. In a minority of franchise systems, one or both of these fees are a fixed amount per time period (usually a month). Given that these contracts typically last 10 to 15 years, the ongoing royalty and advertising fees are much larger in total than the upfront fee, making the former an important focus of the relationship. After paying these fees, however, the franchisee is a residual claimant, that is, the franchisee earns all post-fee profits generated by their establishment. This is in line with what one would expect from an agency-cost perspective, where the agent that can affect outcomes locally should benefit from the effort they put forth. A franchisee's status as residual claimant is meant to lead franchisees to put high levels of effort into running their business locally, increasing revenues by making sure customers get the type of experience they expect and thus return regularly, and decreasing costs by monitoring spoilage or shrinkage and ensuring proper staffing levels and appropriate management.

As residual claimants, however, franchisee incentives are not fully aligned with those of the franchisor or the franchise system as a whole. Because there are both important vertical and horizontal externalities arising from the use of a common brand across establishments in a franchised chain, there are opportunities for franchisees to increase their profits by acting to the detriment of the rest of the

[9] See Lafontaine & Slade (2007) for a review of relevant theory and empirical research.

[10] The salaried manager might object if a sizable portion of their compensation is a bonus based on the revenues or profits of their unit. But the compensation scheme can readily be adjusted to address this issue.

franchise system. For example, franchisees may reduce their effort or costs by free riding on the investments of effort by other franchisees in the franchise system or by those of the franchisor. For these reasons, franchise contracts uniformly impose many (equal) obligations on franchisees, including some of those we discuss below, that constrain the franchisee's behavior directly (Klein, 1980).[11] Restrictive clauses in the contract may be efficiency enhancing because they encourage franchisee effort or reduce their incentives to free ride, and indeed all franchisees may be better off with such uniform restrictions than they would be without them.

A final key fact about business-format franchising: because retail and restaurant chains are pervasive in the U.S. economy today, and many such chains are franchised, there is a tendency to expect franchised systems to be very long lived. While some of them are, each year several new franchises are born and a number of them also exit franchising or go out of business altogether. The landscape is more dynamic than most people expect. Blair & Lafontaine (2005), for example, find that looking at a large set of franchisors as they begin their franchising efforts, on average only about 40 percent of franchisors that start franchising each year are still franchising 10 years later. Our goal in this study is to examine the contracting behavior of franchisors whose business model and contracting practices have stood the test of time, as opposed to franchisors that are new and perhaps have not yet developed their policies fully. As we discuss further below, for this and other reasons, we focus on those franchisors for which we can obtain recent data but also data from ten years before.

2.2. Intellectual Property in Business-Format Franchising

Franchisees earn returns from their local establishments after paying fees to the franchisor for the right to operate these businesses using the franchisor's trademark and the business model developed and provided by the franchisor. As a result, it is not only the responsibility of but also in the interest of the franchisor to protect the business model and trademarks that the franchisees (and franchisor) depend on for their profits. In fact, the franchisor cannot be successful if it fails to invest effort and resources in maintaining, developing, and protecting these assets: the franchisor's profits depend entirely on the franchisees' sales and the profits of its own establishments, if any, all of which depend on the business model and its competitive success in a landscape of similar products and services. Moreover, the franchisor's growth over time depends on its capacity to open new establishments, which itself is a function of the success of its current establishments. Together, these considerations give the franchisor incentives to maintain and protect the value of the brand and business model (Klein, 1980).

[11] See also Blair & Lafontaine (2005) for an overview of specific incentive issues in franchising, and Lafontaine & Raynaud (2002) on specific aspects of the contract used to curb the free-riding incentives of residual claimants—i.e., franchisees—in the context of a chain of establishments operating under a common brand.

To articulate the type of know-how and process information that franchisors develop and want to protect, consider what Five Guys lists as the confidential-information component of its system in its 2020 franchise agreement:

> "The System includes distinctive signage, interior and exterior design, décor and color scheme; special recipes and menu items (including proprietary products and ingredients); uniform standards, specifications, and procedures for operations; quality and uniformity of products and services offered; inventory, management and financial control procedures (including point of purchase and tracking systems); training and assistance; and quality control and promotional programs; all of which we may change, improve, and further develop, in our discretion. Certain aspects of the System are more fully described in this Disclosure Document and the Manuals that are provided to you as a franchisee.
>
> […]
>
> Any and all information, knowledge, know-how and techniques related to the System that we communicate to you, including the Manuals, plans and specifications, marketing information and strategies and site evaluation, selection guidelines and techniques, are considered confidential."

As this type of information becomes embedded in the franchisee and other individuals connected to the outlet via training and sharing of the operations manuals and other proprietary materials provided by the franchisor, one might expect that protecting it against dissemination would normally require the imposition of constraints on these individuals.

Moreover, as markets are dynamic with new business ideas and processes becoming available over time to replace incumbent ones, the franchisor must continue to invest in the brand, and in developing new products and processes, to maintain the value of the business proposition for consumers, and thus also for franchisees who serve these consumers. For example, a recent Wall Street Journal article describes how McDonald's has spent the last seven years on a quest to improve its products:

> "For the past seven years, the chain that made its name on burgers has been on a quest to improve its signature offering.
>
> […]
>
> The more than 50 tweaks on its burgers add up to the Chicago-based company's biggest upgrades in decades to its core menu. With increased competition in the burger market—especially from higher-end, fast-casual burger chains such as Five Guys—executives decided to revamp some of the industrial-scale techniques that have produced cheap, uniform burgers. In some cases, McDonald's is reviving practices it scrapped long ago in a push for efficiency." (Haddon, 2023)

This quotation illustrates well how even very established franchisors must continuously evaluate and rethink their business models and product offerings to remain relevant in the market. But to reap the benefits from such investments, franchisors again must find ways to protect the resulting know-how and proprietary processes while also sharing it efficiently with franchisees and, often, with store managers and other employees.

2.3. Tools to Protect IP

The legal system defines and assigns property rights in information in three main ways: through patent law, through copyright law, and through trade secret and associated contract law. [12] In addition, trademark law grants property rights in labels, such as logos and brand names (Landes & Posner, 1987). While trademarks are ubiquitous components of the business-format franchising model (Blair & Lafontaine, 2005), patents and copyrights play a limited role: as we describe below in Table 1, in our sample of 293 franchised companies, only 7 (12) percent hold one or more patents or copyright in 2010 (2020), 2 (5) percent hold one or more patents in 2010 (2020), and 4 (8) percent hold at least one copyright in 2010 (2020).[13] Thus, a franchisor aiming to protect its intellectual property presumably must rely almost entirely on trade secret and contract law approaches and remedies.

From a legal and economic perspective, the interplay between the protection granted by trade secret law and contract law is important. To prevail on a trade secret claim, three essential requirements must be met: a qualifying type of knowledge or information (i.e., not commonly known in a trade or industry); reasonable precautions (i.e., reasonable diligence in protecting the information); and misappropriation by the defendant in the action. When the parties involved are employees and/or business partners of the franchisee, establishing that reasonable precautions have been taken usually requires a written covenant, of which confidentiality agreements are most typical (Lemley, 2008). In other words, certain contractual covenants are at the very least reinforcing and may be essential to the actionability of trade secret claims, consistent with recent research that finds that covenants such as noncompetes and trade secret litigation are complements (Greenwood et al., 2024).

As information leakage often occurs through individuals moving across organizations, many covenants aim to limit this mobility or limit what individuals can do once they leave a franchise outlet. Covenants such as noncompetes and non-recruitment clauses draw a clear line: the act of accepting employment or starting a new competing business, often within a specified territory and time frame, is prohibited under the former whereas employing someone who worked at the prior firm is prohibited under the latter. With these clauses in place, firms do not need to demonstrate that a trade secret or confidential information was misappropriated or disclosed by the party who is bound by the clause to bring a cause of action.[14] The company need only prove that the individual has begun or seeks to begin a contractually prohibited relationship with another employer or to start a competing business. When a

[12] Hall et al. (2014) classify patents, trademarks, registered designs, and copyright as "formal" intellectual property (IP) protection mechanisms, and secrecy, confidentiality agreements, lead time, and complexity as "informal" mechanisms. Similarly, Gallié & Legros (2012) distinguish between statutory protection mechanisms (referred to here as formal IP mechanisms) and non-statutory protection mechanisms (informal IP mechanisms).

[13] In Appendix (3), we provide more detailed information about the type of patents and copyrights of the franchisors in our data.

[14] See the following American Bar Association (ABA) guides: Kim et al. (2020) and Graham (2021).

contract does not limit mobility, the plaintiff must prove something more—i.e., that the franchisee, employee, or business partner misappropriated and disclosed or used the information—under trade secret law, and this burden is harder to meet because the claim is harder to prove. A defendant accused of misappropriation has multiple potential defenses, including independent development, reverse engineering, and—quite relevant to our research—demonstrating that the plaintiff did not exert reasonable efforts to keep the information secret (Bone, 1998). Noncompetes appear to be effective at reducing labor mobility, even when they are unenforceable (Prescott & Starr, 2024; Boeri et al., 2024). Therefore, franchisors might opt for the consistent use of restrictive covenants not only to reduce information leakage through mobility but also to secure actionability in trade secrets claims ex post.

2.4. Policy Debate over Mobility-Restricting Covenants

According to economic theory, restrictive clauses in franchise contracts have the potential to protect the franchisor's intellectual property (and other franchisees' investments) and to stimulate franchisee and franchisor effort. Under certain conditions, these clauses can be efficiency enhancing. By protecting franchisor investments ex post, restrictive clauses can encourage the franchisor to make investments in the development of intellectual property and in training, information sharing, and being responsive to changing customer tastes and interests ex ante. They can also lead the franchisee to operate their local business with long-term efficiency in mind. However, as the literature on noncompetes in employment contracts shows, when these clauses impair worker mobility, they can also lead to potentially inefficient wage suppression and other anticompetitive concerns (Starr, 2023).

Since it first issued its Franchise Rule in 1978, the FTC has played an important role in overseeing the functioning of franchising and franchised businesses in the U.S. In its consumer protection role, in March 2023, the FTC issued a request for public comments regarding the level of control exerted over franchisees and franchise workers in franchise contracts, asking the public to weigh in on a broad set of policy-relevant issues (FTC, 2023b). These issues included the merits of a franchisee's inability to negotiate contract terms before joining, the effects of a franchisors' ability to change the terms of the contract during the relationship, and the prevalence and justifications for various contract clauses in franchise contracts, among other topics. Not surprisingly, many low-wage workers, who are not typically considered to be privy to valuable information at risk of dissemination, work for outlets of franchised chains and are likely affected by restrictive clauses.

In July 2024, in an "Issue Spotlight" that also relied on scholarship raising concerns around franchisor business practices (see, for instance, Ji & Weil (2015) and Callaci (2021)), the FTC summarized the main issues raised by franchisees and others in the more than 2,200 comments the commission received in response to its request (FTC, 2024a). The FTC then issued a policy statement regarding franchisors' use of some contract provisions, including confidentiality clauses, with the stated goal of

addressing concerns that certain restrictive covenants may have the practical effect of chilling a franchisee's willingness to report unlawful behavior to the FTC or other agencies (FTC, 2024b). Finally, the staff produced new guidance related to franchisor-initiated unilateral changes in contract terms during the contractual period, and the commission reopened the request for public comments (FTC, 2024c). The new request ended in October 2024 and, as of this writing, there have been no further updates.

In a separate but related vein, in January 2023, the FTC also issued a notice of proposed rulemaking (NPRM) under the Section 5 of the FTC Act that aimed at banning the use of noncompetes in employment contracts (FTC, 2023a).[15] In this NPRM, the FTC provides a detailed analysis of the literature and issues with noncompetes in employment contracts, and it describes alternative covenants that could achieve similar goals without hampering labor mobility. In April 2024, the FTC issued the final rule banning noncompete agreements for employees retroactively (FTC, 2024d). Shortly thereafter, in *Ryan LLC v. Federal Trade Commission*, the U.S. District Court for the Northern District of Texas granted a nationwide injunction preventing the FTC Rule banning noncompetes from becoming effective on September 4, 2024, as planned. On October 18, 2024, the FTC filed a notice of appeal to the U.S. Court of Appeals for the Fifth Circuit to challenge the decision.

Although the proposed and then final rule on noncompetes exclude such clauses executed between franchisors and franchisees, the FTC has noted that noncompetes between a franchisor and franchisee may present concerns under Section 5 of the FTC Act similar to the concerns presented by noncompetes between employers and employees.[16] At the time of the proposed rulemaking, the FTC had also sought comments on (1) whether the Rule should cover franchisor/franchisee noncompetes and why; (2) if the Rule were to cover franchisor/franchisee noncompetes, should they be categorically banned or subject to a rebuttable presumption of unlawfulness; and (3) if the rule should apply uniformly to all such noncompetes or whether certain categories of franchisor/franchisee noncompetes should be exempted or subject to different standards.

In clarifying the use of various covenants in franchise contracts, our work aims to inform these regulatory initiatives directly. In particular, the FTC argues in the noncompete NPRM that firms have alternative means to protect valuable investments, such as nondisclosure agreements and the remedies offered by trade secret laws (among other tools), stating that "these alternatives restrict a considerably smaller scope of beneficial competitive activity than noncompete clauses because—while they may

[15] Several states have enacted new rules regarding noncompetes over the last fifteen years, with the large majority of noncompete reforms coming into effect after 2015 (Bishara & Luisetto, 2025). See Appendix (1) for more information also on other post-relationship restrictive covenants.

[16] "By restricting a franchisee's ability to start a new business, franchisor/franchisee noncompete clauses could potentially stifle new business formation and innovation, reduce the earnings of franchisees, and have other negative effects on competitive conditions similar to noncompete clauses between employers and workers …."(FTC, 2023a, p. 3485).

restrict an employee's ability to use or disclose certain information—they generally do not prevent workers from working for a competitor or starting their own business altogether" (FTC, 2023a). More specifically, the FTC indicates that (1) intellectual property law provides employers with viable means of protecting their investments in trade secrets, and (2) appropriately tailored nondisclosure and confidentiality agreements may successfully prevent former employees from disclosing or using certain information, without limiting their freedom to work. The FTC's argument pays little attention to the fact that enforcement and legal costs are considerably lower for noncompetes relative to confidentiality covenants. Moreover, results in Greenwood et al. (2024) suggest that trade secret litigation and covenants such as noncompetes may be complements rather than substitutes.

3. MOBILITY RESTRICTING CLAUSES IN FRANCHISE CONTRACTS

A close examination of business-format franchise contracts reveals that franchisors impose restrictive covenants such as confidentiality, noncompete, and non-recruitment clauses not only on franchisees under certain conditions but also on other individuals, like business partners, managers, employees, and even outsiders with no business connection to the franchised outlet, like franchisee family members. In this section, we discuss theoretical arguments that might help explain the use of these restrictive clauses in the various configurations we observe. These arguments point to hypotheses for how we expect covenant use for these different types of individuals to vary, based on chain characteristics, the type of covenant in question, and the potential purpose of the covenant.

3.1 Clauses Applied to Franchisees

Much of the literature on noncompete covenants centers on their role in employment relationships, where they are understood as restrictions that may benefit employers because noncompetes may impair the diffusion of information to competitors but, also, may lower labor costs by restricting worker mobility and the set of opportunities available to their employees, which in turn may impact the competitive landscape of the employer's product market. To date, empirical research on noncompetes in the employment context largely supports the idea that these clauses suppress wages and mobility-related turnover costs on average, especially when the employee receives no notice of the noncompete (Starr et al., 2021). Three important questions arise in the context of such covenants in business contracts between a franchisor and franchisee (versus an employee): (1) Might intellectual property protection, or a franchisor's understandable concern over potential leakage of valuable information, be more or less important in a relationship with a franchisee compared to the usual employment relationship? (2) Do franchisors also benefit from lower labor costs when they impose mobility-reducing restrictions on franchisees (or their family members) as opposed to employees? Finally, (3) are there other explanations for the use of these covenants in franchisor relationships with franchisees, such as improving incentives for franchisees to engage in efficient levels of effort, that would be inapplicable to employees?

All else equal, if intellectual property protection and information leakage is a more significant concern for franchisors interacting with franchisees (compared to employees), we would expect all three types of covenants (i.e., confidentiality, noncompetition, and non-recruitment clauses) to appear more frequently if not almost uniformly in franchise contracts relative to contracts governing an employment relationship (with the possible exception of high-level management employees). Franchisees have essentially full access to the franchisor's valuable information, training, and materials, so the risk of information leakage is particularly worrisome when it comes to franchisee behavior (versus employee behavior). Furthermore, if information protection is an important motivation for the use of restrictive covenants with franchisees, some franchisor characteristics—such as, for example, the type of business, which may have a consistent and predictable relationship to the value of the franchise's IP or the ease with which it may leak—might affect covenant use even when there are no good reason to believe that franchisees as individuals differ from each other.

By contrast, if noncompetes and non-recruitment clauses mostly serve to keep labor costs low by restricting mobility with respect to employees, franchisors seem unlikely to impose such clauses on franchisees, whose labor they do not pay for, except in the most indirect sense.[17] In particular, the franchisor does not profit by more if the franchisee makes less. The opposite is true, in fact, as a profitable franchisee is likely to continue within the franchised network and open more outlets to build on their success. Thus, on the anticompetitive labor-cost theory, we should expect to see far fewer (if any) mobility-reducing covenants for franchisees (relative to employees). However, one plausible wage-suppression hypothesis is consistent with franchisors demanding that franchisees accept such covenants. Franchisors with many corporately owned establishments might want to reduce labor costs in their own stores by imposing mobility-restricting covenants on their employees. If, for some reason, these franchisors find it helpful or necessary to impose these same covenants on their franchisees so they can also have them applied to employees in corporate stores, we might observe a positive relationship between the use of these clauses and the extent of corporate ownership in the chains.

Finally, post-relationship noncompetes for franchisees (versus employees)—as well as covenants that restrict how much the franchisee can be involved in competing businesses and those that oblige the franchisee to participate full-time in the operation of the franchised business during the relationship—give franchisees stronger incentives to devote effort to their outlet. As residual claimants, franchisees already have strong incentives to maximize profit and keep costs low. However, a franchisee's effort in providing good value creates surplus for other franchisees by enhancing the brand's reputation, and individual franchisees cannot capture these positive externalities (and they do not suffer

[17] Recall that royalty rates are a percentage of revenues, and this percentage is uniform across franchisees, so franchisors cannot extract higher revenues and profits from franchisees that have lower costs.

from any negative externalities they create for the network by excessive cost cutting or poor service). Franchisee performance incentives are, all else equal, socially suboptimal. Therefore, franchisor covenants that limit or prohibit effort-reducing activities have the potential to be efficiency enhancing by making the entire franchise more successful, an economic role that is likely to be important in a brand-based business with individual owner-operators rather than employees, since other contractual terms can create incentives for high-quality performance among employees.[18] Consequently, if welfare-enhancing incentive creation makes the use of such clauses more beneficial for the franchise network, we might expect covenants that restrict franchisees to be more common than clauses that encourage restrictions on employees. (Alternatively, if the data suggest that there is no difference in the coverage, it might suggest that wage suppression gains with respect to employees are as valuable as network efficiency gains with respect to franchisees.)

3.2 Clauses Applied to Franchisee-Related Individuals

Our study of these contracts shows that franchisors also impose many covenants on two types of franchisee-related individuals: franchisee business partners and franchisee family members. The contract imposes these constraints either by naming these individuals in the same clause as the franchisee or by requiring that these individuals sign separate covenants, or both.[19] Indeed, as such individuals often sign the franchise agreement itself (e.g., as guarantors, or formally as part of the franchise relationship), they can be listed among those covered by covenants in the franchise agreement. In addition, courts are apparently sometimes willing to enforce covenants such as noncompetes even against individuals who have not signed the franchise contract when they are actively involved in the operation of the business.[20] In our analyses below, we consider such individuals to be subject to a clause if they are mentioned in the contract or the contract stipulates that they must sign a specific covenant.

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[18] See also Fan et al. (2017) who discuss how franchisee financial constraints, which prevent them from putting forward the level of capital that would give them high-powered incentives to keep the likelihood of default down, impedes franchise chain growth.

[19] An example is: "*Franchisee agrees that it shall require all of its business partners, officers, directors and managers, personnel performing managerial or supervisory functions and service technicians to execute non-solicitation and confidentiality covenants similar to those set forth in Sections 11.02(a)(i), 11.02(c)(i), 11.03(b) and 11.04, in a form satisfactory to Franchisor, which shall include a statement that Franchisor is a third party beneficiary of such covenants and entitled to the enforcement thereof and that such agreements are assignable to Franchisor or its Affiliates without the prior consent of such employee of Franchisee*." Templates for covenants that are to be signed by these individuals are often mentioned in the franchise agreement and included as Exhibits in the FDDs.

[20] For example, in Gold Messenger, Inc. v. McGuay, 937 P.2d 907, 1997-1 Trade Cas. (CCH) ¶ 71815 (Colo. App. 1997) a Colorado Court stated that the defendant was bound by the covenant not to compete even though the defendant had never signed the covenant. The court's rested on the fact that the defendant and the franchisee had operated the franchise together for at least two years, they were both trained by the plaintiff, and they both had access to the confidential information. Similarly, as discussed by Coyle & Effron (2021), in AAMCO Transmission, Inc. v. Romano, 42 F. Supp. 3rd 700, 704 (E.D. Pa. 2014) the Court stated that the wife of the franchisee was bound by the forum selection clause even though she was not party of the agreement (the closely-related-and-foreseeable test often bring relevant corporate affiliate within the scope of the clause).

Of the three potential roles we identify above for restrictive clauses—i.e., the protection of intellectual property, wage suppression, and effort/network efficiency incentives—the desire to suppress wages cannot be operative for individuals who do not receive labor compensation. There is no potential saving for the franchisor or the franchisee that arises from restricting the options of these individuals. There is also very limited scope for the effort incentive argument to apply. The extent to which franchisors impose these constraints on these individuals thus would seem to be an indicator of concerns about information leakage more than anything else, especially given that franchisees could circumvent restrictions imposed on them by having business partners or family members engage in the business activities that their individual contract prohibits. Otherwise, restricting the activities of people connected to franchisees seems likely to, at best, reduce the net surplus created by the contract, which under normal conditions would reduce franchisee investment in the network and would be unlikely to persist as franchise networks move toward equilibrium.

Of course, one might draw the inference that franchisors are just imposing these constraints on these individuals because they can, or because their lawyers always try to cover all contingencies and view the inclusion of such clauses as good practice that does not "cost" franchisors much. However, as we document in Section 5, nowhere close to all franchise contracts include clauses for these individuals or even for managers or employees. There is considerable heterogeneity across types of individuals and across chains, despite the carefully drafting and public nature of these contracts. Significant heterogeneity in the use of covenants is consistent with intentionality in the set of individuals that different franchisors cover with covenants and, moreover, with the idea that imposing these constraints is generally costly.[21] In particular, if imposing these constraints makes it more difficult to recruit experienced franchisees with knowledgeable business partners or family members, franchisors focused on growth might find the inclusion of such clauses to be particularly problematic.

3.3 Clauses Applied to Managers and Employees

In addition to franchisees and franchisee-related individuals, some franchise contracts include explicit requirements that franchisees have their own managers and other employees sign separate covenants, including confidentiality, noncompetes, and non-recruitment clauses. While in some cases contracts explicitly mention these individuals, since they are not signatories, we assume that these mentions do not constitute covenants that franchisors can enforce.[22] We therefore focus on clauses requiring that

[21] See Ganco et al. (2024) who find that firms avoid imposing noncompetes in employment contracts if they rely heavily on talent and are not industry leaders. They argue such firms avoid these constraints to be better able to attract skilled employees.

[22] Unenforceable covenants, in theory, may have some power over employees if they subjectively believe they are enforceable (Prescott & Starr, 2024), but franchisees can decide to impose covenants directly through employment contracts. Therefore, the use of terms that *require* that franchisees impose covenants are most likely material only when the franchisee would otherwise *not* impose them.

these employees be made to comply with covenants—i.e., clauses that obligate the franchisee and other signatories to require that employees accept such restrictions in separate contracts. We note that our evidence that franchisees are sometimes required by contract to have their managers and other employees sign such covenants is important to the broader noncompete literature. Our data establish that business contracts (i.e., franchise relationships) that are separate and distinct from the employment contract are one reason why employment contracts impose restrictive covenants, perhaps in situations where they do not seem to make a lot of sense. It is therefore of particular interest to document the extent to which this occurs, as we do below.

In addition, we separately analyze whether franchise contracts require only managers or instead all employees (including managers) to execute their own covenants. Protecting intellectual property by reducing information leakage seems unlikely to be a strong motivation for imposing these types of covenants on *all* employees in the type of businesses that usually rely on franchising. Using restrictive covenants to induce network-enhancing effort by employees also seems unlikely given the many other tools franchisees can access using employment contract terms. Confusingly, because the franchisor does not benefit directly from lower costs when they require franchisee-related individuals or employees to sign noncompete agreements, the wage-suppression argument also seems to lack validity.[23] Perhaps one could argue that the franchisee benefits from lower labor costs and as a result, franchisors can extract more from their franchisee. However, royalty rates are set uniformly as a function of revenue, and cost reductions only affect the franchisor to the extent they increase the likelihood that the establishment remains in business.

Thus, franchisees who run their business efficiently simply earn higher profits, meaning franchisors can leave the optimal use of such covenants to franchisee discretion unless there is an information-leakage justification. At the same time, the extent to which covenants are imposed on managers only, who are trained and become privy to the type of information that the franchisor may want to keep confidential, versus all employees, who have less access to this type of information, offers further clues on the role of these clauses in franchise contracts. Specifically, greater use of restrictive covenants with managers, who are much more likely to have access to sensitive information and be trained by the franchisor, relative to employees generally, is consistent with a goal of reducing information leakage,

[23] We further note that, on this account, franchisees should have considerably stronger incentives to impose noncompetes, so a franchisor mandate appears unnecessary. We acknowledge that a franchisee might be able to point to a restrictive clause requirement in the franchise contract when trying to justify the imposition of a noncompete on an employee, but this seems unrealistic on its face, given that franchisors retain third-party beneficiary rights to enforce such clauses (suggesting there may be reasons they wish to enforce a covenant when the franchisee does not), that only a small fraction of employees consider negotiation these clauses—at least noncompetes, and employees very rarely consider accepting such clauses to be a choice (as opposed to, more likely, asking for more compensation in return for agreement).

as managers are more likely to have the capability to replicate at least some aspects of the business model in a different location after their employment relationship ends.

4. DATA AND METHODOLOGY

4.1. Data Sources and Processing

Our analysis relies on a large and newly public database of Franchise Disclosure Documents (FDDs) that is accessible through *Franchimp*, a company that collects and organizes FDDs filed with state agencies.[24] At the time we accessed it, the database included more than 15,000 documents covering over 4,000 different franchisors, for an average of four documents per franchisor. Because we are interested in the contracting practices of established franchisors, we opted to search for franchise systems whose FDDs are available from 2010 (plus or minus a year) and from 2020 (plus or minus a year). This 10-year lag ensures that we analyze clauses of the set of franchisors that have been involved in franchising for 10 years or more by 2020. In addition, certain franchisor contracting practices began to attract public policy attention around 2015 and 2016 (see, e.g., Ji & Weil, 2015; Callaci, 2021, Krueger & Ashenfelter, 2022; Lafontaine et al., 2024). Our approach allows us to examine the extent to which contracting practices, and in particular the use of noncompetes and non-recruitment covenants, may have changed between 2010 and 2020 given this policy attention.[25] Finally, but related, using information from these two very distinct time periods allows us to relate the use of clauses in 2020 to conditions for the chain many years earlier, i.e., in 2010.

Given the relatively high exit rate of franchisors, and the varying coverage of the database over time, in the end we have data for 293 different franchised chains whose FDDs are available for both those years (plus or minus).[26] While 293 franchised chains may not seem to be a large number of chains, it is worth putting this number into context. First, the largest numbers of franchised chains included in the database in any given year is about 2,000, in each of 2015 and 2016. Even starting from those years, the subset that survives 10 years or more given high exit rates would be much lower, and the database does not extend even to a full set of FDDs in 2021 or 2022. Second, given our desire to examine the

[24] See https://www.franchimp.com/. The company obtained the FDDs from the government websites of states that require franchisors to disclose their FDD if they want to operate there (the majority of our FDDs come from California or Minnesota). For a short description about the structure of FDDs *see, e.g., The Anatomy Of A Franchise Disclosure Document*, Entrepreneur Magazine (May 14, 2024) https://www.entrepreneur.com/franchises/the-anatomy-of-an-fdd/199088

[25] This 10-year lag also allow us to complement prior literature showing that financial terms in franchise contracts tend to be stable over time (Lafontaine & Shaw, 1999; Lafontaine & Shaw, 2005), thus allowing us to contribute to the literature on contractual innovation more generally. Moreover, Bishara & Luisetto (2025) document that states implemented several noncompete reforms in the last 15 years (including some states with multiple rounds), of which the large majority occurred after 2015. Therefore, the year 2010 allows us to establish the baseline of our analysis before much of the federal and state policy attention on the use of noncompetes and related covenants began in earnest.

[26] See Appendix (4) for further details on the database and the sample.

clauses in two separate years, and to look at the details of the clauses twice, this sample size amounts to a set of franchise contracts that we could feasibly read and code by hand.[27] Finally, the most recent U.S. Census data indicates a total of 498,000 establishments in franchising in 2017. Our sample of 293 chains represents nearly 148,000 outlets in 2020, which corresponds to nearly 30 percent of the total number of these establishments in the U.S. at that point in time.

The franchisors in our final sample operate in the following *Franchimp* defined categories: 21 in "auto and travel"; 80 in "food and beverages"; 50 in "health and fitness"; 16 in "lodging"; 114 in "professional services"; and 12 in "retail." As we aim to examine the relationship between the use on different clauses and franchisor characteristics, we show in Table 1 some descriptive statistics for the franchisor attributes of the franchised chains in our data in 2010 and 2020.

Table 1: Franchised chains characteristics

	Obs.	Mean	Std. Dev.	Min	Max
Total outlets in 2020	293	507.2	1635.7	2	23802
Total outlets in 2010	293	422.5	1542.9	1	23052
Year started franchising	293	1994	15.1	1924	2011
Years in business before franchising	293	3.9	8.1	0	58
Growth in total outlets (2010 to 2020)	293	5.4	36.4	-0.98	577
% corporate units/total units in 2020	293	11.1	21.8	0	96.9
% corporate units/total units in 2010	293	13.6	24.1	0	100
Number of patents in 2020	293	.2	1.9	0	28
Number of patents in 2010	293	.1	1.3	0	17
Number of reg. copyrights in 2020	293	.6	6.0	0	98
Number of reg. copyrights in 2010	293	.2	1.8	0	21
Number of trademarks (2020)	293	7.5	9.0	1	107
Training provided (in weeks)	293	3.9	3.9	0	23.5
California HQ	293	0.10	0.30	0	1

Note: data on training and number of trademarks are for 2020 only.

Table 1 shows that the chains in our data are heterogeneous on many dimensions and experience different outcomes: they range in size (in terms of number of outlets in the U.S.) in both 2010 and 2020

[27] We considered different ways to extract information about contract terms from the FDDs. Machine Learning (ML) techniques are increasingly being deployed for research on contracts and other documents, and even specifically for studying covenants in franchise contracts (Norlander, 2024). However, ML techniques require a large amount of training data, and our sample of contracts is relatively small. Moreover, ML algorithms are agile tools to identify patterns and locate specific information, but they are less effective for the purpose of identifying relevant detailed content and scope, which is what we ultimately want to study. Recent methodological developments show that, unlike machine learning tools, large language models (such as ChatGPT) can accomplish a series of tasks without the need for training data. *See* Frankenreiter and Talley (2024). However, our detailed reading allowed us to find data patterns that we had not expected and would perhaps have missed otherwise.

from very small to very large. Moreover, they have been franchising in some cases for a very long time and spent an average of about four years developing their business model prior to starting to franchise. They also have experienced positive growth on average over the 2010 to 2020 period. However, their growth paths differ markedly, ranging from basically closing down (–99 percent) to increasing their number of outlets almost six-fold. In addition, franchised chains in our sample vary in the extent to which they operate outlets directly (i.e., corporate outlets, owned by the franchisor): they operate 11 (14) percent of their outlets directly on average in 2010 and 2020, but some franchisors operate none while others operate all of them. Consistent with our discussion of the limited use of formal intellectual protection tools in these types of businesses, very few of them report that they own patents or copyrights. Most of them provide about a month (3.9 weeks) of initial training to their franchisees, a variable that represents a potential measure of the extent of information sharing that takes place in these chains. Finally, given the special treatment of noncompetes in the state of California, we note that 30 of the 293 chains in our final sample are headquartered in that state.

4.2. Methodology

For each category of individuals who are bound or required by the franchise contract to sign their own covenant—i.e., franchisees themselves, franchisee-related individuals, and franchisees' managers and employees—we begin our analyses below by providing data about the frequency with which these different individuals are bound by the different types of covenants we consider.[28] We present these calculations as unweighted percentages of the total number of chains for each year separately (i.e., 2010 and 2020), and then we recalculate the percentages on a weighted basis, using the numbers of establishments of each chain in the respective year as weights. If we assume there is one franchisee per establishment, as noted above, the weighted calculations provide a clearer sense of the fraction of potential franchisees (and managers and employees) in our sample covered by these covenants.[29]

We then explore what we refer to as funnels of restrictive covenants. We find that the use of covenants is not randomly distributed across different categories of individuals. Franchise contracts rarely impose covenants on individuals other than the franchisee if the contract does not impose that restriction on the franchisee. But the use of a covenant often does not extend beyond binding the franchisee. When a franchisee is subject to a covenant, we learn only that others might also be subject to the same type of covenant, but when a franchisee is not subject to a covenant, we can be virtually certain

[28] We do not consider every covenant type for every category of individual. As we explain in the results section, only certain types of covenants appear with regard to certain individuals, a fact that speaks again to the intentionality with which franchisors use these tools.

[29] Many franchisees operate more than one establishment, with a few of them operating large sets of establishments, often across several chains. Though the existence of large multi-unit owners is well documented (see, e.g., Johnson, 2019), information about the number of establishments per franchisee in each chain is not available. We know, however, that this number is bounded above by the number of establishments.

that other categories of individuals will not face a restriction. We explore these patterns on the theory that the existence of funnels of this sort imply a level of intentionality in the application of the clauses that we believe are useful in interpreting their role.

Finally, in Section 5.5, we examine how chain characteristics relate to decisions to use post-relationship noncompetes in particular for these different categories of individuals. Noncompetes are of particular policy significance, and with the possible exception of certain types of non-recruitment clauses, the most likely to be welfare reducing. To alleviate simultaneity concerns, our regression analyses focus on how the use of noncompetes in 2020 relates to characteristics of the chain as of 2010. Our use of a long lag accommodates the fact that a franchisor's use of restrictive clauses does not change much over even this long of a time frame. We report results from estimating linear probability models for ease of interpretation, and cluster errors at the industry level.[30]

Our goal in conducting regression analysis is not to make causal arguments. More modestly, we aim to explore relationships that might shed light on the reasons why noncompetes clauses appear in business contracts. We have no exogenous shock to exploit, and all contract clauses and characteristics of the chains are co-determined. For example, some franchisors choose to operate many of their establishments as corporate-owned outlets while others choose fewer or none. They also choose to develop their business over several years prior to franchising, or to start franchising almost as soon as they launch their first establishment. Some grow very rapidly whereas others follow a more gradual process. Nonetheless, by relating the presence of covenants in 2020 franchise contracts to franchisor characteristics in 2010, we can focus on the contract decisions of established franchisors with presumably, by then, more settled practices as well as emphasize the relationship of covenant incidence with fixed, earlier business characteristics and conditions.

Of course, as researchers, we are limited in what we observe. Our descriptive picture is subject to significant omitted variable bias concerns. Moreover, many of the characteristics that we use in our regression analysis may relate to the use of the covenants for different reasons, which makes predictions about coefficients difficult. For example, larger chains (in terms of outlets) are likely to be older, more experienced, and to have more invested in their brand and business model, which would suggest that they might be more interested in protecting their IP. On the other hand, because larger firms are well-established and their brand is known, they might be less worried that a former franchisee or related individuals or employees might start a competing business. Similarly, chains that rely more on formal IP, such as patents and copyrights, may be less concerned about other firms creating a similar business; conversely, they may engage with formal IP mechanisms in part because they are very concerned about these issues. Chains that have spent more time developing their business prior to franchising might have

[30] Logit regression results are similar in substance.

done so to create a higher value business proposition, in which case they may worry less about copycats. At the same time, a greater number of years in business before they start franchising may be a signal that the franchisor is more wary about franchising and the potential dissemination of information is a serious concern. In the end, we let the data reveal the most prevalent patterns and focus our interpretation of results on what the estimated relationships might suggest about the role of the covenants.

5. RESULTS

5.1. Covenants Restricting Franchisees

Table 2 reports the frequency of a wide range of covenants that limit franchisee activities under the franchise contract. The first three columns cover clauses that bind during the franchise relationship (i.e., confidentiality, obligation to operate the business, and prohibition on involvement in a competing business), and the last three columns cover clauses that bind franchisees after the termination of the franchise relationship (i.e., confidentiality, noncompetition, and non-recruitment).

We begin with confidentiality clauses. We find that such clauses are uniformly present as restrictions on franchisees, both during and after the franchise relationship. All franchise agreements in our data define confidential information and describe measures that franchisees must take to protect confidential information against dissemination both during after the end of the relationship.[31] The contracts, moreover, often mention the need to return operations manuals and all copyrighted materials when the franchise relationship ends.[32] Confidentiality clauses have the potential both to interfere with franchise mobility and protect against information leakage (by increasing the risk of litigation in the case of a disclosure in breach of the clause), but as we explain in Section 3, in the context of franchisees, the former account is substantially less plausible. Instead, the uniformity of these clauses with respect to franchisees is consistent with all franchisees (in these business-format franchises) having relatively

[31] An example of such a clause is: "*Franchisee acknowledges that during the term of this Agreement Franchisee will have access to and become acquainted with various trade secrets, inventions, innovations, processes, information, records, and specifications owned or licensed by (…) and/or used by Franchisor in connection with the operation of its business, including, without limitation. Franchisor's business and product processes, designs, methods, supplier and product lists, and procedures. Without this information, Franchisee could not effectively and efficiently operate said business. Franchisee agrees that Franchisee will not disclose any of the aforesaid, directly, or indirectly, or use any of them in any manner, either during the term of this Agreement or at any time thereafter, except as required in the course of operating the Franchised Business*." (emphasis added).

[32] For example: "*Franchisee will immediately turn over to Franchisor the Manual(s), Confidential Information, and all information for which Franchisor claims a copyright, instructions, software and accompanying documentation, all other materials provided by Franchisor related to operation of the Franchised Business, and all copies thereof (all of which are acknowledged to be Franchisor's property). Franchisee will retain no copy or record of any of the foregoing, excepting only Franchisee's copy of this Agreement and any correspondence between the parties, and any other documents which Franchisee reasonably needs for compliance with any provision of law*." Confidentiality clauses are often written in a way that cover both the period during and after the franchise relationship ends, as is the case in the clause in footnote 19.

unfettered access to high-value trade secrets and other sensitive information and materials as well as experience with valuable training methods.

Table 2: Covenants Restricting Franchisees During and Post Relationship

	During the Franchise Relationship			Post Franchise Relationship		
Year	Confidentiality	Obligation to operate the business	No involvement in competing business	Confidentiality	Noncompete	Non-recruitment
2010	100.0	44.4	90.4	100.0	86.7	38.2
Weighted	100.0	43.0	83.2	100.0	76.9	22.4
2020	100.0	41.3	90.1	100.0	86.0	19.8
Weighted	100.0	43.1	81.5	100.0	79.8	6.8

Incidence is calculated based on the full set of 293 chains in each of 2010 and 2020. *Weighted* refers to weighted averages using total number of outlets.

One might be concerned that confidentiality clauses are easy to impose, so perhaps franchisees encounter these covenants because *everyone* that these contracts mention is also required to agree to protect confidential information. By contrast, the leakage-prevention hypothesis predicts that contracts should more often bind franchisees, who pose greater risks of leakage due to their greater access, than other individuals whom these franchise contracts address. We can evaluate this hypothesis by comparing the numbers in Table 2 to Table 4 (franchisee-related individuals) and Table 5 (managers and employees). In our sample, franchisors simply do not impose confidentiality obligations on everyone or almost everyone willy nilly. Franchisees are uniformly bound, but all other categories of individuals are much less likely to face a confidentiality constraint. The ordering of how likely groups are to be bound is consistent with the leakage-prevention hypotheses: business partners are the next most likely to be bound, then managers, then family members, and finally all employees, with family members and employees facing confidentiality requirements less than one-third of the time, regardless of how we weight our observations. This pattern of covenant use aligns far better with the goal of protecting valuable information to encourage franchisor investment in developing and maintaining their IP rather than reducing mobility to suppress wages or reduce turnover costs in a welfare-reducing way.

Other contract constraints on franchisee behavior seem to focus on right-sizing franchisee incentives in potentially welfare-enhancing ways. As we argue above, although franchisees are residual claimants and so in general have strong incentives to exercise effort, a franchisee's effort also produces positive externalities that the franchisee cannot capture. Being responsive to customers, having clean facilities, etc., create surplus for other franchisees (and the franchisor) by building the brand's reputation for value. Franchisors often choose to develop their brand and business via franchising because they are interested in having owner-operators with very strong incentives building their business in their local

market. Franchising is much more about finding owner-operators than it is about finding absent investors. Recent survey data from Entrepreneur Magazine, for example, indicate that more than 3 out of 4 franchisors say no when asked, "Is absentee ownership allowed?" (PR Newswire, 2024). Ownership provides relatively strong incentives for effort, but economic theory tells us that these incentives are suboptimal for the network and can be improved through the use of constraints that formally prohibit choices that might lead to lower effort levels.

In our data, we find that many franchise contracts require that the franchisee work full-time operating the franchised business. This requirement goes beyond merely forbidding involvement in another business that competes with the franchisor in the product market. By prohibiting any opportunity, including leisure, that might distract or dissuade the franchisee from personally running the franchise, the clause effectively augments the franchisee's return on effort by conditioning their franchise on their promise to eliminate potential conflicts of commitment. These clauses are fundamentally related to the franchisee's role in the business and the incentives for effort that the contract aims to create.[33] We find that somewhat fewer than half of the franchisors in our data explicitly impose this requirement, with 44 (41) percent of them doing so in 2010 (2020), and that this frequency remains about the same when we use the number of outlets to weight the contract data.

During the franchise relationship, not surprisingly, franchise contracts also typically limit the other business activities franchisees may undertake, a prohibition on conflicts of interest as opposed to conflicts of commitment. Restrictions on competition, in column 3, are very common: around 90 percent of contracts include a clause restricting the franchisee's opportunity to operate or own or be involved in a competing business during the franchise relationship. This proportion is somewhat lower, at 82 percent, when we weight the data to reflect the number of establishments the covenant covers, which suggests, perhaps, that encouraging effort or reducing information leakage (or both) is relatively less important among larger, more established chains. It is unclear what would drive such a pattern if these franchisee restrictions were anticompetitive or otherwise welfare-reducing.

After the franchise relationship ends, franchise contracts constrain franchisee behavior in at least three ways: by insisting on confidentiality, by prohibiting competition with the franchisor, and by restricting recruitment (i.e., "poaching"). Confidentiality obligations bind all franchisees after the contract ends, as before, but we also find that 86 percent of the contracts include noncompete covenants. The frequency of noncompetes binding franchisees is much higher than the frequency of such clauses

[33] We classify as a "yes" only the clauses that require the full-time involvement in the operation of the business—otherwise, one could operate the business but still be involved in other businesses. An example of such a clause is: "*You must personally participate in the day-to-day operation of your Restaurant or Restaurants*." An example of language that we code as not imposing this restriction is: "*if you are an individual, you must either serve as a Manager or designate a Manager*" (i.e., not requiring the franchisee to operate since they are allowed to designate a Manager).

in employment contracts, which Starr et al. (2021) estimate at 18 percent of the labor force, while Rynders & Looney (2024) estimate an 11 percent frequency. Even in industries and professions where the incidence of noncompetes in employment contracts appears to be very high, few if any categories of employees are bound at rates of 80 percent or higher. Noncompetes that bind franchisees, as we note in Section 3, make sense as devices to increase franchisee effort ex ante and reduce information leakage ex post, but make little sense as a means of inefficiently appropriating surplus from franchisees. The fact that more than four out of five contracts include covenants not to complete implies that the former motives for the use of these clauses are particularly salient in franchising.

The scope of a noncompete clause—in terms of duration, geography, and industry—affects its economic impact and enforceability. We find that virtually all the post-termination noncompete covenants in franchise contracts are limited in duration, and the average period is 23 months in both 2010 and 2020. Starr et al. (2021) find a similar duration for such covenants in employment contracts. The contracts also almost always (i.e., 96 percent of the time) delimit the geographic scope of the noncompete clause, typically in terms of distance from the franchisee's previous outlet, averaging about 25 miles.[34] This is more limited in scope than the clauses found in employment contracts, which often cover the entire state or country (Starr et al., 2021).[35] Finally, essentially all noncompetes in our sample define what it means to compete, although this can be either via a simple statement referring to "a competing business" or with a specific mention of type of business (i.e., sector or industry).[36] What these terms imply for the motivation behind requiring noncompetes for franchisees is unclear, but the limited geographic scope of the typical constraint for an inter-state franchisor appears more consistent with improving incentives for effort.

Table 2 also shows that non-recruitment clauses, which typically prevent a former franchisee from hiring individuals employed by the franchisor (or any other franchisee in the network) for a new venture outside of the chain once the franchise relationship ends, appear in 38 percent of franchise

[34] Specifically, in 2020, more than 85 percent of them use a distance in miles, while 8 percent limit the restriction to a designated area such as a county. Only 1 percent of the contracts stipulate that the restriction covers the entire Unites States.

[35] Starr et al. (2021) also report that 20 percent of individuals with noncompetes are uncertain as to the precise terms of their covenant, which might explain the difference in geographic scope. On the other hand, franchisors might be more careful in tailoring these clauses to increase enforceability.

[36] For example: *"directly or indirectly, irrespective of whether compensation is provided, enter into the employ of, render any service to or act in concert with any person, partnership, limited liability company, corporation or other entity that owns, operates, manages, franchises or licenses any business that (A) sells pizza or other non-pizza products (excluding soft drinks) that are the same as those sold by* (…) *restaurants on a delivery or carry-out basis, including, without limitation, business formats such as* (…)*, or (B) derives 20% or more of its gross revenues, at the retail level, from the sale of pre-cooked, ready-to-eat food products on a delivery basis (a 'Competitive Business.')*"

contracts in 2010 but a smaller 20 percent of these contracts in 2020.[37] Frequencies are lower when we weight observations using the number of establishments in the chains, implying larger chains rely less frequently on these covenants. Of note, in 2020, non-recruitment clauses apply to only 19.5 percent of chains, and 7 percent of establishments, in our data.[38] Non-recruitment clauses can encourage franchisee effort ex ante by limiting post-relationship alternatives in all industries in the same way that noncompetes can within the franchisor's industry. Reducing the ability of a former franchisee to recruit managers or employees from the franchise may dampen the bargaining power of managers and employees somewhat but certainly not to the extent that imposing noncompetes on managers and employees has the potential to do. All in all, our data seem consistent with the use of non-recruitment clauses to enhance franchisee effort. Other accounts appear less plausible.

We examine whether franchises in different lines of business differentially rely on franchisee restrictive covenants in Table 3, which shows the frequencies across the six industry categories in our data for 2020. Interestingly, none of the chains in the lodging sector in our data impose any restrictive covenants besides confidentiality on franchisees (which all franchisors use in our data). Why this is the case is an interesting question. One possible explanation lies in the lack of alternative uses for the physical capital in the lodging industry. Preventing a franchisee from continuing to operate after the relationship terminates would likely lead a hotel owner to avoid affiliating with a brand, since the asset has no other comparably valuable use. And, indeed, the lodging sector turns out to be one where franchisees do operate a given property under different brands at different times, with changes arising as the physical capital ages or locations become desirable from the brand's perspective as well (Ruane, 2014). Hence, the norms about being involved in competing businesses, and the issues surrounding intellectual property as well, might be different in this industry.

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[37] For example, "*You may not, during the term of this Agreement and for a period of three (3) years after any termination, or expiration (…) You further agree that neither you, nor any member of your immediate family, nor any such shareholder or partner will:*

(…)

(e) recruit or hire any employee of ours, our Affiliates, or our franchise owners without our prior written consent and/or that of the other franchise owner or Affiliate."

[38] In Appendix (5), we provide the equivalent of Tables 2, 4, and 5, focusing on within-chain changes in the usage of these clauses. This analysis confirms that the very similar frequencies we find for 2010 and 2020 are the result of franchisors keeping the same clauses in their contracts over these 10 years. We also find that the few changes we see in the use of covenants are not all one-way, i.e., there are franchisors that add and franchisors that drop the same type of covenant. However, we document that 21.5 percent of firms stopped using post-relationship non-recruitment clauses in their contracts between 2010 and 2020. We believe that the impetus for this set of changes may be related to the removal of no-poaching clauses (non-recruitment within the chain while a franchisee) by numerous franchisors reacting to increased policy concerns around these clauses. In the absence of shocks such as legal challenges, contractual solutions to protecting information do not change much over time (Jennejohn et al., 2022; Choi et al., 2013). Slow adaptation in contract content is perhaps not surprising in the franchising context where contracts often last for 15 to 20 years, but it is nonetheless an important feature of our data that is consistent with prior literature (Lafontaine & Shaw, 1999; Lafontaine & Shaw, 2005).

Table 3: Covenants Restricting Franchisees By Industry

Industry, 2020	*During*		*After*	
	no involvement in competing business	obligation to operate the business	noncompete	non-recruitment
Auto	100.0	42.9	95.2	19.0
Food & Beverage	95.0	36.2	97.5	16.2
Health & Fitness	92.0	42.0	86.0	20.0
Lodging	0.0	0.0	0.0	0.0
Professional Services	97.4	50.9	89.5	25.4
Retail	83.3	33.3	75.0	16.7

Incidence out of the 293 chains in our data, which is divided by industry as follows: 21 auto & travel; 80 food & beverages; 50 health & fitness; 16 lodging; 114 professional services; 12 retail.

Table 3 also shows that while on average franchises across all sectors tend to rely on noncompetes and non-competition during the relationship to a much greater extent than the other two types of covenants, industries differ discernably in their usage of the former clauses as well. In contrast to the uniformity in the use of confidentiality clauses, average frequencies for noncompete-type clauses differ by 10 percentage points or more apart in the sectors with the least versus most frequent use. There is considerable variation in the use of different covenants within industries as well. This heterogeneity, on its face, suggests different motivations and factors affecting the use of these clauses.

5.2. Covenants Restricting Franchisee-Related Individuals

Table 4 summarizes the frequency with which franchisors apply restrictive clauses to business partners and family members.[39] We consider these categories of individuals to be subject to a clause if the covenant language references them or the contract stipulates that they must sign their own covenant.[40] We find that business partners—who are often part owners of the business—are not covered by clauses as frequently as franchisees are, but contracts do regularly impose restrictions on them: a large majority of contracts impose confidentiality and noncompete covenants on business partners. For family members, the numbers are substantially lower, with only one out of four or so contracts imposing a

[39] There is another category of individuals mentioned in some of the clauses, namely directors and officers, who can be part of the franchised business if the latter is incorporated. We do not analyze clauses for this category for conciseness, but also because some of these individuals may be employees while others are not, and we want to clearly identify clauses for employees and non-employees. Appendix (6), Tables 6.a, 6.b, and 6.c, gives some information about clause frequency for these individuals, which tends to be lower than those we report for other categories of individuals with the exception of all employees—presumably because, while some franchised businesses are incorporated and can be quite large (even publicly traded), most franchised businesses would not have directors and/or officers that would be distinct from the franchisee, business partners and managers.

[40] For example, "*Franchisee acknowledges that Franchisor has granted Franchisee the rights under this Agreement in consideration of and reliance upon Franchisee's (and its Owners') agreement to deal exclusively with Franchisor with respect to the products and services that (...) Restaurants offer. Franchisee therefore agrees that, during the term of this Agreement, neither Franchisee nor any of its Owners, nor any members of their Immediate Families (defined below), will: ...*". In Appendix (6), we provide the frequencies distinguishing between when franchisee-related individuals are only covered by post-relationship restrictive covenants via mention in the franchise contract and when they are only required to sign separate covenants.

confidentiality or a noncompete clause. Notably, these frequencies drop when we weight them based on the numbers of establishments. In other words, smaller chains in our data more often extend these post-termination covenants to cover these individuals than do larger ones, which matches the pattern we observe for covenants binding franchisees.

Table 4: Post-Termination Covenants Restricting Franchisee-Related Individuals

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Business partners	Family members	Business partners	Family members	Business partners	Family members
2010	74.4	24.6	65.2	24.2	31.4	7.5
Weighted	51.8	18.8	38.4	15.2	15.9	1.9
2020	76.5	31.4	67.6	31.1	19.5	7.5
Weighted	55.5	21.6	49.2	21.5	10.0	2.7

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

Our findings are consistent with franchisors using all three types of clauses to reduce information leakage. Neither business partners nor family member operate franchise outlets directly, nor do these categories of individuals receive wages or generate turnover costs. Some of them may be owners of the business, and some may even participate in the operations of the business. But the imposition of these constraints on them seems unlikely to inefficiently extract surplus or generate anticompetitive rents. Effort-enhancement and wage-suppression theories thus seem hard to square with these contractual choices. Of the two, franchisee effort enhancement seems more plausible because franchisees may be able to operate through business partners and family members in ways that distract from the operation of the franchised business. But both sets of individuals have access to confidential information, especially business partners, and confidentiality and noncompetes have the potential to discourage the dissemination of valuable information. Importantly, the heterogeneity we observe is inconsistent with a kitchen sink way of drafting the contracts, and contractual references to family members, in particular, imply a more complex set of motivations on the part of franchisors.

5.3. Covenants Restricting Managers and Employees

Restrictive clauses that relate to the conduct of business partners and family members operate by treating these individuals as "covered" by the franchise contract, making the franchisee and other signatories at a minimum responsible for their behavior, although business partners and family members may be held personally accountable under some conditions in certain jurisdictions even if they do not sign the franchise contract themselves. Franchisors approach restricting employee conduct differently, presumably because traditional post-employment covenants that simply refer to employees—for example, "franchisee agrees that employees shall not compete," i.e., the franchisee agrees to the covenants on employees' behalf—are unenforceable against employees absent their separate assent. Consistent

with this, we find it is relatively rare that franchise contracts simply describe employees and their obligations in the franchise agreement (see Appendix (6), Table 5.B). Instead, franchise contracts typically impose covenants on employees indirectly by requiring that the franchisee execute separate agreements with them. In our analysis, we consider managers and other employees to be bound by a covenant when the contract stipulates that the franchisee, to avoid breach, must require that these individuals sign their own contract containing the covenant in question.[41]

Table 5 shows how often franchise contracts require managers only, and then all employees, to sign their own post-employment covenants.[42] We find that managers are bound by confidentiality agreements in almost two-thirds of the chains in our data in 2020, but fewer than one out of every four franchisors requires that all employees sign such covenants. A smaller percentage of chains require both managers and all employees to sign noncompetes (37 and 10 percent, respectively, in 2020), and even fewer impose non-recruitment covenants on managers and on all employees (13 and 5 percent, respectively). Notably, weighted results again show that larger franchised chains on average rely less on such covenants to restrict employees' post-employment opportunities. In fact, when we study incidence at the outlet level via weighting, which gets us closer to measuring the proportion of employees covered, we see a rate of noncompete for employees of less than 3 percent in 2020, much lower than the 11 percent mentioned in Rynders & Looney (2024).[43] These authors also put the rate of noncompetes for employees in fast-food services at about 5 percent, which is more in line with our results. The chains here, however, are not involved only, or mostly, in the fast-food sector.

Table 5: Covenants Restricting Managers and All Employees

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Managers	All employees	Managers	All employees	Managers	All employees
2010	59.0	22.2	35.5	13.0	17.7	5.8
Weighted	30.2	17.3	12.8	5.1	5.2	1.7
2020	63.8	22.5	37.5	9.9	12.6	4.8
Weighted	34.9	16.0	16.8	2.7	4.6	1.7

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

[41] As Appendix (6), Table 5.C, shows, including cases where the franchise contract mentions employees does not change covenant frequencies by very much. However, we do not view these cases as creating enforceable constraints, for reasons we describe in Section 3.

[42] An intermediate group of employees, referred to as "key employees" or "employees with access to confidential information" or the like is also mentioned in some of the contracts. Typically, the frequency with which contracts require these individuals to sign their own agreements is between the frequency for managers and all employees, but closer to that of managers. We do not discuss these data for the sake of brevity.

[43] However, it is worth recalling that in our data we see whether the franchisor requires franchisees to have (some of) their employees sign covenants such as a noncompete. This means that franchisees might extend this requirement beyond managers, for instance, thus leading to a larger incidence of noncompetes in fact.

Franchise contracts often explicitly justify requiring restrictive covenants for employees on the grounds that employees have access to confidential information, training, or both. This motivation implicitly limits the scope of the covenants by making it clear that employees need not agree to the covenant when they do not, for instance, pose a risk of information leakage.[44] Admittedly, wage suppression may be a negative byproduct of a franchise contract that imposes covenants on "all employees," but it is hard to credit wage suppression as the underlying motivation for requiring the clauses. As we note in Section 3, franchisors only benefit indirectly from franchisee wage suppression, given that franchisor returns are a function of revenue, not profit. Reducing labor and turnover costs benefits franchisees' bottom lines much more directly, so even if a franchisor benefits indirectly from a franchisee exercising monopsony power, a franchise-contract mandate would be unnecessary. By contrast, the franchisee has much weaker incentives to protect valuable franchise information than the franchisor does. The fact that franchisors *require* that franchisees impose covenants on employees is therefore more consistent with the goal of preventing information leakage. A franchise contract might also require the franchisee to impose covenants on all employees with the goal of inducing optimal effort among employees, but supervision and other employment contract terms exist can accomplish these ends.

The disparity in the use of covenants between managers and all employees is also harder to understand without putting some weight on traditional efficiency explanations for such clauses. If wage suppression were somehow an important motivation for imposing the restraints, we would expect usage to be more uniform across classes of employees and perhaps also more common across the board. Managers have greater access to valuable information and materials and have more discretion in how they carry out their tasks and supervise employees, so the more intensive use of covenants among their ranks seems in line with preventing information leakage and encouraging optimal effort.

Our results also surface an important insight about the larger literature on noncompetes, which has generally treated the relationship between the employer and employee as the locus of the decision to impose noncompetes and other post-contractual covenants. Our research shows that in contexts such as franchising, but also potentially in joint ventures, alliances, and so on, business entities that are related to the employer by virtue of a commercial contract may have an efficiency-oriented interest in whether the employer constrains their employees. In franchising, the franchisor owns the valuable IP that might be protected via such clauses and so the franchise contract can be the reason why an employer imposes, or is constrained by contract to impose, contractual restrictions on their employees.

[44] An example for a confidentiality clause is: "*Franchisee agrees to require any personnel having access to any confidential information of (...) or information about Clients or potential clients to execute covenants that they will maintain the confidentiality of information they receive in connection with their employment by or association with Franchisee in the* (…) *Business. Such covenants shall be in a form satisfactory to* (…)*, including specific identification of* (…) *as a third-party beneficiary of such covenants with the independent right to enforce them*" (emphasis added).

5.4. Covenant Funnels: From Franchisees to Other Covered Individuals

Post-relationship covenants often come in bundles (Balasubramanian et al., 2024; Boeri et al., 2024).[45] Table 2 shows that franchisees' covenants are bundled in a very particular way. All franchise contracts include a confidentiality clause for franchisees, and almost all of them impose restrictions on competition following the termination of the franchise. For franchisees, then, whenever the contract includes a non-recruitment clause, all three post-relationship clauses occur together, while confidentiality and noncompete clauses are almost universally bundled. These bundles are generally consistent with the goal of protecting valuable information and reinforcing efficient incentives to engage in optimal effort; while confidentiality agreements may create some drag on mobility, they almost certainly have less potential than noncompetes to give franchisors market power. Accordingly, labor monopsonistic and wage suppression theories predict that franchisors would at least sometimes prefer noncompetes over confidentiality agreements. But we do not observe this configuration.

Our results also suggest another way in which contracting parties can "combine" covenants: by applying similar covenants to different sets of individuals (as opposed to different covenants to the same set of individuals). A franchise contract addresses many types of individuals at once. In an employment setting, we would explore this question by examining covenant use in the aggregate nexus of individual employment contracts. Existing noncompete research raises questions about "which" employees working for the same employer are subject to these provisions, for instance, and has sometimes sought to draw inferences from an employer's choice to apply covenants only to highly compensated individuals, to individuals with access to client lists, and to individuals in particular occupations. To our knowledge, little information exists on the distribution of covenants across employees with the same employer, but FDDs allow us to investigate this idea within a franchised network.

More specifically, in this section, we ask: If a franchise contract restricts a franchisee's activity by imposing a particular covenant, are other individuals within the franchise network more likely to face the same covenant? Alternatively, if a franchisee does not face a certain restriction, do we ever observe other individuals within that franchise being subjected to that restriction? This question is more than just a curiosity. Critics of restrictive covenants point out that noncompetes imposed on low-wage workers but not managers within an employer are unlikely to be motivated by traditional concerns about information leakage. If restrictive covenants in franchise contracts enhance welfare by reducing information leakage and improving incentives, we should see them apply first to franchisees, where such motivations are most salient, and then perhaps to other sets of individuals under certain circumstances.

[45] The rationale behind the bundling is relatively straightforward: for example, once an individual is required to sign a covenant such as a noncompete, it is often the case that the same agreement also includes a confidentiality clause aimed at specifying the information that the noncompete aims to protect.

However, we should rarely if ever see covenants apply to other groups of individuals if franchisees are untouched. Other motivating theories, like wage-suppression, do not imply such a pattern.

Table 6 summarizes our results, with each group of individuals in the last four columns assessed based on whether the franchisee is covered by a particular type of covenant. As franchisees are always covered by confidentiality clauses, the number of franchise contracts in 2020 that cover, for example, business partners, or family members, shown in the first row of the table, is the proportion shown for 2020 in Table 4 for these types of individuals, multiplied by the number of franchisors in our data. But for the other clauses, the number of occurrences for the clauses for the sets of individuals in the header is split by whether the franchise contract binds the franchisee with such a covenant.

Table 6: Funnels of Post-Relationship Restrictive Covenants

Confidentiality					
	Franchisees	Business partners	Family members	Managers	All employees
Yes	**293**	224	92	187	66
No	**0**	0	0	0	0
Noncompete					
	Franchisees	Business partners	Family members	Managers	All employees
Yes	**252**	198	91	107	27
No	**41**	0	0	3	2
Non-recruitment					
	Franchisees	Business partners	Family members	Managers	All employees
Yes	**58**	48	20	24	9
No	**235**	9	2	13	5

Number of clauses in the 293 chains in our sample in 2020.

What Table 6 allows us to show is that it is rare for individuals in a franchise network to face a restrictive covenant if the franchisee does not. There are some exceptions, especially for non-recruitment clauses, but as a rule, a franchise contract applies clauses to other individuals only when the franchisee is bound by the same covenant.[46]

The funneling of clauses of course suggests a degree of intentionality in the use of the covenants that goes beyond mere heterogeneity. A certain dimension of that heterogeneity has a clearly discernable pattern that is clearly nonrandom. More important for our purposes, if the rationale for the use of covenants were a desire to suppress wages, we would expect to see a higher incidence of clauses for managers and employees at least when franchisees are bound. Instead, most franchisors choose not to

[46] The reliance on non-recruitment clauses with franchisees is one place where there has been change over the 2010-2020 period—see Appendix (5). We expect that the imposition of this restriction on others when the franchisee is not bound by the same might well be due to a lag in adjusting the terms of the contract. In particular, the clauses might remain embedded in templates for other individuals but not the franchisees because the templates have not yet been updated.

impose post-relationship restrictive covenants on managers and employees even when imposing these same covenants on franchisees. Ganco et al. (2024) discuss how firms' decisions to use (or not use) covenants such as noncompetes depend on their specific needs and strategies. In our context, franchisors face additional tradeoffs in imposing these constraints on franchisees and other individuals. For instance, most franchisors are continuously recruiting new franchisees. The burden of restrictive covenants already renders it difficult to recruit strong candidate franchisees, so imposing requirements also on their business partners or family members can make the franchise opportunity even less appealing to potential franchisees, leading to slower growth overall for the chain. Similarly, the desire to require franchisees to have their employees sign certain covenants must be weighed against the risk of exerting levels of control over franchisees' business activities that could raise concerns about their status as independent business owners and creating a risk of joint employment status (Griffith, 2019).

5.5. Noncompetes and Chain Characteristics

One approach to explore franchisors' motivation for the use of restrictive covenants is to look for relationships between characteristics of the franchised network and covenant use. This analysis allows to consider, for example, whether formal IP protections or large numbers of corporate-owned outlets are associated with the use of restrictive clauses, although, as we note earlier, our analysis is not causal and, even if it were, the interpretation of any correlation is often ambiguous. We assess the potential descriptive value of this approach by analyzing the determinants of noncompete clauses that bind our different categories of individuals (i.e., franchisees, business partners and family members, and managers and employees). Given the widespread academic and public policy attention devoted to noncompetes in recent months, it makes sense to report these results here. Results for other clauses are available upon request.

Table 7 shows the estimates of linear probability models of the use of noncompetes for different individuals in 2020. The use of a noncompete is regressed on a number of fixed characteristics of the chain, including the year it started franchising, the number of years it spent in operation developing its business model prior to franchising, the amount of training the chain provides to franchisees, whether the chain's headquarters are in California, and several time varying characteristics such as the size of the chain, the extent of corporate ownership of outlets, and the amount of formal intellectual property the franchisor owns. We measure the time-varying characteristics of the chains using our 2010 observations to avoid any reverse causation issues in the regressions.

The regression results show first that the chain characteristics appear to do a much better job at explaining the use of noncompetes for franchisees than for any of the other types of individuals: the goodness of fit is much higher in the franchisee column compared to the other columns, and more regressors have statistically significant coefficient estimates in the franchisee column as well. In other

words, chain characteristics that lead to the use of noncompetes for franchisees in many cases do not have the same capacity to explain when franchise contracts impose noncompetes on others. In all cases, however, we see that the chain's line of business matters, that the use of the covenants varies depending on the type of industry. While all theories are conceivably consistent with this pattern, using noncompetes to successfully suppress wages seems relatively less likely to depend on the industry if many of the employees receive low wages and are not highly skilled.

Table 7: Noncompetes and Chain Characteristics

	Franchisee noncompete	Business Partners noncompete	Family members noncompete	Managers noncompete	All employees noncompete
Log(total outlets in 2010)	-0.029*	-0.037*	-0.009	-0.028	-0.016
	(0.012)	(0.017)	(0.008)	(0.025)	(0.015)
% Corporate Outlets in 2010	0.001*	0.000	0.001	0.001	-0.001
	(0.000)	(0.001)	(0.002)	(0.001)	(0.001)
Log(yrs in bus. pre-franchising)	-0.012	-0.018	-0.051	-0.016	0.008
	(0.018)	(0.016)	(0.039)	(0.010)	(0.012)
Year first franchised	0.003	0.001	0.001	0.003	0.001
	(0.002)	(0.001)	(0.002)	(0.002)	(0.001)
Log (formal IP in 2010)	0.027**	0.014	0.064***	-0.001	-0.004
	(0.010)	(0.042)	(0.014)	(0.035)	(0.008)
Training (in weeks)	0.006	0.010	-0.008	0.006	0.008*
	(0.005)	(0.007)	(0.006)	(0.005)	(0.004)
HQ in California	-0.069*	-0.153**	-0.152**	-0.041	-0.080*
	(0.033)	(0.057)	(0.041)	(0.032)	(0.039)
Sector Fixed Effects	Yes***	Yes***	Yes***	Yes***	Yes***
R-squared	0.440	0.167	0.098	0.107	0.072
Obervations	293	293	293	293	293

Whether a noncompete is present is measured in 2020. Errors clustered at the sector level.
Significance levels: 0.01: ***; 0.05: **; 0.10: *

With respect to franchisee noncompetes, we detect a tendency for larger franchised chains to rely less on noncompetes. This could reflect the fact that larger, more established chains are less likely to be concerned about copycats. But since larger chains might benefit relatively more—albeit indirectly—from reduced labor costs throughout the chain, this tendency for large chains to use noncompetes less seems inconsistent with a wage suppression motive.

Chains with more corporate units have an incentive to keep costs low in those outlets. If imposing noncompetes in corporate stores necessitated, for some reason, also imposing them on franchisees, the positive relationship between of the proportion of corporate stores and the use of noncompetes is consistent with a wage suppression motive. However, since chains are only about 11-13 percent corporate, imposing noncompete constraints on franchisees in all other outlets seems like a blunt and perhaps costly way to suppress wages. Moreover, we detect no relationship for managers and all employees in columns 4 and 5, which one would expect to see if wage suppression were the reason for the franchisee relationship. As a potential confounder, chains with higher value brands have been shown to operate more outlets corporately (Lafontaine & Shaw, 2005), presumably to protect their brand. Such

franchisors might impose noncompetes to protect their investments in their brand and business model from dissemination as well.

The results in Table 7 also show that the year in which franchisors first started franchising is positively – though not quite statistically significantly - related to the use of noncompetes. Early adopters of the franchise model of business development thus seem to rely less on noncompetes with their franchisees, and with their managers, than franchised chains that became involved in franchising more recently. This might be ascribed to some form of learning or adoption of innovation in contracting over time. On the other hand, chains that rely more on formal IP tend to impose noncompetes on their franchisees and their family members, suggesting that those chains have more need to protect IP. It is also noteworthy that the amount of training provided is the one variable that is positively and statistically significantly related to the use of noncompetes with all employees.[47] All in all, Table 7's results are consistent with our previous findings, suggesting a degree of intentionality in the use of noncompetes and highlighting distinct rationales for their inclusion in business versus employment contracts.

6. CONCLUSION

In this paper, we examine the use of various covenants—including noncompetes, confidentiality, and non-recruitment clauses—in business-format franchise contracts. Our primary goal is to document how these clauses are deployed in contracts and to distinguish between three theoretical explanations for their use: preventing the leakage of competitively sensitive information (IP protection), inducing effort by limiting alternative outside opportunities, and restricting mobility to suppress wages. Our findings highlight the need to differentiate the use of mobility-restricting covenants in business versus employment relationships, as these clauses can serve distinct functions depending on the context.

Focusing on franchisees, we find that confidentiality clauses are present in all contracts in our data, noncompetes in nearly all, and full-time attention requirements in about half. These restrictions often extend beyond franchisees to business partners and family members, even though these individuals do not receive wages from the franchisor or franchisee. Unlike franchisees, these individuals' outside opportunities do not directly affect the success of the business, suggesting that the primary motivation for imposing such constraints is to prevent information leakage. The fact that managers are bound by these clauses in 38 percent of contracts—but noncompetes apply to all employees in only 10 percent of contracts, covering just 3 percent of establishments—further supports the idea that these covenants are primarily aimed at protecting proprietary information rather than suppressing wages.

[47] Finally, chains headquartered in California rely on noncompetes to a lesser extent with all types of individuals, either reflecting their understanding of the local lack of enforceability, or their capacity to develop mechanisms to otherwise protect their business model. Starr et al. (2021) shows that noncompetes in employment contracts are used also in California even if they are unenforceable.

Our results also show that franchisors do not impose covenants indiscriminately. Chains in different sectors vary in their reliance on these clauses, influenced by both industry and franchise-system-specific characteristics. While policy discussions have focused on noncompetes in employment relationships, our findings suggest that business contracts—such as those in franchising, licensing, joint ventures, and alliances—also can have a strong interest in restricting the use or dissemination of sensitive information. Regulatory efforts should therefore maintain a distinction between business and employment relationships. While nuanced regulations may be needed to prevent unfair restrictions on former franchisees, outright limitations on these covenants could undermine business formation and job creation by making franchising and similar arrangements less attractive (Murry & Newberry, 2022).

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Appendix 1. The current legal framework for covenants

In this appendix, we summarize the legal rules governing noncompetes, confidentiality, and non-recruitment covenants in the U.S. As a general legal matter, the legitimacy of these types of covenants is assessed under a reasonableness test when they are ancillary to either business or employment contracts. In other words, these covenants do not independently violate the antitrust laws. However, they might be assessed to determine if they are reasonable.

Noncompete covenants prevent individuals from competing with their former business partner or employer during the contractual relationship, or after it ends, or both. In a franchise contract, a typical noncompete clause for the franchisee after the franchise relationship ends would prevent them from operating a competing business within a geographical location and for a certain period. If included in the contract of an employee of a franchisee and/or the franchisor, a noncompete clause would prevent the employee from working for a competitor or operating a (new) competing business, usually within some time and geographical limitation. The legal status of noncompete clauses in employment and commercial contracts is governed by state laws [Westlaw, American law report, Validity and construction of restrictive covenant not to compete ancillary to franchise agreement (accessed October 19, 2023)]. They are usually assessed under a reasonableness test and enforced accordingly, although in recent years several states have restricted or banned their use in the context of employment relationships (Bishara & Luisetto, 2025).

At the state level, the same statute often regulates the use of noncompete covenants in commercial and employment contracts. In the state of Georgia, for example, the same rule applies to employment and commercial contracts (i.e. restrictive covenants are legitimate as they "serve the legitimate purpose of protecting legitimate business interests") by statute [2011 Georgia Laws Act 99 (H.B. 30)]. However, courts usually apply different standards of reasonableness, favoring noncompete covenants in commercial contracts over those in employment contracts. For example, noncompetes in employment contracts are banned by statute in California, with no exemption for commercial contracts—thus a contractual provision prohibiting the franchisee from competing is void and unenforceable; however, courts might enforce a noncompete clause if the franchisee uses the franchisor's trade secrets or otherwise engages in unfair competition [Westlaw, § 9. Noncompetition and trade secrets clauses | Secondary Sources | California (accessed October 19, 2023). The case of reference is Scott v. Snelling and Snelling, Inc., 732 F. Supp. 1034 (N.D. Cal. 1990) (applying California law)].

Unlike noncompetes, **confidentiality covenants** (often referred to as non-disclosure agreements) do not restrict job switching or mobility. The covered individual can work for a competitor or operate a competing business, but they cannot use any confidential or proprietary information of the

former business partner or employer. Obligations typically imposed include: restrictions against disclosure of the information to third parties; restrictions on use of the information, generally limiting use to the business purpose stated in the original commercial or employment agreement or to fulfilling contractual obligations; restrictions on access to and use of the information within the recipient's business and among its employees [Westlaw, Practical Law Commercial Transactions, Confidentiality and Nondisclosure Agreements (accessed October 19, 2023)]. Traditionally courts enforce confidentiality covenants if the restriction is reasonable in scope and tailored to protect legitimate business interests (Bishara et al., 2015). In recent years, some courts have started not enforcing confidentiality agreements that go beyond the protection of trade secret information—e.g., when they cover public information or workers' general knowledge (Hrdy & Seaman, 2023).

Unlike noncompetes, confidentiality clauses do not need to be restricted to a geographic area to be enforceable. Conversely, confidentiality covenants do not prevent the operation of a competing business or an employee working for a competitor. Thus, a franchisor interested in avoiding the replication of their business in the local market—i.e., a franchisor focused on its other units or new replacement—might favor the use of noncompetes, while a franchisor whose goal would be protecting their confidential information and system more generally might rely on confidentiality clauses. Whether franchisors aim at fulfilling either one or both these interests is an empirical question, and we can anticipate here that we see a large preponderance of both.

Non-recruitment covenants limit the ability of those who sign them to hire employees of the firm or current contracting party in other businesses during the relationship or upon departure. Non-recruitment agreements limiting a former employee from soliciting former colleagues to join in competition against the former employer are usually enforced by courts when they are reasonably limited—some states, such as Georgia, assimilate them to other restrictive covenants in employment contracts, thus requiring the same limitations as to time, territory, and scope of activities. In the context of franchising, when the franchisee or a business partner/owner are covered, the covenant forbids the recruitment of former employees, while they would be framed as non-recruitment of former co-workers when an employee is the subject of the agreement.

Appendix 2. Example FDD Table of Contents Provided by the FTC

Sample Table of Contents:

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Source: FTC (2008), Franchise Rule Compliance Guide, available at https://www.ftc.gov/business-guidance/resources/franchise-rule-compliance-guide

Appendix 3. Types of patents and registered copyrights used by franchisors

To shed light on the types of patents and registered copyrights used by franchisors in our sample, we extract and analyze information from the FDDs, specifically Items 14.

Patents. The U.S. Patent and Trademark Office (USPTO) issues different types of patents. A recently issued patent document is one of six types, of which the two relevant for our sample are (i.e. franchisors in this sample do not hold other types of patents): *Utility Patents* (Issued for the invention of a new and useful process, machine, manufacture, or composition of matter, or a new and useful improvement thereof, it generally permits its owner to exclude others from making, using, or selling the invention for a period of up to twenty years from the date of patent application") and *Design Patents* ("issued for a new, original, and ornamental design embodied in or applied to an article of manufacture, it permits its owner to exclude others from making, using, or selling the design").

N. of patents by type	2010	2020
Utility	27 (61%)	42 (62%)
Design	17 (39%)	26 (38%)
Total	44	68

Registered Copyrights. We follow the classification system used by the U.S. Copyright Office to classify the registered copyrights in our sample (note that this classification system is an internal policy of the office). This classification system consists of four designations: *Class TX: Nondramatic Literary Works*, which includes "included all types of published and unpublished works written in words (or other verbal or numerical symbols)"; *Class PA: Works of the Performing Arts*, which includes "published and unpublished works prepared for the purpose of being "performed directly before an audience of indirectly by means of any device or process"; *Class VA: Works of the Visual Arts*, which includes "published and unpublished pictorial, graphic, or sculptural works, including two-dimensional and three-dimensional works of fine, graphic, and applied art, photographs, prints and are reproductions, maps, globes, charts, technical drawings, diagrams, and models"; *Class SR: Sound Recordings*, which includes "both published and unpublished works in two situations: (1) where the copyright claim is limited to the sound recording itself; and (2) where the same copyright claimant is seeking to register not only the sound recording but also the musical, dramatic, or literary works embodied in the sound recording".

N. of registered copyrights, by designation	2010	2020
TX: Nondramatic Literary	33 (43%)	59 (32%)
PA: Works of the Performing Arts	22 (29%)	82 (45%)
VA: Works of the Visual Arts	16 (21%)	40 (22%)
SR: Sound Recordings	5 (7%)	3 (2%)
Total	76	184

Appendix 4. Sample construction and coding

Business-Format Franchise Contract Sample

Franchimp offers a database of FDDs representing 4,466 separate chains in total (https://www.franchimp.com/). From the original database, we selected a sample where we have franchised firms over 10 years (2010-2020ish) rule: 2021-2019 and 2011-2009 are good substitutes of 2010, with preference given to 2021 and 2011, and then recoded as either 2010 or 2020. We obtained a sample of 372 franchised chains. However, we found several cases where, although *Franchimp* had linked FDDs as being for the same chain, they turned out, in fact, to be for different chains. Eliminating these reduced our sample to 297 separate chains with FDDs available circa both 2010 and 2020. Moreover, we identified one case where the same chain was coded and linked to two different FDDs in the same year, so we remove the duplicate. This led to a sample of 296 separate chains with FDDs available circa both 2010 and 2020.

We then attempted to implement a strategy directed at extracting the information regarding noncompete covenants (as reported in ITEM 17) automatically. However, we realized that the information contained in ITEM 17 (the relevant ITEM for noncompete covenants) is not a precise description of what the franchise agreement states. Likewise, we found that franchise agreements contain further covenants as well as references to additional covenants to be signed by some individuals, and that FDDs contain templates, none of which are captured by the various ITEMS or in an organized way in the FDDs. This led us to conclude that proceeding manually – reading the franchise agreements directly - was best. However, we developed a data processing algorithm to extract information about the franchised chains' characteristics presented in Table 1.[48]

Having extracted information about the number of units (franchised, corporate-owned, and total units) for each franchised chain in each of 2010 and 2020, we implemented a series of checks to make sure that the extracted information was consistent (for example, the sum of the number of franchised and corporate-owned units must be equal to the total number of units). In doing so, we found that some of the FDDs related to 13 franchised chains reported 0 units. We searched for information about these

[48] Unlike most of the covenants we focus on (which are not found in pre-defined location in FDDs or franchise agreements), some information is listed in tables or specific ITEMS in FDDs. For example, the covenant that imposes the "obligation to participate in the actual operation of the franchised business" is listed in ITEM 15 in each FDD. For this covenant, then, we were able to extract the information automatically for roughly 2/3 of the franchisors in our sample (in the remaining cases, we had to extract that information via inspection). The same applies to other pieces of information (such as number of outlets) that do not require further action if extracted correctly. The performance of the automation process also heavily relies on the quality of the documents, and unfortunately, those related to the year 2010 were often not machine readable.

franchised chains in adjacent FDDs (e.g., 2012 and 2013 for 2010-ish, as FDDs typically report information about the number of outlets in the previous 3 years) and other sources, such as Entrepreneur Magazine. Upon verification we found that 3 chains did not have any unit in 2010 or 2020, so we removed them. Our final sample consists of 293 separate chains with FDDs available circa both 2010 and 2020.

Coding the covenants of interest

Locating the covenants in the franchise agreement

We use several keywords to identify the covenants of interest, including "non-compete," "confidential," "confidentiality," and "nondisclosure," among others, while also conducting a thorough review of franchise agreements. For identifying the covenants of interests and the requirement for individuals to sign additional covenants separately, in this analysis we consider only information in the franchise agreement, not from any of the ITEMS (apart from ITEM 15, which contains information on the obligation to participate in the actual operation of the business).

Other individuals covered by the same covenants as the franchisee

Noncompetes in the franchise agreement always mention that the franchisee is restricted from competing "*directly or indirectly*". Indirect ways to compete might involve running a competing business through a family member. In our coding, we do not take this reference into account, and code other individuals as covered only if they are mentioned explicitly.

Obligation to participate in the actual operation of the business

There are different possible levels of requirements to participate in the actual operation of the business (e.g., full-time, or part-time). In a 0-1(no-yes) framework, we code as a 0/no every time there is a way to not being involved, even if it is recommended and there is minimum training or monitoring duties. We code 1 if it is said that the franchisee needs to operate themselves if they are an individual. For example: "*We require at least one individual who signs the Franchise Agreement to participate personally in the direct operation of (…)*" is a coded as a 1. A fuzzy division is as follows: "*You may, with our written consent, designate another individual as your District Manager*" (coded as a 0); conversely clauses such as "*You must personally supervise the operation of your Restaurant unless we otherwise permit in writing*" (coded as a 1). In addition, we code as a 0 also the cases in with the full-time involvement is required for a certain number of months/years (for example: "*Franchisees are required to devote their full time, energy, effort, and resources to the management and operation of the Franchised Business for at least the first six (6) months of operation".* The reason is that the duration of franchise contracts is usually 10 or 15 or 20 years.

Requirement to sign additional covenants

We code this requirement differently depending on whether it is mandatory or upon request. Therefore, we put together all cases with language along the lines of "*you shall require and obtain*", "*you agree that you will require*", "*you agree to require and obtain*", "*you agree to obtain similar covenants*", "*you must sign*" "*you must implement all reasonable procedures we prescribe from time to time to prevent unauthorized use or disclosure of the Confidential Information, including the use of nondisclosure agreements (in form and substance satisfactory to us) with your officers, directors, managers and assistant managers and the delivery of such agreements to us*". We differentiate these from cases such as "*at franchisor's request*", "*Franchisor may request that Franchisee require*" or "*franchisor may require*", "*including, restrictions on disclosure to your employees and the use of nondisclosure and noncompetition agreements we may prescribe for employees or others who have access to the Confidential Information*", "*We reserve the right to require each of your owners to execute and bind themselves to the confidentiality and non-competition covenants*", "*The Franchisor reserves the right to require*" or "*if requested by Company, using confidentiality and non-competition agreements with those having access to Confidential Information*".

Appendix 5. Within chain variation over time

Here we provide the equivalent of the previous tables showing the incidence of the covenants of interest (Tables 2, 4, and 5) but focus on within firm changes. This analysis confirms that individual franchisors have not changed their reliance on the various clauses much at all. In addition, we find that the few changes in the use of these covenants are bidirectional, i.e., some franchisors add, and other franchisors remove, the same covenant.

Table 2.A: Use of different covenants in franchise contracts during and post relationship (293 observations)

	No change	Added	Removed
Obligation to operate the business	89.4	3.8	6.8
No involvement in competing business	99.0	0.3	0.7
Noncompete	98.0	0.7	1.4
Non-recruitment	75.4	3.1	21.5

Table 4.A: Covenants in franchise contracts that apply to franchisee-related individuals post franchise relationship (293 observations)

	No change	Added	Removed
Business partners			
Confidentiality	94.5	3.8	1.7
Noncompete	92.8	4.8	2.4
Non-recruitment	83.3	2.4	14.3
Family Members			
Confidentiality	89.8	8.5	1.7
Noncompete	90.4	8.2	1.4
Non-recruitment	93.9	3.1	3.1

Table 5.A: Employees required to sign post-employment restrictive covenants (293 observations)

	No change	Added	Removed
Managers			
Confidentiality	86.3	9.2	4.4
Noncompete	85.0	8.5	6.5
Non-recruitment	90.8	2.0	7.2
Some Employees			
Confidentiality	85.7	9.2	5.1
Noncompete	86.0	7.5	6.5
Non-recruitment	94.2	2.0	3.8
Employees			
Confidentiality	90.8	4.8	4.4
Noncompete	92.2	2.4	5.5
Non-recruitment	95.6	1.7	2.7

The one exception to the stability of clauses over the 10 years of our data is the reduction in the use of post-relationship (inter-firm) non-recruitment clauses in franchise contracts. We believe the explanation lies in the scrutiny that has been applied to a different type of non-recruiting clause, namely what has been called no-poaching requirements. The use of this type of clause prevents franchisees from hiring employees of other franchisees of the same chain, or their franchisor, during the franchise relationship. We did not include this type of clause in our analyses given our interest in clauses that can

be used to prevent dissemination of confidential information to copycats or other competitors. A no-poaching clause applies within a chain, so there is no information dissemination issue with these. However, post-relationship non-recruiting clauses have often been written in combination with a no-poaching clause. With the issues raised about no-poaching clauses in franchise contracts, many franchisors discontinued their use.[49]

In table 1.A, we exploit the fact that approximately 20 percent (58 out of 293) of the franchisors in our sample agreed to sign an AOD to test whether the joint clause, in combination with the AG's efforts, may have led to the reduction in post-relationship non-recruitment clauses. Specifically, we estimate:

$$y_f = \alpha + \beta WAAGinitiative_f + \delta JointClause_f + \gamma\left(WAAGinitiative_f \times JointClause_f\right) + \eta_i + \varepsilon_f$$

for the subsample of firms that had a post-relationship non-recruitment clause in 2010.[50] In this regression, the subscript *f* refers to an individual franchisor, $y = 1$ if the franchisor had dropped the inter-brand non-recruitment clause, $WAAGinitiative$ is a binary variable for whether the franchisor signed an AOD, and $JointClause$ captures whether the post-relationship non-recruitment clause was written in a way that combined it with a no-poaching clause in the 2010 contract, and the η_i represents industry fixed effects.

We find that the interaction of the two covariates in this regression perfectly predicts the outcome for the 12 observations where the interaction is equal to 1. This means that all the chains that had a joint clause in 2010 and signed an AOD following the State of Washington AG dropped the non-recruitment clause. For the remaining chains, results are shown in Table 1.A. They imply that for chains that do not have a joint clause, the propensity to drop the post-relationship clause goes from .43 to .93 if they signed an AOD. For those with a joint clause, the propensity goes from .47 to 1.0. For franchised chains that have not signed an AOD, the use of a joint clause does not predict whether franchisors drop the non-recruitment clause (the propensity increases by only .05, and per Table 1.A, the difference is not statistically significant).

[49] See Krueger & Ashenfelter (2022), Callaci et al. (2024a), and Lafontaine et al. (2024) for more on no-poaching clauses. See also Washington State Office of Attorney General, *AG Report: Ferguson's initiative ends no-poach practices nationally at 237 corporate franchise chains* (June 16, 2020) (https://www.atg.wa.gov/news/news-releases/ag-report-ferguson-s-initiative-ends-no-poach-practices-nationally-237-corporate)

[50] Meaning that either the franchisor has a joint clause in the contract, or the no-poaching clause is not included or located elsewhere in the contract. By looking at firms that had the post-relationship non-recruitment clause in 2010, our sub-sample consists of 112 franchised chains, of which 23 signed an AOD following the State of Washington AG Initiative.

Table 1.A: Logit regressions

VARIABLES	Drop non-recruitment	Drop non-recruitment
State of WA AG Initiative	2.514**	3.112**
	(1.054)	(1.325)
Joint clauses	0.094	0.190
	(0.437)	(0.286)
Constant	-0.211	-2.464***
	(0.437)	(0.556)
Industry FE	No	Yes
Observations	100	100

Standard errors clustered at the industry level in parentheses: *** p<0.01, ** p<0.05, * p<0.1

We conclude that the impetus to drop the post-relationship non-recruitment clause was related to some extent to the Washington State AG's initiative. As a result, despite the low cost of separating the covenants to keep the constraint on post-relationship non-recruitment, the fact that a number of franchisors chose to forgo this clause potentially along with the no-poaching clause would suggest that these franchisors did not find the post-relationship non-recruitment clause particularly valuable.

Appendix 6.

Clauses applied to franchisee-related individuals

FRANCHISEE-RELATED INDIVIDUALS *COVERED* BY THE FRANCHISE CONTRACT

Table 4.B: Franchisee-related individuals covered by post-relationship covenants in the franchise contract

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Business partners	Family members	Business partners	Family members	Business partners	Family members
2010	53.9	19.8	53.6	19.8	22.9	5.8
Weighted	30.3	14.0	30.3	14.0	10.8	1.8
2020	59.4	28.0	58.4	27.6	14.3	6.1
Weighted	40.3	19.5	40.1	19.5	4.9	1.9

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

FRANCHISEE-RELATED INDIVIDUALS *REQUIRED TO SIGN* SEPARATE COVENANTS

Table 4.C: Franchisee-related individuals required to sign post-relationship restrictive covenants

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Business partners	Family members	Business partners	Family members	Business partners	Family members
2010	46.8	9.9	29.7	7.8	14.0	2.7
Weighted	27.9	3.1	14.5	2.3	8.0	0.3
2020	48.5	11.6	30.0	9.2	9.6	2.4
Weighted	30.0	5.6	18.2	3.7	6.7	0.9

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

Use of covenants with employees

EMPLOYEES *COVERED* BY THE FRANCHISE CONTRACT

Table 5.B: Employees covered by post-relationship covenants in the franchise contract

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Managers	All employees	Managers	All employees	Managers	All employees
2010	14.0	7.8	13.7	7.5	6.1	4.1
Weighted	3.9	1.8	3.9	1.8	1.1	0.8
2020	13.7	7.2	12.6	6.1	4.1	3.1
Weighted	5.1	2.8	4.9	2.6	0.6	0.6

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

EMPLOYEES *COVERED* BY THE FRANCHISE CONTRACT OR REQUIRED TO SIGN

Table 5.C: Employees required to sign post-employment restrictive covenants or by post-relationship covenants in the franchise contract

Year	*Confidentiality*		*Noncompete*		*Non-recruitment*	
	Managers	All employees	Managers	All employees	Managers	All employees
2010	61.8	25.9	40.3	17.1	21.5	9.2
Weighted	28.9	15.3	15.5	6.4	6.2	2.5
2020	66.9	26.3	42.7	14.0	14.7	7.2
Weighted	36.8	18.3	19.5	5.0	5.0	2.2

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

Clauses applied to directors and officers

DIRECTORS/OFFICERS *COVERED* BY THE FRANCHISE CONTRACT OR *REQUIRED TO SIGN* SEPARATE COVENANTS

Table 6.A: Directors/officers covered by post-relationship covenants in the franchise contract or required to sign post-relationship restrictive covenants

Year	*Confidentiality*	*Noncompete*	*Non-recruitment*
2010	45.4	39.7	13.3
Weighted	29.7	16.2	3.1
2020	48.5	32.4	9.6
Weighted	33.8	22.2	2.9

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

DIRECTORS/OFFICERS *COVERED* BY THE FRANCHISE CONTRACT

Table 6.B: Directors/officers covered by post-relationship covenants in the franchise contract

Year	*Confidentiality*	*Noncompete*	*Non-recruitment*
2010	17.1	17.1	6.5
Weighted	10.4	10.4	1.1
2020	18.4	17.7	4.4
Weighted	13.6	13.5	1.0

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.

DIRECTORS/OFFICERS *REQUIRED TO SIGN* SEPARATE COVENANTS

Table 6.C: Directors/officers required to sign post-relationship restrictive covenants

Year	*Confidentiality*	*Noncompete*	*Non-recruitment*
2010	37.5	21.5	9.2
Weighted	21.9	8.1	2.3
2020	38.2	20.5	6.5
Weighted	23.6	11.6	2.1

Incidence out of the 293 chains in our sample each year. *Weighted* represents weighted averages for total number of outlets.