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Environmental legislation has created potential liability for retailing franchisees that purchase previously contaminated land. Because of the quasi-integrated nature of the franchise relationship, the franchisor also may be drawn indirectly into liability for its franchisee's cleanup costs. The franchisor has two options to reduce its chance of liability. Faced with a decision to distance itself from the site selection process or incur the added costs and potential pricing impacts of greater involvement in the process, franchisors have strong incentives to reduce franchisee support. This reduction in support has detrimental implications for both franchise policy and environmental policy. The authors report the results of an empirical study that links franchisors' concerns about potential environmental liability to actions to distance themselves from the site selection process or, alternatively, formally to require franchisee environmental investigation of all prospective properties.

Public policies sometimes collide. An example of such a collision is the application of the Comprehensive Environmental Response, Compensation, and Liabilities Act's (CERCLA) (42 U.S.C. § 9601. et seq.) cleanup cost liability to franchisors that have assisted franchisees in selecting sites that later are found to have been contaminated. Helping franchisees find suitable retail sites is one of the most important services franchisors provide. It significantly increases the chance of survival for these small businesses, a key policy goal of franchise regulation. Holding franchisors liable for cleanup costs on the basis of their providing such services creates a perverse incentive to reduce their support for the franchisees.

A better, but costly, alternative approach to avoiding cleanup costs is to order a Phase I Environmental Assessment. Environmental policy is served well when franchisees choose to commission environmental assessments of all suspicious sites. It provides for the timely identification of contaminated sites and increases the chance that the costs of cleanup will be borne by the guilty party. If the franchisor requires such an assessment, however, the franchisor has changed the assessment from an independent business decision of the franchisee to the equivalent of an increase in the price of the franchise. Franchisors want to sell franchises. It is unlikely that a franchisor enthusiastically will choose to increase its price, especially when there is the less costly option of distancing itself from the process.

Because of the prevalence of franchising in the U.S. economy, the impact of environmental policy on franchising and vice versa have significant implications. Franchising now accounts for over one-third of all U.S. retail dollars (University of Louisville and IFA Educational Foundation 1994) and is arguably the most important method of distribution for a wide range of products and services.[1] It has been estimated that in 1990 there were over 500,000 retail franchised establishments (Trutko, Trutko, and Kostecka 1993). Undeveloped retail sites appropriate to franchised businesses are increasingly hard to find, and the chances of purchasing previously contaminated property are substantial.

Theoretically, franchising is an extremely efficient organizational form that creates incentives for franchisees to work hard and for franchisors to provide a full range of support services (Rubin 1978). In practice, however, some franchisors abdicate their responsibility to support their franchisees, and franchisees, often having invested their life savings, are vulnerable to severe financial losses. How to ensure that franchisees are not disappointed in their reliance on franchisor services and the role that regulation should play in reaching that goal have been central focuses of the policy debate (U.S. House of Representatives 1990; see also Continental Franchise Review 1995c, 1996). In fact, aggressive protection of "franchisees, the majority being small businesses," from franchisor abuse was the only specific enforcement initiative singled out and urged on the Federal Trade Commission in the Appropriations Committee Report accompanying H.R. 3814, the 1996 appropriations bill (U.S. House Committee on Appropriations 1996).

Here, we argue that in pursuing well-established environmental protection goals, courts and regulators inadvertently may have created incentives for some franchisors to reduce the level of support they provide their franchisees. When a

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[1]There are two general forms of franchising: business format franchising and product franchising. Business format franchisors are typically operating retailers that license franchisees to replicate their business formats or concepts in another geographic location (e.g., McDonald's, Midas, Jiffy Lube). Product franchisors are typically manufacturers that seek to control the channels of distribution by restricting distribution of their products to licensed franchisees. Some are retail franchisors (e.g., General Motors), and some are wholesale franchisors (e.g., Coca-Cola). We focus here on business format franchising.

franchisee purchases or leases a site that turns out to have been contaminated previously, that franchisee is liable as owner and operator for the costs of cleanup. Whether the franchisor also is held liable turns on the level of involvement in the site selection process.

The franchise relationship joins two parties that are functionally dependent yet legally independent. It is this quasi-integrated relationship that provides the franchisor with two radically different methods of controlling its exposure to indirect environmental liability. It can (1) actively control the franchisee's site selection process, require environmental assessments of all prospective sites,[2] and thus reduce its own exposure by reducing the franchisee's exposure, or (2) distance itself entirely from the site selection process and the ongoing control of the franchise operation, leaving the franchisee to fend for itself. In other words the franchisor can *approach* and solve the problem or seek to *avoid* entanglement in the problem. When franchisors take control of the process, both environmental policy and franchise policy are well served. When franchisors distance themselves from the process, neither policy is well served. Here, we examine that approach/avoidance dilemma and suggest that the unique and ubiquitous nature of franchising in the U.S. economy necessitates clarification of the statute's application to franchisors in the same way its application to banks and other commercial lenders has been clarified.

We begin with an example of the franchisor's choice. We then describe the relevant statutes and discuss the various legal theories under which a franchisor might be held liable for the cleanup of sites owned and operated by its franchisees. Next, we develop several hypotheses that relate the threat of environmental liability to possible responses by the franchisor. We then describe a pretest of franchise attorneys and report the methodology and findings of the franchisor survey. We end with a discussion of the implications for practice and policy.

An Example

As prime retail sites become more and more scarce, unused but conveniently located sites, such as abandoned gas stations, are becoming increasingly attractive. Unfortunately, the potential for finding contamination on such properties is high, and under CERCLA, franchisees that place retail outlets on contaminated land can be held liable for the cleanup costs, even if the contamination took place before they purchased the property.

Consider the following: In 1990, a prospective franchisee was finalizing the purchase of a franchise and what appeared to be a perfect site for its new restaurant. The $25,000 franchisee fee was competitive with other franchises, and the $50,000 for what appeared to be undeveloped land seemed reasonable. The prospective franchisee was preparing to sign both the land purchase agreement and the franchise agreement but first was required to obtain the franchisor's approval of the site.

At this point, several things could have happened relevant to this article. The franchisor could have withheld approval pending a Phase I Environmental Assessment of the property at the franchisee's expense. If it did so, the relative cost of buying this franchise would increase by at least 10%,[3] and the franchisee might have purchased a competing franchise. The franchisor could have paid for the assessment itself by increasing either its own costs or its franchise fee (with the same result of possibly losing the sale). Alternatively, the franchisor could have approved the site and left it up to the franchisee to decide what to do about potential environmental liability.

As it turned out, the franchisor had been involved actively in the site selection process (e.g., engaging in market demand studies). It continued this active involvement by requiring an environmental assessment. The franchisee finally and begrudgingly agreed to pay the additional expense rather than seek another less demanding franchise system. The examiner found that a gas station had been operated on the site and subsequently had been torn down. Further investigation determined that the leaking tanks that remained below the surface of the property required a cleanup that would amount to $500,000. The seller, not the franchisee, ultimately bore the cost of cleanup.

In this example, the franchisor approached the problem directly and required that the franchisee conduct a Phase I Assessment prior to the approval of the site. As it turned out, by requiring the assessment, the contamination was revealed, and the franchisor reduced its own liability as well as that of the franchisee. But that is all hindsight. The property could have been clean. By requiring the assessment, the franchisor increased the relative price of its franchise in the highly competitive market for franchises and nearly lost the sale. Knowing this, the franchisor might have attempted to avoid becoming entangled in the possible environmental liability and might not have increased the price of the franchise. To avoid such entanglement, however, the franchisor not only would need to leave the assessment decision up to the franchisee, but also might need to remove itself from the site selection process entirely and perhaps change the level of ongoing support it offers its franchisees. In other words, current environmental regulation not only permits, but also may encourage, franchisors to limit their exposure to environmental liability by reducing support for their franchisees. In the next section, we describe the legal theories under which a franchisor might be drawn into a CERCLA action if it tries to take the middle ground (i.e., offers support to its franchisees for site selection and ongoing operations without completely controlling the process and requiring the assessment).

Comprehensive Environmental Response, Compensation, and Liabilities Act

CERCLA was enacted in response to the increasing concern about the vast problems of contamination from and disposal

[2]Here, we use the current term *Phase I Environmental Assessment* to refer to the initial examination of a site to determine its potential for contamination. Previously, this examination was referred to as a Phase I Environmental Audit. That term, however, now is used to refer only to government-conducted examinations.

[3]Phase I Environmental Assessments typically cost between $2,500 and $3,000 for the type of site in this example. If a Phase I Assessment suggests the necessity for a Phase II Assessment (i.e., one including invasive procedures such as soil testing), costs escalate rapidly to between $10,000 and $100,000. Required insurance against environmental liability is another option. This also would increase the relative price of the franchise.

of hazardous and toxic waste throughout the country. CERCLA's purpose is to place the ultimate responsibility for cleaning up hazardous waste on those responsible for causing the problems rather than on the government. CERCLA authorizes the federal government, when necessary, to clean up hazardous waste sites and recover the costs of its cleanup efforts from "responsible" parties. Responsible parties are defined in 42 U.S.C. § 9607(a) and include the "*present owner or operator* of a site where hazardous substances *have been released*" (emphasis added).

CERCLA holds these owners or operators strictly liable (without regard to fault) to the United States for expenses incurred in responding to the environmental and health hazards posed by the waste at that site (42 U.S.C. § 9607[a][1]; *New York v. Shore Realty* 1985). In other words, if a franchisee purchases property that has been contaminated prior to the purchase, it would be held strictly liable for cleanup costs, even though it had nothing to do with the original contamination. The franchisee's liability is based solely on its current ownership of the contaminated property and/or the fact that it is operating a business on the property. This application of CERCLA to subsequent purchasers of contaminated property creates a mechanism for identifying problem sites each time the land changes hands. Thus, it should be noted that liability derives not only from ownership of the property, but also from the franchisee's failure to search diligently for environmental problems before purchase, as discussed subsequently.

Although the potential liability of the franchisee is equivalent to that of any purchaser, the potential liability of the franchisor presents more interesting and unique legal, marketing, and public policy issues (Sniff and Trachtenberg 1989). Under some of the legal theories suggested subsequently, franchisor liability for environmental cleanup resembles the vicarious liability imposed on franchisors for the actions of their franchisees (Morgan 1987), whereas under other theories the analysis is quite different. In the next section we explore some of these possible theories of franchisor liability. In doing so, we assume that the franchisee has purchased previously contaminated property and would be held liable for cleanup under CERCLA.

Potential Sources of Franchisor CERCLA Liability

Franchisor as "Operator" of the Site

Franchisors typically have "deeper pockets" than franchisees. If a franchisee purchases a contaminated site, the government may look to the franchisor for recovery of the costs of the environmental cleanup. One theory available to the government is that the franchisor is a co-operator of the contaminated site along with the franchisee (see Table 1). The term "operator," defined in the statute as any person operating a facility, has been interpreted broadly. In *U.S. v. Kayser-Roth Corp., Inc.* (1990), the defendant was held liable, because the court found that it had exerted sufficient control over the corporation occupying the site that it could be deemed an operator of the site (see Chermside 1995).

Because of the unique, quasi-integrated relationship between franchisor and franchisee and the obligation of a trademark holder to control the product or service delivered under its trademark, the concept of franchisor as operator of the franchised outlet is especially interesting. Some insight may be gained as to the interpretation of the term "operator" in franchise cases from a similar type of lawsuit involving the Americans with Disabilities Act (ADA). American Dairy Queen, a franchisor, was sued over the compliance of its franchisees with the provisions of the ADA. In that case, the Justice Department argued that the franchisor, American Dairy Queen, was the "operator" of the franchised outlets, because the franchisees must obtain the franchisor's approval before they build or modify a store (*Margo Neff, et al. v. American Dairy Queen, Inc.* 1994; see also *Evelyn L. Young, et al. v. American Dairy Queen, Inc.* 1994). In a friend-of-the-court brief, the International Franchise Association replied that this control was only over the look and feel of the franchised unit and not over the day-to-day operations. Furthermore, if franchisors are held liable for bringing the stores into compliance with ADA requirements, franchisees will become free riders and wait for their franchisors to make the necessary modifications (Continental Franchise Review 1995a). This will have the undesirable effect of actually lessening the level of compliance within the system and is therefore against public policy.

The District Court ruled, and the Court of Appeals affirmed, that though the franchisor had the right to approve all modifications to the building, it did not have the right to order modifications. Moreover, the remedial nature of the statute was not thwarted by the ruling, because the franchisee still could be sued (*Margo Neff, et al. v. American Dairy Queen, Inc.* 1994). Had the franchisor maintained the right to order modifications to the building, however, the result might have been different.

The *Neff* decision turned on the definition of "operator." In the ADA's legislative history, it is clear that Congress rejected the idea of specifically addressing the franchise relationship or adopting definitions of affiliated entities from other bodies of law, preferring the vague and ambiguous concept of "operator" (Horn and Buckberg 1995). Under CERCLA, franchisors face the same ambiguity.

It is likely that the government's arguments involving franchisors as operators under CERCLA would be similar to those arising under ADA. If the franchisor has the right and obligation under the contract to locate a site for the franchisee (instead of simple veto power over undesirable sites), the franchisor might be found to be an operator under the test in *Neff.*

The increased potential for exposure to environmental liability occasioned by involvement in the site selection process presents an incentive for the franchisor to distance itself from that crucial support. This approach is not unusual in franchising. Conventional wisdom in the franchise community is that a good way to avoid legal entanglement is to reduce support for the franchisee in the particular area under scrutiny. For example, instead of requiring franchisees to institute sexual harassment policies, franchisors have been counseled to avoid any involvement in the human resources function of their franchisees lest they be dragged into sexual harassment suits themselves (Continental Franchise Review 1995b).

All else being equal, the greater the perceived danger of purchasing previously contaminated property, the more anx-

Table 1. Theories of Franchisor Liability

Theories of Liability/Defense	Critical Elements	Related Hypotheses
Franchisor as operator	CERCLA action directly against the franchisor Franchisor's control over franchisee Did franchisor play a formal role in the site selection process?	H_1
Contractual	CERCLA action against franchisee with franchisor joined for contribution Franchisor's contractual obligation to franchisee Did franchisor formalize its role in the agreement to find a suitable site?	H_1
Franchisor as owner	CERCLA action directly against franchisor Indicia of ownership in the form of a security interest in property Franchisor's control over franchisee Did a secured franchisor play a formal role in the site selection process?	H_2
Franchisor as innocent landowner	CERCLA action directly against franchisor based on operator status or indicia of ownership Defense to liability based on the attempt to identify contaminated properties Did the franchisor require the environmental assessment of the site prior to approval?	H_3, H_4

ious the franchisor will be to avoid entanglement in the site selection process. In terms of the approach/avoidance model suggested previously, when faced with the threat of vicarious environmental liability, one path open to the franchisor is to avoid the site selection process altogether. We pose the following hypothesis:

H_1: The greater the franchisor's awareness of and concern about liability for environmental cleanup, the less likely it is to play a formal role in the franchisee's site selection activity.

Franchisor's Indirect Contractual Liability

Even if the government pursues only the franchisee that purchased the contaminated site, the franchisor still could find itself held liable. In this case, the franchisee may seek contribution for cleanup costs on the basis of the franchisor breaching its contract to find the franchisee a suitable site.

The extent of franchisors' obligations regarding site selection varies widely. Some agreements provide only that the franchisor has the right to approve the site after it has been selected by the franchisee. Most often, franchisors require franchisees to select sites that comply with site criteria that they have developed in regard to general location, neighborhood, traffic patterns, parking, size, layout, other physical characteristics of the site, rental terms, purchase price, the economic circumstances of the community, and other basic demographics. Other franchisors exercise extensive control over site selection through formal real estate programs and obligate themselves in the franchise agreement to find the franchisee a suitable site. This level of franchisor involvement and support substantially reduces the franchisee's business risk and is consistent with policies protective of franchisees' interests.

When the franchisor is obligated to find a suitable site, however, franchisees held liable as operators or owners under CERCLA may look to the franchisor for breach of contract, even if the site was "suitable" in terms of competition and market demand. Essentially, the claim would be that the franchisor has failed to do what it had agreed to do in the franchise contract, because a contaminated site is not suitable, no matter what business the franchisee is in.

In anticipation of this problem, many franchisors include exculpatory language in the franchise agreement, which expressly indicates that they do not guarantee the site. Such language has been sufficient to relieve a franchisor from liability for approving an unprofitable site (*Burger King Corp. v. James R. Austin, Loretta W. Austin and Austin Food Corp.* 1990). Because of the distinctly different policy considerations, however, it is not clear whether the same language would insulate a franchisor from claims arising from a franchisee's environmental liability. Thus, though "suitable" does not imply profitable, it might imply an obligation to find an uncontaminated site.[4]

In addition to any contractual duty franchisors may have assumed, franchisees often claim that franchisors owe them a fiduciary duty. In site selection, if the franchisor has such a duty, the franchisee might rely on the franchisor's assistance to ensure that a chosen site is suitable and uncontaminated. If the franchisor has not taken the steps to ascertain the suitability of the site before approving it, the franchisee could claim a breach of fiduciary duty. Although the vast majority of the state and federal jurisdictions have relied on "independent contractor" language in the franchise agreement to rule out any fiduciary duty, a few courts have ignored such language and found the franchisor liable (*Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.* 1984; *Power Motive Corp. v. Mannesmann Demag Corp.* 1985).

Under either contractual or fiduciary duty, to the extent that the franchisor obligates itself to play a formal role in the site selection process, it increases its chances of being held liable for contribution for CERCLA cleanup. These alternative theories, therefore, offer additional support for H_1.

[4]The courts also have honored exculpatory language in the franchise agreement when the claim was for franchisor negligence for failing to select a successful site for its franchisees (*Burger King Corp. v. James R. Austin, et al.* 1990), but whether a franchisor's duty of care includes identifying an environmentally clean site has not been tested yet.

Franchisor as "Owner" of the Site

A franchisor also might be held liable under CERCLA as an "owner" if it holds "indicia of ownership" in the franchised unit. Many franchisors have language in their franchise agreement or other agreements that states that they are taking a security interest in the site to ensure payment of all fees and royalties. This security interest alone would constitute indicia of ownership, and the franchisor would be liable for cleanup of any property in which it held such an interest. CERCLA's definition of owner, however, specifically excludes any "person, who, without participating in the management of a ... facility, holds indicia of ownership primarily to protect his security interest in the ... facility" (42 U.S.C. § 9601[20][A]). Under this exclusion, a remote creditor (e.g., bank) that does nothing more than hold a security interest in the assets of the franchised unit is exempt from liability, despite the indicia of ownership. Unlike banks, however, franchisors with indicia of ownership often play a significant role in the day-to-day management of the franchisee's operation. In fact, franchisees pay royalties so that the franchisor will (among other things) create standards, monitor compliance with those standards, provide consultation on problems and issues faced by the franchisee, and assist generally in the management of the franchise.

Whether a secured franchisor is exempt, therefore, turns on whether these activities as a franchisor constitute "participation in the management" of the outlet (*U.S. v. Fleet Factors Corp.* 1990). In *Fleet Factors*, the court found a secured creditor liable under CERCLA, even though the secured creditor was not an actual operator. By participating in the financial management of a facility to the degree of having the capacity to influence the facility's treatment of hazardous waste, the creditor lost the use of the exemption. The court found that the phrase "participation in the management" and the term "operator" were not congruent.

> It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable—although such conduct will certainly lead to the loss of the protection of the statutory exemption. Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather, a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose (*U.S. v. Fleet Factors Corp.* 1990, 1557–58).

In the case of liability for the purchase of a previously contaminated site, the critical question may be whether the franchisor had the ability to affect the decision to purchase the property or order an environmental assessment. If so, the indicia of ownership significantly increase the franchisor's exposure by lowering the control hurdle.[5]

Because indicia of ownership lower the level of control necessary to impose liability, a franchisor that holds a security interest in the site faces the same dilemma suggested previously, that is, whether to approach or avoid the problem. One option, that of avoidance, would be to decrease its involvement in the site selection process. We therefore pose the following hypothesis:

> H_2: Franchisors that have a security interest in the franchisee's real property will be less likely to play a formal role in the franchisee's site selection activity.

The Innocent Landowner Defense

To this point we have focused on the franchisor's avoidance of entanglement in the franchisee's environmental liability, which suggests that the greater the perceived threat, the more likely the franchisor is to distance itself from those activities that might extend liability to the franchisor. As suggested previously, if such a course is followed, franchisees are deprived of the expertise that the franchisor might have on a wide range of topics, including site assistance. The other choice is to become involved actively. Instead of distancing itself from the site selection process, the franchisor can assume an even more aggressive role, thereby ensuring that the problem does not occur in the first place. This, then, is the approach option.

Even if a franchisor is not successful in helping its franchisees avoid purchasing any contaminated properties, by following this approach it still is exonerated (as is the franchisee) from liability (42 U.S.C. § 9601[35]). The innocent landowner defense basically enables the owner or operator to escape liability for cleanup costs if, at the time of acquisition of the property, it conducted "all appropriate inquiry" into the history of use and ownership of the property and therefore had no knowledge or reason to know of the presence of hazardous substances on the property. This feature of the law creates the self-enforcing mechanism whereby each time a site changes ownership, incentives exist to discover and cure any existing contamination problems.

The innocent landowner defense therefore creates an alternative mechanism for the franchisor to manage its exposure to environmental liability, that is, by approaching the problem head on instead of seeking to avoid it, even though this may lead to increases in the relative price of the franchise. This becomes an increasingly attractive option as the criteria for finding control by the franchisor become less demanding. According to some franchise attorneys,

> The ever-increasing aggressiveness of lawmakers and courts to impose cleanup responsibilities on franchisors, and franchisees' expectations of franchisor paternalism, require franchisors in the future to take affirmative action to manage their risks caused by environmental considerations (Schumacher, Sniff, and Trachtenberg 1990, p. 25).

There may be any number of operational reasons for engaging in site selection assistance. These may overcome the incentives to avoid entanglement envisioned in the first two hypotheses. After the decision is made that lack of involvement in the site selection process is not an option, the franchisor must pursue the alternative aggressively. By formally requiring the appropriate environmental assess-

[5]In September, 1996, Congress enacted the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996 as part of the Omnibus Consolidated Appropriations Act for 1997. This new act overrules the interpretation of participation in the Fleet Factors case and requires actual, not potential, participation in the management of the facility to negate the lender exemption (CERCLA § 107[20][F][i], as amended). The data in this study were gathered when Fleet Factors was still good law and thus should reflect the franchisors' reactions to the lower threshold of control applied to those with indicia of ownership.

ment, the franchisor can provide operational support to its franchisees during the site selection phase without concern that by doing so it will lay itself open to liability under the various theories described previously. Consequently, if a franchisor chooses to offer site selection assistance, it should be more likely to reduce its perceived exposure to environmental liability by requiring an environmental assessment of all prospective franchised sites. We pose the following hypothesis:

> H_3: For those franchisors that play a formal role in the site selection process, the greater the franchisor's awareness of and concern about liability for environmental cleanup, the more likely it will be to require an environmental assessment prior to its franchisees purchasing or leasing a site.

As suggested previously, because the holding of a security interest in the property lowers the level of site involvement necessary to find liability, it is expected that franchisors with these indicia of ownership that have chosen to manage the site selection process will opt to manage aggressively the environmental investigation as well. It should be noted that there is an additional rationale for this expectation. If the franchisee is held liable for the cleanup and defaults on the franchise agreement, the foreclosing franchisor will be left with ownership of contaminated property. We therefore propose the following hypothesis:

> H_4: For those franchisors that play a formal role in the site selection process, if the franchisor holds a security interest in the property, it will be more likely to require an environmental assessment prior to its franchisees purchasing or leasing a site.

The Study

Pretest of Franchise Attorneys

To understand better franchisors' awareness of potential indirect environmental liability and develop reasonable measures for testing the propositions relating to franchisor attitudes and actions, we conducted telephone interviews of franchise attorneys representing franchisors in the oil change/quick lube, muffler, and transmission repair industries. Attorneys were chosen because of their intimate role in protecting the franchisor from any potential liability. We chose these three industry categories as a sampling frame because they were thought to be those most likely to have franchisees that purchased or leased potentially contaminated commercial sites, such as former gas stations. Twenty franchisor attorneys were interviewed, who represented 50% of the 40 active franchisors known to be operating in these three sectors.

A structured interview protocol was employed, using open-ended questions. The attorney-informants were encouraged to provide any details they thought important, even if not required specifically by the questions. We sought responses related to potential sources of liability and the action taken by franchisors in response to that possible exposure. Initial findings confirmed that site selection was an important franchisor support activity and that environmental assessments were used by some franchisors as an integral part of the site selection process. On the basis of these interviews, the questionnaire for the franchisor study was constructed.

Franchisor Sample

The sample for the main study was drawn from the directory of active franchisors compiled for *Bond's 1995 Franchise Guide* (Bond 1995). The strength of this particular nationwide directory, in addition to its relative completeness, is the fact that it contains significant information on the franchise agreements of many of the listed franchisors (Lafontaine 1995). These data on the sampling frame itself are useful in testing for nonresponse bias. Surveys were mailed to the development manager or president of all listed franchisors in two industry groups: 153 automotive support franchisors (oil change, transmission repair, etc.) and 320 fast-food franchisors. Following the same reasoning as in the pretest, these two groups were chosen as having the highest likelihood of having franchisees that might purchase convenient but contaminated properties on which to develop their franchised outlets. Franchisors are notoriously oversurveyed, primarily by proprietary researchers, and two follow-up mailings were necessary to obtain a satisfactory sample size. Mailings to 55 franchisors were returned as undeliverable.

In all, 35 automotive support franchisors (25% response rate) and 65 fast-food franchisors (23% response rate) provided usable questionnaires. Because of the inherent differences between the industries, tests for nonresponse bias were conducted separately. Data on total number of units were available for the entire sampling frame (adjusted to remove those identified as undeliverable), and the respondents were compared to nonrespondents in both industries on that basis. There was no significant difference between either industry sample and the relevant sampling frame population (at $p < .05$). Data were available on a subset of franchisors in the sampling frame on several other variables that could indicate potential response bias. Respondents from that subset were compared to nonrespondents for each industry on size of franchise fee, royalty rate, age of company, number of years franchising, whether they allowed area development or subfranchising or passive investment, and, most important, whether they assisted in lease negotiations and offered site selection assistance. Although respondents required a larger franchise fee than nonrespondents in the fast-food industry and were more likely to allow passive investors in the automotive support industry (at $p < .05$), these factors alone did not appear likely to introduce bias into the study that would distort the findings. There were no other significant differences. It is especially noteworthy that there is no nonresponse bias in the sample on either site selection assistance or lease negotiation assistance, the two most critical comparison variables.

Analysis and Results

From the pretest, we knew that environmental liability for the cleanup of previously contaminated sites was associated with the acquisition of traditional stand-alone units (i.e., not kiosks, carts, or stores within other stores). To identify relevant respondents, the data therefore were screened initially to include only those franchisors with at least some stand-alone, traditional outlets.

A central predictor variable was the perceived threat to the franchisor that arises from the purchase of a previously contaminated site. This variable was measured on a five-point Likert scale running from "strongly disagree" to "strongly agree." The statement read, "In our industry, the unknowing acquisition of previously contaminated properties poses a significant threat of legal liability for site clean-up" (THREAT). Respondents ranged from one to five on the level of perceived threat from environmental liability, with a mean of 3.58 and a standard deviation of 1.23. Sixty percent of the respondents agreed or agreed strongly with the statement.

In H_1, this perceived threat of liability is hypothesized to be related to the likelihood that the franchisor will reduce its formal site selection assistance. The dependent variable was operationalized as a categorical (yes/no) response to the question, "Does your Franchise Agreement obligate the company to assist the franchisee in identifying suitable sites for operating a franchise" (ASSIST)?

H_2 hypothesizes that the retention of a security interest in the property would be associated with a higher likelihood that the franchisor would reduce its formal role in the site selection process. The franchisor's security interest (SECURE) was operationalized with the categorical (yes/no) response to the question, "Are franchisee obligations under the Franchise Agreement secured by the property, such that the company has the right to take over a site upon termination of the franchise for cause?"

H_1 and H_2 were examined using logistic regression because of the categorical nature of the dependent variable ASSIST. The results of that regression are reported in Table 2. The THREAT variable was associated negatively and significantly with the likelihood of providing formalized site assistance as predicted ($p < .05$) in H_1. The security interest of the franchisor was not a significant predictor, and there is no support for H_2.

For H_3, the dependent variable ASSESS was the categorical (yes/no) answer to the questions "Does your company require franchisees to have a Phase I environmental audit (assessment) performed on all traditional non-mall sites that they intend to purchase (lease from third parties) in the U.S.?" All franchisors that required assessments for purchased property also required them for leased property. H_3 hypothesizes a positive association between THREAT and SECURE and the dependent variable ASSESS for those franchisors that have assumed a formal role in the site selection process.

The data were screened to identify respondents who indicated a formal role in site selection, and a logistic regression was run with ASSESS as the dependent variable and THREAT and SECURE as the predictors. The results reported in Table 3 indicate a positive and significant relationship between the perceived threat of liability and the requirement of an environmental assessment for all sites ($p < .05$). The findings support H_3. There was only a marginally significant relationship between the holding of a security interest and the requirement of the assessment ($p < .1$), and thus support for H_4 is questionable.

Table 2. Logistic Regression Analysis of H_1 and H_2

Model Chi-Square 9.129 df 2 Sig. .0104

Dependent Variable ASSIST (yes = 1, no = 0)

Variable	B	S.E.	Wald	df	Sig.
THREAT (H_1)	–.8595	.3476	6.1132	1	.0134
SECURE (H_2)	.6516	.6227	1.0950	1	.2954
Constant	5.7769	1.8599	9.6470	1	.0019

Table 3. Logistic Regression Analysis of H_3 and H_4

Respondents screened on ASSIST = yes

Model Chi-Square 12.306 df 2 Sig. .0021

Dependent Variable ASSESS (yes = 1, no = 0)

Variable	B	S.E.	Wald	df	Sig.
THREAT (H_3)	.1453	.4780	5.7401	1	.0166
SECURE (H_4)	.9532	1.1663	2.8049	1	.0940
Constant	–7.2242	2.3339	9.5806	1	.0020

Discussion

Previously undeveloped locations appropriate for stand-alone retail outlets have become scarce. Because of their emphasis on convenience-oriented business concepts, franchise systems are constantly in need of high-traffic locations to satisfy their expansion plans. Consequently, franchisors are asked increasingly by prospective franchisees to approve sites with unknown or vague prior usage. Unfortunately, many of the best, most convenient sites turn out to have histories that suggest the strong likelihood of environmental contamination (e.g., abandoned gas stations). Both franchise and environmental regulatory policies are served when the franchisor requires a Phase I Environmental Assessment of suspicious prospective sites. As shown previously, however, there are reasons why this does not always occur.

Although the primary focus of both state and federal regulatory policy toward franchising has been to encourage franchisors to disclose accurately all relevant information to prospective franchisees, ensuring that franchisees receive adequate support from their franchisors also has been an important policy goal. If the common rubric regarding retailing is true ("location, location, location"), one of the key areas of franchisor assistance is site selection. When this works correctly, the franchisor combines the franchisee's local market expertise with the institutional knowledge that the system has acquired from opening many previous outlets in order to make optimal site decisions. This reduces the franchisee's business risk and protects what is often an investment of the franchisee's life savings. It appears from the findings reported here, however, that for at least some franchisors, a reduction in the level of assistance in the site selection process is related to concerns about being drawn into potential liability arising from the franchisee's acquisition of contaminated property. Consequently, not only is environmental policy not served, but some franchisees also might get insufficient business support.

The source of the problem is the unusual nature of the franchise relationship itself. Functionally, it is a highly dependent relationship. Legally, it is a relationship between independent entities. When faced with a situation in which its franchisee could become liable for environmental cleanup costs, the franchisor has two options. It can focus on either the functional dependence or the legal independence. It can use its influence to solve the problem proactively for the franchisee and itself or avoid entanglement in it.

The franchisor's dilemma is not unique to environmental issues. As was mentioned previously, franchisors face similar decisions regarding franchisees' ADA compliance and sexual harassment suits involving franchisees' employees. In these areas (and others), the potential for franchisor liability has a chilling effect on legitimate and needed business support for franchisees. We believe a precipitating factor leading to this unfortunate outcome is the ambiguity surrounding the franchisor's liability. Congress consistently has avoided addressing the franchise relationship directly. This is particularly unfortunate given the importance of franchising to the U.S. economy. Franchisor liability cannot be left to the courts, in which inconsistent and state-specific findings only have added to the confusion.

In the area of environmental liability, as long as franchisors are unclear as to what level of support will subject them to indirect liability, the initial impetus will be to avoid entanglement by lowering their support. This tendency is demonstrated in the findings related to H_1. The more a franchisor perceives environmental liability as a threat, the more likely it is to avoid formal support for franchisees in the site selection process. Franchising policy thus is undermined by this ambiguity, but so too is environmental policy. The alternative to disentanglement through avoidance of formal support is the timely identification of contaminated property through the franchisor's proactive involvement in the site selection process. Franchisors will be unlikely to take the more costly alternative of compelling environmental assessments, however, unless it is clear that all franchisors will require them as a matter of course. Otherwise, to do so would place them at a disadvantage in pricing and selling their franchises.

Congress should either include franchisors unambiguously as responsible parties (along with their franchisees) for purposes of CERCLA liability for the purchase of previously contaminated property or exclude unambiguously activity supportive of franchisees as evidence of that status. The first alternative would force all franchisors to take a proactive role in determining whether an environmental assessment is called for, while obviating any competitive disadvantage associated with doing so. It would place their analyses of the environmental suitability of a franchisee's proposed site on a par with their analyses of its prospective profitability. The second approach would permit franchisors to provide important and desirable business services to their franchisees without fear that those services would be used to ensnare them in unforseen environmental liability lawsuits. Whereas the second alternative is consistent with the policy of encouraging franchisor support of franchisees, the first alternative also has the salutary benefit of identifying contaminated property prior to purchase, when it is more likely that the original polluter will bear the cost of cleanup.

Clarification of this kind is what Congress has attempted to provide the commercial lending industry for much the same reasons. Like franchisors, lenders are connected intimately with the purchase of property by another party. As in franchising, the lending relationship is between legally separate but highly interdependent entities. Although franchising is not as pervasive as commercial lending, it is nonetheless a major factor in the purchase of retail sites in the United States and deserves specific attention. It would be no more difficult than creating the lender provisions. In fact, definitional issues, a significant concern in the treatment of lenders, would not be problematic with respect to franchising. The Federal Trade Commission has defined what a franchisor is for purposes of its disclosure requirements (FTC Rule 1979), and that could be referenced easily in CERCLA.

The findings in this study indicate that franchisors are struggling to find solutions to the ambiguity they face, and Congress can and should take steps to clarify the issue. Whether Congress should take an inclusionary or exclusionary tack with franchisors, however, is much less clear. That question raises the type of policy balancing that the court faced in *Margo Neff, et al. v. American Dairy Queen, Inc.* (1994). Would drawing all franchisors into the process increase the likelihood that environmental assessments would be done when appropriate? Or would it result simply in franchisors always requiring costly assessments even when not necessary, because the cost could be passed on to franchisees and ultimately consumers? Conversely, would allowing franchisors to assist in the business analysis of sites without fear of entanglement in environmental liability lead to a reduction in environmental assessments even when appropriate? If so, we expect an increase in franchisee bankruptcies with taxpayers ultimately bearing the costs of cleanup as the original polluter becomes increasingly remote from the property.

An opposing viewpoint is worth noting. Franchise regulatory policy has been focused not only on franchisee support, but also on the uneven power that is presumed to exist between franchisor and franchisee. In this context, what is perceived as support by the franchisor may be perceived as coercion by franchisees and regulators (see Boedecker and Morgan 1980). Franchisor requirements of environmental assessments, then, could be interpreted as forcing unnecessary costs on the franchisee. This argument does not seem appealing, however, when applied to site selection assistance, in which it is difficult to see the motivation for a franchisor to control the process to the franchisee's detriment.

Both franchise policy and environmental policy are served best if franchisors take an active role in the site selection process, one that includes the formal requirement of an environmental assessment in all cases in which it is appropriate. To ensure such a direct approach to the problem, and in the absence of effective industry self-regulation, direct governmental involvement may be necessary.

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