International Franchise Association
56th Annual Legal Symposium
May 5-7, 2024

Use of Artificial Intelligence in Franchising and Associated Legal Issues: Avoiding Ethical Minefields

Charlie Britt
Wyndham Hotels & Resorts, Inc.
Parsippany, New Jersey, United States

Manal Hall
Dentons
Salt Lake City, Utah, United States

Christine Jackson
Osler, Hoskin & Harcourt LLP
Toronto, Ontario, Canada

Mark McCreary
Fox Rothschild
Philadelphia, Pennsylvania, United States

Table of Contents

1. Introduction[1]

Artificial intelligence ("AI") is transforming various industries and sectors, including franchising, by offering unprecedented opportunities for innovation, efficiency, and customer satisfaction. Over the past few years, this powerful technology has increasingly become integrated in our day-to-day activities, revolutionizing business operations and decision-making processes. In the context of franchising, AI presents both opportunities and challenges for franchisors and franchisees, such as enhancing customer experiences, streamlining workflows, automating tasks, and promoting data-driven insights. While there may be concerns with respect to the protection of confidential information and data, use of infringing content, among others, AI is here, and its use is inevitable.

The focus of this paper will be on how franchise systems can minimize risks related to AI use and applicable legal and ethical considerations, including bias, harm and discrimination. More specifically, the paper discusses the legal and business considerations that franchisors and franchisees must address when deploying and integrating an AI system in franchise systems, including contractual terms, data ownership and use, intellectual property rights, confidentiality and privacy, and ethical and responsible use guidelines. The paper proposes strategies to proactively mitigate against the risks of AI by emphasizing the need for transparency and informed consent, ensuring data protection and algorithmic fairness, fostering a culture of continuous learning and collaboration, and compliance with regulatory standards and ethical principles.

2. Overview of Artificial Intelligence

AI has disrupted traditional industries by revolutionizing business operations and decision-making processes. It has become an integral part of the commercial landscape and has begun to play a prominent role in the context of franchising. Sundar Pichai once proclaimed that AI is "*the most profound technology humanity is working on. More profound than fire, electricity, or anything that we have done in the past*." Emphasizing the transformative potential of AI across various aspects of society, Bill Gates further underscored the potential of its global impact and the far-reaching implications of its integration:

> *The development of AI is as fundamental as the creation of the microprocessor, the personal computer, the Internet, and the mobile phone. It will change the way people work, learn, travel, get health care, and communicate with each other.*

The size of the global AI market is projected to reach US $305.90 billion and is expected to grow at an annual rate of 15.83%.[2] The United States, currently holding the largest market size in the AI market, is projected to achieve a market size of approximately US

[1] The authors would like to thank Dorsa Eshtehardian, an articling student-at-law at Osler, Hoskin & Harcourt LLP, for her assistance in the preparation of this paper.

[2] *Artificial Intelligence – Worldwide*, STATISTA (Aug. 2023), https://www.statista.com/outlook/tmo/artificial-intelligence/worldwide#global-comparison.

$106.50 billion in 2024.[3] Common examples of AI include virtual assistants (such as Apple's Siri or Amazon's Alexa), autonomous vehicles, Open AI's ChatGPT and AI-powered diagnostic tools in the healthcare sector. As further discussed below, AI encompasses machine learning and deep learning techniques, with natural language processing as a subset, while generative AI leverages these algorithms to create novel content or outputs.

(a) Artificial Intelligence Defined

AI refers to the creation of machines that are constructed to replicate the human brain, enabling the machine's ability to perform the cognitive functions that are associated with human behaviour.[4] These cognitive behaviours, among others, include learning, reasoning, self-correction and creativity.[5] AI models possess a wide range of capabilities, including anything from speech recognition to decision-making. AI systems are designed to analyze large amounts of data, promote operational efficiency and improve decision-making. AI has been categorized as "weak" or "strong" AI. Weak AI is designed and trained for the purpose of a specific task, such as Apple's Siri or Alexa. Strong AI, also known as general AI, is capable of exhibiting human-like intelligence across a broad range of tasks.[6] Strong AI possesses general intelligence comparable to humans and is capable of understanding, reasoning and problem-solving in various situations.

(b) Machine Learning

Machine learning, a subset of AI, enables AI to initiate human-like cognitive thinking through the use of algorithms that are trained to analyze vast amounts of data to identify patterns and make informed decisions or predictions.[7] The function of machine learning has been described as descriptive, predictive and prescriptive.[8] Through iterative learning processes, machine learning models are capable of analyzing large datasets, identifying trends and obtaining valuable insights which improve the models' accuracy over time. An example of the use of machine learning is Keira, a contract search and review platform.

---

[3] *Id*.

[4] Kerry R. Green, Manal Z. Hall and Keri McWilliams, *Implementing Challenging Technologies in Franchise Systems*, AM. BAR ASS'N (Oct. 8, 2023), https://www.americanbar.org/content/dam/aba/events/franchising/46annual/w16.pdf.

[5] Nicole Laskowski, *What is Artificial Intelligence and How Does AI Work?,* TECH TARGET, https://www.techtarget.com/searchenterpriseai/definition/AI-Artificial-Intelligence (last updated November 2023).

[6] Kathleen Walch, *Rethinking Weak Vs. Strong AI*, FORBES (Oct. 4, 2019), https://www.forbes.com/sites/cognitiveworld/2019/10/04/rethinking-weak-vs-strong-ai/?sh=372213c66da3.

[7] *Id*. at 4.

[8] Sara Brown, *Machine Learning, Explained*, MIT MGMT (Apr. 21, 2021), https://mitsloan.mit.edu/ideas-made-to-matter/machine-learning-explained.

There are two primary approaches used to train machine learning algorithms: supervised and unsupervised learning.[9] Supervised learning uses labeled data to train the algorithms to make predictions or decisions based on examples with clear answers. Unlike supervised learning, unsupervised learning operates without the need for labeled data and operates autonomously to discern patterns and relationships within data. Supervised and unsupervised machine learning are utilized to address and solve distinct problems. The suitability of deploying one over the other hinges on the intended purpose of its use within an organization's context.[10]

(c) Deep Learning

Deep learning, a subset of machine learning, is a type of algorithm with multiple layers that mimics the human brain using neural networks to train the model by using vast amounts of labeled data.[11] These layers facilitate the transformation of input data into meaningful representations and enhance the algorithm's ability to perform image recognition, natural language processing (as defined below), and predictive analytics. These algorithms are capable of processing unstructured data efficiently; they identify hidden relationships and patterns and engage in unsupervised learning on how to improve over time from user behavior.[12] An example of deep learning is Open AI's Chat GPT, where the "GPT" in Chat GPT stands for Generative Pre-Trained Transformer.

(d) Natural Language Processing

Natural Language Processing ("NLP") works in combination with machine learning and deep learning algorithms to bridge the gap between human language and AI. NLP does so by enabling machines to comprehend and process data, derive meanings, and generate responses.[13] Given the large volume of data that an organization holds from various channels, franchisors can leverage NLP to automatically process data, analyze the intent, and respond in real time to communications.[14] NLP applies to both written text and speech, and can be applied to all human languages.[15] Common use examples of

---

[9] *Supervised vs. unsupervised learning: What's the difference?,* GOOGLE CLOUD, https://cloud.google.com/discover/supervised-vs-unsupervised-learning#:~:text=The%20biggest%20difference%20supervised,correct%20output%20values%20should%20be (last visited Mar. 25, 2024).

[10] *Id*.

[11] *What is natural language processing (NLP)?,* IBM, https://www.ibm.com/topics/natural-language-processing (last visited Feb. 7, 2024).

[12] *What is Deep Learning?,* AWS AMAZON, https://aws.amazon.com/what-is/deep-learning/#:~:text=Deep%20learning%20is%20a%20method,produce%20accurate%20insights%20and%20predictions (last visited Feb. 19, 2024).

[13] *Id*.

[14] *Id*.

[15] *What is Natural Language Processing (NLP)?*, ORACLE, https://www.oracle.com/ca-en/artificial-intelligence/what-is-natural-language-processing/ (last visited Feb. 18, 2024).

NLP include automatic translation of text or speech, document summarization, sentiment analysis, and grammar or spell checking.

(e) Generative Artificial Intelligence

Generative AI is a subset of machine learning that is intended to mimic human creativity by generating output based on user input, including images, music and text through the synthesis of existing data patterns.[16] Unlike traditional AI systems, generative AI does not rely on predefined rules; rather it learns from the underlying structure and relationship within the training data to generate new outputs. For example, OpenAI's DALL-E, an image generation model, can create images based on textual descriptions that are inputted into the model without being explicitly programed.

(f) Large Language Models

Large Language Models ("LLM") are a type of generative AI that specialize in processing and generating text in response to an input. LLMs, also known as advanced AI systems, are designed to analyze vast amounts of text data and utilize that data to generate new text.[17] LLM's are capable of understanding context, syntax, semantics and nuances of language and have been leveraged for summarization, question answering and text classification.[18] Generative AI platforms, such as ChatGPT, rely on Large Language LLMs and have been leveraged in the franchising context to optimize marketing, content operations and analysis of data.

Franchises should be cognizant of the ethical concerns associated with the use of generative AI and its output. These ethical implications are multifaceted and include the possibility of generating output that could mislead or deceive individuals (i.e., hallucinations or deep fakes), exhibit biases, rely on misinformation or pose a threat to an individual (i.e., discrimination, harassment, hate speech or privacy violations). For a more fulsome discussion on these and other ethical considerations associated with the use of generative AI and its output see Section 6 of this paper below.

3. The Use of Artificial Intelligence in Franchising

In the digital world, the convergence of AI with franchising heralds a paradigm shift, empowering both franchisees and franchisors to transcend traditional boundaries and embrace a future defined by agility and innovation. The adoption of AI in franchising presents opportunities to, among other things, streamline business operations, elevate customer experiences, automate mundane tasks, and promote data-driven decision

[16] Helen Toner, *What Are Generative AI, Large Language Models, and Foundation Models?*, CTR. FOR SEC. & EMERGING TECH. (May 12, 2023), https://cset.georgetown.edu/article/what-are-generative-ai-large-language-models-and-foundation-models/.

[17] *Introduction to Large Language Models,* GOOGLE FOR DEV., https://developers.google.com/machine-learning/resources/intro-llms (last visited Feb. 19, 2024).

[18] *Id*.

making and use of predictive analytics.[19] Many proponents of AI are firmly of the view that early adopters of AI will have a competitive advantage over late adopters who have not yet leveraged AI to streamline their operations and enhance the consumer experience.[20] As AI becomes increasingly integrated in our daily lives, franchises may want to prioritize staying ahead of the competition by meeting consumers' expectations for greater efficiency, personalized interactions and enhanced experiences. The comments and thoughts expressed herein explore the potential of AI within franchising, unravel its capacity to redefine processes, amplify efficiency, elevate customer experiences and cultivate solutions that benefit individuals in their business endeavors.

Over the past two years, we have seen rapid advancement in the various use-cases for AI. Businesses and consumers are using AI to create videos, generate text and prose, compose music, create images and write computer code. In the franchise context, AI can be used for:

- *Automation:* At the heart of AI's prowess lies its ability to automate mundane tasks and streamline operational workflows. AI has been leveraged to automate repetitive tasks, such as responding to FAQs and customer service inquiries by automatically updating knowledge bases. Automating the user knowledge base allows franchisors and franchisees to optimize communications with existing and potential franchisees and consumers through personalized email campaigns and correspondence.[21] The integration of AI in franchising also presents an opportunity for the franchisor and franchisee to automate the customer support process by augmenting the franchisors' capacity to glean insights from customer feedback and sentiment. Franchisors have also utilized AI to provide consumers with a self-service center where they can research answers to inquiries. AI-driven tools, like robotic process automation ("RPA"), herald a new era of administrative efficiency within franchising. By automating tasks such as inventory management, scheduling, and financial reporting, RPA not only mitigates the risk of human error but also liberates franchisees from the shackles of repetitive and time-consuming tasks. Freed from the burdens of administrative minutiae, franchisees can redirect their focus toward strategic initiatives and customer engagement, thereby fortifying the franchise's competitive position and fostering sustainable growth.[22]

- *Supply Chain:* In modern franchising, data reigns supreme as the lifeblood that fuels informed decision-making and operational optimization. AI enables franchisors to harness the power of data analytics and predictive modeling to uncover hidden patterns, discern emerging trends and unlock actionable insights.

---

[19] Gustavo Guimaraes, *The Rise of Artificial Intelligence for Franchising,* INT'L FRANCHISE ASS'N, https://www.franchise.org/blog/the-rise-of-artificial-intelligence-for-franchising (last visited Feb. 7, 2024).

[20] *Id*.

[21] Paul Flick, *Leveraging AI to Propel the Franchise Industry Forward*, FORBES (Sept. 27, 2023), https://www.forbes.com/sites/forbesbusinesscouncil/2023/09/27/leveraging-ai-to-propel-the-franchise-industry-forward/?sh=a3ff45669efa.

[22] *Complete Guide to AI Workflow Automation: Streamlining Productivity*, JESTOR (Jul. 7, 2023), https://jestor.com/blog/a-i/complete-guide-to-ai-workflow-automation-streamlining-productivity/.

The predictive capabilities of AI allow franchisors to leverage predictive ordering, including when and how much to order, and allows for informed decision-making with respect to pricing, marketing and inventory management to ensure optimal service levels and minimize operational costs.[23] The use of AI allows the franchise to gain deeper insights into customer behaviour, preferences and purchasing patterns to predict future behaviours.[24] The franchise can analyze historical sales data, demographic trends, and external factors, such as weather conditions, to predict peak hours with unparalleled accuracy. By leveraging predictive maintenance ("PdM") solutions powered by AI to scrutinize equipment performance metrics and anticipate potential failures, franchisors can proactively schedule maintenance interventions, forestalling costly downtime and preserving operational continuity.[25] This predictive prowess not only enhances asset reliability but also imbues franchisees with the confidence to navigate the rigors of day-to-day operations with aplomb, secure in the knowledge that AI stands as a stalwart guardian against unforeseen disruptions.

- *Customer Support & Personalized Marketing:* Franchises are increasingly leveraging AI to make better business decisions, enhance their customer experiences and optimize marketing strategies.[26] The use of generative AI in franchising has revolutionized the consumer experience by equipping the franchise with AI-driven recommendation engines capable of mining vast repositories of customer data. These AI engines enable the franchisee to discern individual preferences, purchase histories and browsing behaviors to curate personalized product recommendations and cultivate cross-selling opportunities that resonate with customers on a deeply personal level. Common use cases include providing assistance to customers through chatbots or virtual assistants, including to assist with room bookings, and generating personalized recommendations, such as in-app recommendations for local attractions and amenities based on consumption trends and user analytics.

- *Communicating with Franchisees and Customers:* In modern franchising, customer experience reigns supreme as the linchpin that underpins brand loyalty and sustains competitive differentiation. AI empowers franchisors to orchestrate seamless, personalized interactions that resonate with customers on a profound level. Franchisors can streamline the customer review process by automating personalized responses to feedback and inquiries. AI has also been leveraged to automate the process of crafting personalized email campaigns that are tailored to individual customer preferences and behaviors. Furthermore, deploying AI-driven chatbots endowed with NLP capabilities elevates the guest experience to

[23] *Id*.

[24] Guimaraes, *supra* note 19.

[25] Md Rakibul Islam, Shahina Begum & Mobyen Uddin Ahmed, *Artificial Intelligence in Predictive Maintenance: A Systematic Literature Review on Review Papers, in* LECTURE NOTES IN MECHANICAL ENGINEERING 251 (Fakher Chaari, Francesco Gherardini, Vitalii Ivanov & Mohamed Haddar eds., 2024).

[26] Flick, *supra* note 21.

unprecedented heights, imbuing each interaction with a sense of warmth, efficiency and personalized attention, and enables franchisees to engage guests in intuitive, context-aware conversations.[27] Several franchisors, including McDonald's, Checkers and Rally, have integrated AI in their drive-thru operations to facilitate the ordering process. The AI system used by these franchisors had several weeks to pick up on dialect and variations to train the AI model. Since its implementation, Checkers found a 96% accuracy rate, with the output requiring correction only 4% of the time.[28] From addressing routine inquiries to facilitating seamless transactions, AI-powered chatbots augment franchisees' capacity to deliver timely, personalized assistance that engenders trust, loyalty, and advocacy.

- *Product Generation:* Franchisors can harness AI as a powerful tool to brainstorm ideas for new products or service offerings. AI provides franchisors with the potential to analyze vast amounts of data, including market trends, consumer preferences and competitor insights. For example, AI can be utilized to create a new menu for a restaurant, a new recipe or to stay on top of social trends in a competitive market.

- *Image Creation:* AI and text-to-image algorithms, like OpenAI's DALL-E, have been increasingly leveraged to create marketing and promotional materials. These algorithms have the potential to enhance branding and reduce the time and costs associated with traditional photo shoots.

- *Advertising and Marketing:* AI empowers franchisors to craft customized interactions that transcend the confines of traditional marketing paradigms. The use of AI-driven services has the potential to minimize creative production timelines and can be leveraged for product generation, image creation, advertising and marketing.[29] By leveraging AI, franchisees can tailor marketing strategies, optimize product assortments and orchestrate targeted promotions that resonate with their customer base, thereby driving conversion rates and bolstering bottom-line profitability.[30] Generative AI, such as OpenAI's Chat GPT, can be a valuable tool for facilitating brainstorming and assessing the viability of marketing, promotional or advertising endeavors in the franchising context.[31] Armed with the

[27] Emi, *The Best AI Hotel Chatbot: Everything You Need to Know*, CHATLYN BLOG (May 25, 2023), https://chatlyn.com/en/blog/the-best-ai-hotel-chatbot/.

[28] Emilee Wentland*, For Maximum Efficiency, Automation Could Be the Solution, Panelists Say*, FRANCHISE TIMES (Nov. 15, 2022), https://www.franchisetimes.com/franchise_news/for-maximum-efficiency-automation-could-be-the-solution-panelists-say/article_fa211334-6548-11ed-93f3-7b11958abe9f.html.

[29] *Id*.

[30] *How to Use AI to Market Your Franchise*, FMS FRANCHISE (Jul. 21, 2023), https://www.fmsfranchise.com/how-to-use-ai-to-market-your-franchise/.

[31] Eleanor Vaida Gerhards, *How Franchisors Can Use Artificial Intelligence (AI) to Improve their Franchise System and Help Franchisees*, FOX ROTHSCHILD (Jun. 16, 2023),

nuanced understanding of customer sentiment, franchisors can fine-tune their service offerings, address pain points, and cultivate a culture of continuous improvement that resonates with customers on a visceral level. [32]

4. The Drawbacks: How Artificial Intelligence Can Harm Franchising

Although the integration of AI holds immense potential to revolutionize franchising, franchisors must be cognizant of the barriers and drawbacks associated with its adoption and take a proactive approach to mitigate the risks associated with its use. The rapid pace of advancements in AI introduces complexities with respect to data security and privacy, bias and regulatory compliance, among others, as further discussed below, which can pose significant risks to the operations and brand recognition of a franchise.

In the franchising context, franchisors and franchisees should be mindful of the following drawbacks when deploying AI systems:

- *Increased Cost*: Adoption of the new and ever-evolving AI is expensive and, though, it may result in greater productivity and profit in the long run, adoption will be costly to both the franchisor and franchisees.

- *Job Losses*: AI-powered automation can replace human workers in various tasks, such as customer service, data entry and inventory management. This can lead to reduced labor costs for franchisors and franchisees but can also result in job displacement and reduced opportunities for human interaction. Karim Lakhani, a professor at Harvard Business School, emphasizes that AI won't directly replace humans but rather augment their capabilities. In his view, humans working alongside AI will eventually replace those who do not embrace AI. He suggests that business leaders should experiment, create sandboxes, and develop AI use cases for all employees, not just technology workers. Change management is crucial in this evolving landscape.[33]

- *Data Privacy and Security*: AI systems often rely on large amounts of data function effectively. This data can include personal information about customers and franchisees, which raises concerns about data privacy and security. If AI systems are not properly secured, there is a risk of data breaches and unauthorized access to sensitive information. Such a breach in a franchise system is heightened, as a problem at even one franchise location can impact the entire brand.

- *Bias and Discrimination*: AI systems can perpetuate or amplify existing biases and discrimination. For example, if an AI system is trained on data that contains biased

https://franchiselaw.foxrothschild.com/2023/06/articles/business-updates/how-franchisors-can-use-artificial-intelligence-ai-to-improve-their-franchise-system-and-help-franchisees/.

[32] Mayur Wankhade, Annavarapu Chandra Sekhara Rao & Chaitanya Kulkarni, *A Survey on Sentiment Analysis Methods, Applications, and Challenges*, 55 A.I. REV. 5731 (Feb. 7, 2022).

[33] Karim Lakhani, *AI Won't Replace Humans — But Humans With AI Will Replace Humans Without AI*, HARV. BUS. REV. (Aug. 4, 2023), https://hbr.org/2023/08/ai-wont-replace-humans-but-humans-with-ai-will-replace-humans-without-ai.

information, it may make decisions that are unfair or discriminatory.[34] This can have negative consequences for franchisees and customers and may damage the reputation of the franchisor.

- *Lack of Human Touch*: AI systems lack the human touch and emotional intelligence that are essential for building strong relationships with customers and franchisees. This can make it difficult for franchisors and franchisees to connect with their customers and provide personalized service.

- *Rapid Rate of Change and Attendant Uncertainty*: The rapid pace of AI development and the uncertainty surrounding its impact on franchising can create challenges for franchisors and franchisees. It can be difficult to keep up with the latest AI trends and to make informed decisions about how to incorporate AI into franchising operations.

5. Legal and Business Considerations

(a) The Ecosystem Players

When trying to understand the intricate landscape of AI, it is important to understand that it is comprised of a robust ecosystem of different contributors that together make up AI. These contributors include data providers, foundation model architects, AI system deployers and end users.

The data provider curates vast repositories of training data to be provided to the AI system to discern patterns, derive insight and to make informed recommendations. Concurrently, the foundation model architect builds the foundation models and shapes the structure of the AI system. These robust algorithms and models are designed to parse through complex datasets, decipher correlations and generate predictive insights. The AI system deployers configure and customize AI solutions adapted from foundational models for use by the end users. Depending on the AI system, in the franchise context, the franchisor, franchisee, employees and customers could be the end users. The end users can interact with the AI systems directly to, among other things, leverage insights, optimize decision-making, enhance the customer experience and drive business growth.

(b) Legal and Business Considerations when Rolling out an Artificial Intelligence System in the Franchise System

The introduction of new AI to a franchise system implicates several issues – both from a legal perspective as well as from a business and logistical perspective. A careful examination of existing franchise agreement provisions, as well as applicable franchise laws, will inform the process. Once the legal basis to introduce AI to the franchise system

[34] Philip Di Salvo & Antje Scharenberg, *AI Bias: The Organized Struggle Against Automated Discrimination*, THE CONVERSATION (Mar. 4, 2024), https://theconversation.com/ai-bias-the-organised-struggle-against-automated-discrimination-223988.

is established, the implementation process and other logistical concerns can more easily be navigated.

(i) General Franchise Agreement Contractual Terms and the Duty of Good Faith

When assessing whether a franchisor has the right to introduce AI into its franchise system, the first thing to consider will be the specific terms and conditions of the franchise agreement. More often than not, the ability to introduce a new technology into the franchise system will be governed by the "systems modification" or "system change" provision in the franchise agreement. A well-drafted systems modification provision should give the franchisor the contractual right to implement AI into the franchise system. The following is an example of a typical systems modification provision in the United States:

> *In order to maintain the high quality and standards, methods, techniques, and specifications associated with the Franchised Business, the Trademarks, and the System, and to promote and protect the goodwill associated with the Franchise System, as well as to remain up to date with all technological advancements and innovations, Franchisor reserves the right, in its sole discretion, to change and modify the System. This includes, but is not limited to, modifications to the Manuals, System Standards, Information Systems, required equipment, and [POS/SMS] Systems. Franchisee agrees to accept and adopt such changes, modifications, or upgrades strictly in accordance with instructions and specifications from the Franchisor or as outlined in the Manuals and to bear all of the costs associated with such changes, modifications, or upgrades, including, but not limited to, the purchase of any new technology-related equipment.*

In more recent years with the rapid advancements of technologies, including delivery aggregator technologies, in addition to typical system modifications provisions like the one above, we have seen a movement to more technology-specific system change provisions that provide the franchisor with very clear rights to introduce new technologies. If the franchise agreement does not have a strong system modifications clause or a specific technology system change provision, another provision to consider as the basis for allowing the introduction of AI into the franchise system would be the obligation on the franchisee to follow the operations manual(s), and a right for the franchisor to update the operations manual(s) from time to time. Having said that, a franchisor may need to be cautious about using the operations manual(s) to make material changes to the terms of the franchise agreement.

In addition to determining whether the franchisor has a contractual right to introduce AI into the franchise system, the franchisor will need to ensure any system change is done in accordance with the duty of good faith and fair dealing. In the United States, the franchisor's right to implement changes to the system through the franchise agreement is supported by existing case law, even if it comes at a great financial cost to the

franchisee.[35] Additionally, in the United States, the application of the implied covenant of good faith and fair dealing has, generally, not been a hindrance to the implementation of changes that are intended to benefit the system as a whole.[36] Currently, there is no case law in the United States considering the duty of good faith and fair dealing in the context of AI. However, courts in the United States that have applied the doctrine in other contexts have looked to the reasonableness of the applicable system changes. Where the franchisor exhibits candor, transparency, and the interests of the system as a whole and does not act "with improper motives, or arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties[,]" the doctrine has usually supported the proposed system modifications.[37]

In Canada, while there are slight differences between the various franchise statutes, they all impose a substantially similar duty of good faith and fair dealing on both franchisor and franchisee in the performance and enforcement of the franchise agreement. Accordingly, when exercising any discretion that a franchisor may have under the franchise agreement to introduce AI into the franchise system, it must exercise such discretion in good faith. Similar to the United States, the franchisor's right to implement changes to the system through the franchise agreement is supported by existing case law.

The courts in Canada have been clear that the duty of good faith and fair dealing does not go so far as to impose a fiduciary duty on the franchisor to act in the best interests of the franchisee.[38] Nor is it a stand-alone duty that alters the express terms of the agreement reached by the parties. As stated by the court in *Fairview Donut Inc v. TDL Group Corp*, "[t]he duty is imposed in order to secure the performance of the contract the parties have made. It is not intended to replace that contract with another contract or to amend the contract by altering the express terms of the franchise contract [citation omitted]."[39] Parties are entitled to act in their own interest, so long as they deal honestly, reasonably and fairly with the other.[40] In *Fairview Donut*, the court found that the franchisees' good faith claims could not succeed because the system changes at issue were "rational business decision[s] made by Tim Hortons for valid economic and strategic reasons, having regard to both its own interests and the interests of [all the system's]

---

[35] *See, e.g.*, *Bores v. Domino's Pizza*, LLC, 530 F.3d 671 (8th Cir. 2008) (Franchisor could require franchisees to purchase and use only the franchisor's custom-designed integrated computer system); *see also*, *JDS Grp. Ltd. v. Metal Supermarkets Franchising Am.*, Inc., No. 17-cv-6293, 2017 WL 2643667 (W.D.N.Y. June 20, 2017); *Trail Burger King, Inc. v. Burger King of Miami, Inc.*, 187 So.2d 55 (D. Fla. 1966); *Principe v. McDonald's Corp.*, 631 F.2d 303 (4th Cir. 1980), *cert. denied*, 451 U.S. 970 (1981).

[36] Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 641 MICH. STATE L. REV. 641 (2015).

[37] *In re Sizzler Restaurants, Int'l, Inc.*, 225 B.R. 466, 470 (Bankr. C.D. Cal. 1998); *see also*, Robert W. Emerson, *The Faithless Franchisor: Rethinking Good Faith in Franchising*, 24 U. PENN J. BUS. L. 411, 424 (2022).

[38] *Shelanu Inc v Print Three Franchising Corp*, 2003 CarswellOnt 2038 at paras 67-71 [*Shelanu*] (Can.); additional reasons 2006 CarswellOnt 2627 (Can.); *Fairview Donut Inc v The TDL Group Corp*, 2012 ONCA 867 at para 503 [*Fairview Donut*] (Can.).

[39] *Fairview Donut*, *supra* note 38 at para 500.

[40] *Id* at para 499.

franchisees".[41] *Fairview Donut* remains one of the leading court decisions on good faith in Canada. This language suggests that Canadian courts, like those in the U.S., will show deference when considering the franchisor's exercise of discretion when such discretion is based on a rational exercise of business judgment by the franchisor.

(ii) Specific Contractual Provisions

In addition to the general provisions that allow for introduction of AI initiatives, more specific provisions in the franchise agreement can prove very useful in minimizing franchisee resistance or pushback regarding AI modifications or upgrades. These provisions can manage franchisee expectations from the very beginning of the relationship. By including these provisions in the franchise agreement, franchisors can set a tone and culture that is committed to technological innovation and adoption – whether AI or otherwise. Such a culture is one that is becoming essential – perhaps even of existential importance – today and moving forward.

(A) Information Technology Requirements

A specific clause requiring franchisees to stay current with information technology is one such contractual provision that would send a message of the franchise system's commitment to stay current, and even ahead, of the AI cutting edge.

(B) Technology Fund/Fee

The collection of a technology fee that goes into the franchisor's technology fund has now become a must for any franchise system. A technology fund fee operates in the same way as an advertising fund fee. A franchisee pays a set amount, usually a percentage of gross revenues, into a fund that the franchisor uses for the benefit of the system by investing in new technological innovations to create a competitive advantage.

(C) Franchisee Tech Advisory Council

A franchisee tech advisory council is an excellent method for the franchisor to signal its commitment to innovation and technological development to the system, as well as inclusion and transparency regarding such innovations and system modifications. Innovation is essential for growth and being innovative should be a shared responsibility across the franchise system, not reserved just for the franchisor.[42]

Inclusion of a provision in the franchise agreement regarding the formation of such a council is both practical and strategic in that it manages expectations and contributes to a culture of innovation and agility, while also setting up the mechanism for creation of the council. A sample provision in the United States could read as follows:

---

[41] *Id* at para 6.

[42] Trever Ackerman, *Why Company Culture is Crucial in the Franchise System,* FORBES (Jun. 7, 2018), https://www.forbes.com/sites/forbescommunicationscouncil/2018/06/07/why-company-culture-is-crucial-in-the-franchise-system.

In order to provide a forum to exchange ideas and information between the franchisor and franchisee regarding the latest technological developments and ideas that would be most beneficial to the System, franchisor reserves the right to establish a Technology Advisory Council (the "Tech Advisory Council") pursuant to the terms and conditions set forth, and regularly updated, in the operations manual.

A tech advisory council can also be a great resource for innovative ideas and direction, as the franchisees are the ones most deeply immersed in the operations of the franchise business and often have great insights, suggestions, and feedback. Additionally, working with a franchisee council throughout the development and actual implementation of any new tech will enable the franchisor to better understand, and resolve more rapidly, any contentious issues or pushback from the system.

(D) Pilot Programs

Involving franchisees in the innovation and change process can also be a valuable testing and implementation tool.[43] The inclusion of a provision regarding the use of pilot programs to test and prove out new tech prior to rollout allows the franchisor to set certain parameters and requirements for such programs. Specifically, the franchisor can set out some basic threshold parameters of franchisee participation, including: (a) a requirement to participate in additional training; (b) to purchase new software or equipment; and (c) the expenses involved.

Franchisors should avoid including too much detail in a pilot program provision and instead refer to the operations manual for the more detailed aspects that can, of course, vary greatly depending on the tech involved. For example, the use of a pilot program in the context of developing a digital delivery app will likely present different issues and needs than the pilot program for a new CRM/POS system or use of the metaverse.[44]

(iii) Logistical Considerations

There is a lot to consider in the legal landscape surrounding the implementation of new technology in a franchise system. The logistical challenges are numerous and must be addressed carefully and with clear and transparent system-wide communication.

(A) Contracting With Third-Party Vendors

One of the earliest decisions in the roll-out of new AI is the contractual relationship with the vendors developing and implementing the new technology for the franchise system.

---

[43] Tanya Morrison, Charlene Wilson & Ashley Williams, *Digital Transformation in a Franchise System: Keeping Up with the Technology Race Within the Bounds of Existing Franchise Agreements*, INT'L FRANCHISE ASS'N 52ND ANN. LEGAL SYMP. at 10 (2019).

[44] Anne P. Caiola, Brittany Johnson & Andra Terrell, *Age of Disruption: Current Issues for Restaurant Franchises*, ABA 43RD ANN.F. ON FRANCHISING at W-20, 6 (2020); Chris Dull, Clint Ehlers, Andraya Frith & Max Staplin, *Ch-ch-ch-ch-changes: Implementing System Changes, Upgrades and New Directions Under Existing Agreements*, INT'L FRANCHISE ASS'N 50TH ANN. LEGAL SYMP.at 15 - 17 (2017).

Should the franchisor negotiate an umbrella agreement for the entire system in the franchisors name or should franchisees contract directly with the vendors? There are advantages and disadvantages to both approaches. Given the greater bargaining power of the franchisor entity when contracting for an entire system, it is likely to negotiate more favorable terms. However, this also means that the franchisor retains a fair amount of contractual liability that it will have to be cognizant to mitigate. Nonetheless, with this approach, the franchisor can ensure that the interest of the system as a whole, rather than the individual needs of each franchisee, are met, as well as brand integrity and system uniformity. For a more fulsome discussion regarding contracting with AI providers, see Section 7(c) below.

(B) Proprietary Technology Development

Alternatively, a franchisor can develop its own proprietary AI technology. Such technology would be uniquely tailored to the system and able to specifically address the needs and concerns of franchisees. In-house development would also give the franchisor greater control over the customer experience and interface with the brand and, presumably, the ability to update and revise as needed to stay current with new developments. Ownership and control of the data could more easily rest with the franchisor with fewer logistical concerns.[45]

The cost of developing proprietary AI, however, can be prohibitive for most systems. Additionally, with the speed of advancements and innovations in this sector, the risk of such technology becoming outdated before it can offer a return on investment could be quite high. Systems would also likely need to pass this cost on to its franchisees, making the effort of system-wide implementation much more challenging.

(iv) Implementation

Once the franchisor has established the contractual basis and authority for the proposed introduction of AI, and addressed the logistical challenges, it should create and send a detailed roll out plan to the entire system. Such transparency and direct communication will engender trust and greater cooperation by franchisees.

Franchisors should be clear in their communications about the expectations for the program, the requirements of franchisees, the specific timeline (with built-in leeway, of course) for the roll-out, and instructions for participating in the program. Presumably, if the franchise culture, expectations and use of the franchisee tech advisory council have been in place and employed from the beginning, the entire franchise system should be well-primed and prepared for the roll-out.

A crucial part of the communication and ultimate success or failure of the new AI initiative will depend on the reason for the changes that are being implemented. The franchisor must make a persuasive bottom-line case for the changes, showing that the changes will

[45] Ashley Weis, *What Franchisors Should Know About Data Privacy Compliance in 2023*, FRANCHISE WIRE (Mar. 14, 2023), https://www.franchisewire.com/data-privacy-compliance-for-franchise-systems-in-2023.

benefit all. The franchisor should look to present the diligent and thorough research that has been conducted on customers/clients, demographics, competitors, and the industry as a whole.[46] Such a bottom-line case for the changes will serve to solidify support for the changes, strengthen the franchisor-franchisee relationship, and minimize the risk of potential disputes.[47]

(A) Use of Tech Advisory Council

The involvement and assistance of the franchisee tech advisory council will be vital at this stage.[48] If a tech advisory council has been set up and involved in the research and development of technological improvements and upgrades thus far, then their continued involvement in the implementation will be a natural extension and will serve to continue the cooperative relationship already extant. The tech advisory council will also continue to provide the important feedback from the rest of the franchise system as the roll-out and pilot programs are progressing.

(B) The Pilot Program

As discussed in Section 5(b)(ii)(D) of this paper, pilot programs are short-term tests that can help a system learn how a larger-scale implementation might work. They provide a platform for the system to test the logistics and spot any potential deficiencies before a full roll-out.[49] If the franchisor has corporate-owned units, it might consider conducting a smaller-scale pilot program in those units first to better understand how the modifications will affect daily operations, make refinements, and document the results. Piloting, or perhaps, pre-piloting, at the corporate level also demonstrates a franchisor's good faith and confidence in implementing the change since they are leading the way and taking the risks of trial and error first.[50]

(c) Data Ownership and Use

From a business perspective, data ownership is a critical aspect of utilizing AI. Businesses need to consider who owns the inputs and outputs of an AI system, and how these elements can be used, but with the understanding that such determinations are not trivial legal questions currently.[51] The inputs to an AI system often come from various sources, including the provider, the customer, or a third party. The ownership of these

---

[46] Dull, et al., *supra* note 44, at 16.

[47] Morrison, et al., *supra* note 43, at 10.

[48] David A. Beyer, Himashu M. Patel & John Dent, *Changes in System Standards – What is the Extent of Franchisor's Latitude?*, ABA 35TH ANN. F. ON FRANCHISING, at W-14, 10 (2012).

[49] Ron Ashkenas & Nadim Matta, *How to Scale a Successful Pilot Project*, HARV. BUS. REV. (Jan. 28, 2021), https://hbr.org/2021/01/how-to-scale-a-successful-pilot-project; Caiola, et al., *supra* note 41, at 6.

[50] Morrison et al., *supra* note 43, at 10.

[51] Gil Appel, Juliana Neelbauer & David A. Schweidel, *Generative AI Has an Intellectual Property Problem*, HARV. BUS. REV. (Apr. 7, 2023) https://hbr.org/2023/04/generative-ai-has-an-intellectual-property-problem.

inputs can be defined contractually, often with the provider retaining ownership of the initial training data and the customer owning any additional data they contribute.

As for the outputs of an AI system, businesses often want to retain ownership of these, as they can contain valuable insights. However, providers may also want to use these outputs to improve their products and services. In such cases, the provider should explicitly define these rights in the contract. Typically, providers retain ownership of "aggregated and anonymized" customer data, specifying its use for improving products and services or for monetizing insights. For a more fulsome discussion regarding the contractual considerations around data ownership and use of inputs and outputs, see Section 7(c)(ii) below.

(d) Intellectual Property Considerations

The current landscape of intellectual property ("IP") laws is still evolving to better address the protection of intangible assets created by AI, including the IP rights associated with the AI-generated work.[52] IP issues surrounding inventorship and ownership are complex, multifaceted and challenge the traditional frameworks of IP law. Given the multitude of players in the AI ecosystem, the output generated by an AI system blurs the line of authorship and challenges the notion of IP as a human creation.[53] This issue is further complicated by the varying degrees of involvement that users of AI have in the output generated by AI. Accordingly, the adoption of AI and generative AI introduces a heightened need to protect the IP rights of the franchise.

Claims that an AI is an inventor or author of copyrightable work have been rejected by patent and copyright offices in Canada and the U.S., who have found that an inventor or the author must be a natural person.[54] Under Canadian and United States copyright laws, the creator owns the copyright and has the rights to license the work. The notion that AI requires human "skill and judgement" to achieve the desired output is a key argument with respect to AI outputs and authorship in Canada. The Supreme Court of Canada ("SCC") has held that for a work to be deemed to be "original" within the meaning of the *Copyright Act*, it must be more than a mere copy of another work.[55] This does not require that the work be "novel" or "unique", but rather it must be produced by exercising "skill and judgment".[56] The United States Copyright Office has similarly determined that there

---

[52] Rachel Free, *Artificial Intelligence – Questions of Ownership*, CMS, https://cms.law/en/int/publication/artificial-intelligence-questions-of-ownership (last visited Feb. 8, 2024).

[53] *State of the Arts: How Should Canadian Copyright Law Treat Works Generated by Artificial Intelligence?*, CAN. BAR ASS'N, https://www.cba.org/CBAMediaLibrary/cba_na/PDFs/Sections/IP-Copyright-of-AI-created-works-AODA.pdf (last visited Feb. 10, 2024).

[54] Nathaniel Lipkus, *Can AI Be an Inventor on a Patent or Author of a Copyrighted Work?*, OSLER (Apr. 27, 2023), https://www.osler.com/en/resources/regulations/2023/can-ai-be-an-inventor-on-a-patent-or-author-of-a-copyrighted-work.

[55] *CCH Canadian Ltd. v. Law Society of Upper Canada*, [2004] 1 S.C.R. 339 at para 16 (Can.).

[56] *Id*.

is no copyright protection for works created by non-humans, including AI.[57] In a recent decision by the United States Court of Appeal for the District of Columbia Circuit, the plaintiff sought copyright protection for AI-generated artwork, listing the AI system as the artwork's creator.[58] The Court affirmed the United States Copyright Office's decision, finding that human authorship is a "bedrock requirement" of copyright.[59]

Although undefined in the Copyright Act, the concept of authorship dictates ownership.[60] Current IP laws also lack clarity around the permissible use of training data, including whether the use of AI to generate new outputs based on data or inputs used infringes the IP rights of the owners of the data or inputs.[61] Currently, content that is wholly created by AI is not protected under copyright or patent laws. Access to copyright-protected data poses challenges, as AI systems rely heavily on vast amounts of data for training purposes. Copyright laws require permission from the rightful owners for the use of protected material, however the extensive nature of data used to train AI systems poses significant challenges in obtaining the required permission for its use.[62]

In light of the above, franchise systems need to carefully consider the IP risks related to using AI. For example, the potential risks related to using their own IP to train third-party AI models, as well as the potential risks of using AI-generated outputs that may infringe the IP rights of third parties. When integrating AI in franchise operations, franchisors should ensure that they: (i) have implemented controls to protect against their sensitive IP being used to train third-party AI models; (ii) understand what third-party data is being used to the train the AI model they are leveraging; (iii) have negotiated provisions in AI provider contracts to ensure that the franchise system will have the appropriate rights to use the AI outputs as intended; and (iv) have included appropriate provisions in their franchise and employment agreements regarding the ownership and use of AI inputs and outputs. This can be achieved by including AI-specific provisions in franchise and employee agreements, implementing appropriate franchisee and employee AI use policies, as well as proper review and negotiation of AI provider contracts. As AI systems continue to evolve to exhibit greater autonomy, the need for legal frameworks addressing inventorship and ownership of AI output becomes increasingly apparent. For a more fulsome discussion on these topics, see Section 7(c)(ii) below.

---

[57] Blake Brittain, *Computer Scientist Makes Case for AI-Generated Copyrights in US Appeal*, REUTERS (Jan. 23, 2024), https://www.reuters.com/legal/litigation/computer-scientist-makes-case-ai-generated-copyrights-us-appeal-2024-01-23/.

[58] *Thaler v. Perlmutter*, Civil Action No. 22-1564, 2023 U.S. Dist. LEXIS 145823 (Aug. 18, 2023).

[59] *Id*. at 11.

[60] *Copyright Act*, R.S.C. 1985, c C-42 (Can.).

[61] Lynh Li, *AI and IP Law: What You Need to Know*, CARAVEL (Dec. 27, 2023), https://caravellaw.com/ai-and-ip-law-what-you-need-to-know/.

[62] *Consultation Paper: Consultation on Copyright in the Age of Generative Artificial Intelligence*, INNOVATION SCI. & ECON. DEV. CAN. (Dec. 1, 2023), https://ised-isde.canada.ca/site/strategic-policy-sector/en/marketplace-framework-policy/consultation-paper-consultation-copyright-age-generative-artificial-intelligence (Can.).

(e) Confidentiality and Privacy

When utilizing AI for business purposes, it is important to understand the data that may be provided to the AI system. Depending on the use cases, it is conceivable there is an interest to input confidential data, such as personal information, financial information, proprietary code, or other sensitive business information. While the use cases and potential value add may be compelling, businesses must consider the risks of potential data leakage.

When considering use cases that involve personal information, such as information of consumers of a business, it is important to understand that the collection and use of such data can raise privacy concerns. Modern privacy laws generally afford broad individual rights that would naturally extend when their personal information is processed within AI. Businesses should be mindful to understand whether they have the legal right to input such personal information into AI, which may involve reviewing existing privacy notices, and properly collecting and managing the consent of individuals.

6. Ethical Considerations

(a) Artificial Intelligence Bias and Harm

Ethical considerations include potential bias and discrimination in AI-driven decision-making processes. Bias in AI refers to the systematic error introduced into machine learning models due to the assumptions made during the model training process.[63] This can occur when the training data used to teach the AI system reflects discriminatory or unfair societal biases, but also when the AI algorithm itself contains bias.[64] For example, if an AI system is trained on a dataset that contains racial, gender, or socioeconomic biases, the system may inadvertently learn and perpetuate these biases, leading to unfair outcomes. To further illustrate, imagine asking one of the AI platforms to generate an image of a scientist, to explore the potential bias when using AI for image generation.[65] With an input of "generate a picture of a typical scientist," the image provided in Appendix A was created by one of the major generative AI platforms.

Harm in AI can occur when these biased decisions are applied in real-world scenarios. For instance, a biased AI system could unfairly disadvantage certain groups of people in areas such as hiring, lending, or law enforcement. This can lead to a perpetuation of existing inequalities and injustices.[66] Furthermore, AI systems can also cause harm if they are used maliciously, such as in the creation of deepfakes or other forms of misinformation. A combination of "deep learning" and "fake", deepfakes are synthetic media that combines AI algorithms with deep learning to create highly realistic and

---

[63] IBM Data & AI team, *Shedding light on AI bias with real-world examples*, IBM (Oct. 16, 2023), https://www.ibm.com/blog/shedding-light-on-ai-bias-with-real-world-examples/.

[64] *Id*.

[65] *Id*.

[66] James Manyika, Jake Silberg & Brittany Presten, *What Do We Do About the Biases in AI?*, HARV. BUS. REV. (Oct. 25, 2019), https://hbr.org/2019/10/what-do-we-do-about-the-biases-in-ai.

deceptive videos, images or audio recordings. Franchisors must prioritize fairness, transparency, and accountability to mitigate risks, including regular audits of AI systems and fostering inclusivity and diversity within organizations. For example, AI algorithms used in recruitment processes may inadvertently perpetuate biases present in historical hiring data, leading to discriminatory outcomes. Franchisors can address this by regularly reviewing and updating algorithms, diversifying training data to reduce bias, and by implementing measures to ensure transparency and accountability in hiring practices.

(b) The Implication of Artificial Intelligence Bias and Harm to Franchising

Despite the various benefits, such as increased efficiency, savings, and better personalized consumer experiences within the context of a franchise business model, the implication of AI bias and harm can extend across the franchisor and franchisee operations. [67] For example, from the franchisor perspective, the use of AI in identifying, screening or qualifying potential franchisees has the potential to significantly improve the efficiency of building a pool of franchisee candidates that meet certain criteria.[68] However, use of AI for this recruitment purpose may also contain biased results.[69]

In situations where the franchisor is offering a common service on the behalf of the franchisees, such as a shared call center, the use of AI within those operations could have impacts both to the franchisor and franchisee. For example, if the use of AI to address a particular matter via a call center agent results in discrimination, both the franchisee and franchisor may be implicated in potential claims. The question of who is legally responsible for such AI outputs, to the extent bias is discovered and results in harm may arise.[70] This question of ownership in outputs with respect to the use of AI is still an evolving topic, with courts working on the application of law to these cases.[71]

(c) Legal Obligations Related to Artificial Intelligence Bias and Harm

Given how quickly AI has evolved and entered the market, the current state of legal obligations in the United States with respect to AI bias and harm is largely based on existing laws and regulations as evidenced through a joint statement released by the

---

[67] Romany Thresher, *Navigating the Future: Balancing the Benefits and Risks of AI in Franchising*, LINKEDIN (April 12, 2023), https://www.linkedin.com/pulse/navigating-future-balancing-benefits-risks-ai-romany-thresher/.

[68] Andrew Swann, *How We Are Leading the Way in Using Artificial Intelligence to Successfully Recruit Quality Franchisees*, LINKEDIN (Oct. 29, 2023), https://www.linkedin.com/pulse/how-we-leading-way-using-artificial-intelligence-recruit-andrew-swann-hlsze/?trk=public_post.

[69] *Id*.

[70] *The Legal Impact of AI on Entrepreneurs, Business Owners, and Franchisors*, INTERNICOLA LAW FIRM, https://www.franchiselawsolutions.com/learn/franchise-compliance/the-legal-impact-of-ai-on-entrepreneurs-business-owners-and-franchisors (last visited Feb. 28, 2024).

[71] Appel et al., *supra* note 51.

Bureau of Consumer Financial Protection, Department of Justice, U.S. Equal Employment Opportunity Commission, and Federal Trade Commission on the topic.[72]

In the United States, the FTC issued a report evaluating the use and impact of AI in combatting online harms identified by Congress.[73] The report outlines significant concerns that AI tools can be inaccurate, biased, and discriminatory by design and incentivize relying on increasingly invasive forms of commercial surveillance. The FTC has also warned market participants that it may violate the FTC Act to use automated tools that have discriminatory impacts, to make claims about AI that are not substantiated, or to deploy AI before taking steps to assess and mitigate risks.[74] Finally, the FTC has required firms to destroy algorithms or other work product that were trained on data that should not have been collected.[75]

The Equal Employment Opportunity Commission ("EEOC"), in addition to the EEOC's enforcement activities on discrimination related to AI and automated systems, issued a technical assistance document explaining how the Americans with Disabilities Act applies to the use of software, algorithms, and AI to make employment-related decisions about job applicants and employees.[76]

The Consumer Financial Protection Bureau ("CFPB") published a circular confirming that federal consumer financial laws and adverse action requirements apply regardless of the technology being used. The circular also made clear that the fact that the technology used to make a credit decision is too complex, opaque, or new is not a defense for violating these laws.[77]

The Department of Justice's Civil Rights Division (the "Division"), among the Division's other work on issues related to AI and automated systems, recently filed a statement of interest in federal court explaining that the *Fair Housing Act* applies to algorithm-based tenant screening services.[78]

From a privacy perspective, such as under US State laws and GDPR, such regulations are generally focused on the use of AI in automated decision making which produces

---

[72] *Joint Statement on Enforcement Efforts Against Discrimination and Bias in Automated Systems*, U.S. EQUAL EMP. OPPORTUNITY COMM'R, https://www.eeoc.gov/joint-statement-enforcement-efforts-against-discrimination-and-bias-automated-systems (last visited Mar. 2, 2024).

[73] FED. TRADE COMM'N, COMBATTING ONLINE HARMS THROUGH INNOVATION (2022).

[74] *Id*.

[75] *FTC Finalizes Settlement with Photo App Developer Related to Misuse of Facial Recognition Technology*, FED. TRADE COMM'N (May 7, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/05/ftc-finalizes-settlement-photo-app-developer-related-misuse-facial-recognition-technology.

[76] U.S. EQUAL EMP. OPPORTUNITY COMM'R, *supra* note 72.

[77] *Id*.

[78] *Id*.

legal or similarly significant effects with no human involvement.[79] Legal or similarly significant effects are often associated with decisions that result in access to, or the provision or denial of, financial or lending services, housing, insurance, education enrollment or opportunity, criminal justice, employment or independent contracting opportunities, or compensation, healthcare services, or essential goods or services.[80]

Most recently, the European Union's Artificial Intelligence Act ("AI Act") is a landmark legislation that aims to regulate the development and use of AI systems within the EU.[81] Here are some key points[82]:

- *Risk-Based Classification*: The AI Act classifies AI systems based on the level of risk they pose to health, safety or fundamental rights. High-risk AI systems, such as those used in healthcare, education, border surveillance, and public services, are subject to strict rules.

- *Transparency and Ethics:* The AI Act introduces binding rules on transparency and ethics. For instance, technology companies are required to notify people when they are interacting with a chatbot or with biometric categorization or emotion recognition systems.

- *Data Quality and Protection:* The AI Act emphasizes the importance of high-quality datasets and robust data protection measures. It also mandates impact assessments on how using AI systems will affect people's fundamental rights.

- *Enforcement:* The AI Act will be enforced by a new European AI Office. It also includes provisions outlining the penalties for non-compliance.[83]

Canada is currently in the process of various privacy reform and AI-specific legislative initiatives that will focus on specifically regulating AI technologies in Canada, including the proposed Artificial Intelligence and Data Act ("AIDA") and the Voluntary Code ("Code").[84]

---

[79] *See* Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), OJ L 119, 4.5.2016, p. 1–88, art. 22; Kevin J. Angle & Ropes & Gray LLP, *Jingle All the Algorithms: Automated Decisionmaking Amidst a Blizzard of State Privacy Laws*, LEXOLOGY (Dec. 14, 2023), https://www.lexology.com/library/detail.aspx?g=696412d1-12bd-4e57-8d37-def057ad6ada.

[80] *Id*.

[81] *Shaping Europe's Digital Future*, EUR. COMM'N, https://digital-strategy.ec.europa.eu/en/policies/regulatory-framework-ai (last visited Mar. 2, 2024).

[82] *Id*.

[83] *Id*.

[84] Innovation, Sci. and Econ. Dev. Canada, *Artificial Intelligence and Data Act*, GOV'T CAN. https://ised-isde.canada.ca/site/innovation-better-canada/en/artificial-intelligence-and-data-act (last visited Mar. 25, 2024) (Can.).

(d) Strategies to Minimize Bias and Harm

To mitigate bias and harm in AI, it is important to start with appropriate governance relative to uses of AI.[85] It is crucial to use diverse and representative datasets during the training process. Additionally, regular audits of AI systems can help identify and correct biases.[86] Transparency in AI decision-making processes can also help ensure fairness and accountability.[87] Often, a franchisor may be leveraging AI services from a third-party provider, whose control over the datasets and training process is limited, if at all. In these instances, it is extra critical to perform due diligence before engaging such third party, in the form of assessing AI impacts.[88] Such assessments are similar in nature to security and privacy assessments that businesses may already have implemented as a part of their third-party due diligence processes.

As AI tools continue to evolve, the developers of these systems likely will be continuously making modifications to try and mitigate the effects of bias and harm to the outputs. In time, this should result in comprehensive understandings by these third parties, and their ability to provide detailed information on how they address bias and harm.

Franchisors should also ensure they have adequate contractual provisions when engaging with such AI third parties.[89] The following is an example of sample language aimed to address ethical considerations and bias within AI:

> *Provider maintains and adheres to industry standard policies and procedures relating to the ethical or responsible use of AI at and by Provider, including policies, protocols and procedures for: (i) developing and implementing AI in a way that promotes transparency, accountability and human interpretability; (ii) identifying and mitigating bias in training data or in the algorithmic model used in AI, including without limitation, implicit racial, gender, or ideological bias; and (iii) management oversight and approval of implementation of AI;*
>
> *Provider retains and maintains information in human-readable form that explains or could be used to explain the decisions made or facilitated by the AI, and Provider maintains such information in a form that can readily be provided upon request.*

---

[85] IBM Data and AI Team, *Shedding light on AI bias with real-world examples*, IBM (Oct. 16, 2023), https://www.ibm.com/blog/shedding-light-on-ai-bias-with-real-world-examples/.

[86] *Id*.

[87] *Id*.

[88] Flick, *supra* note 21.

[89] Danielle Lafollette, *AI and Vendor Contracts: What You Need to Do to Reduce Risks*, VENMINDER (Sept. 13, 2023), https://www.venminder.com/blog/ai-vendor-contracts-what-you-need-do-reduce-risks.

(e) Navigating Hallucinations and Bad Information

AI has become increasingly integrated into various sectors, revolutionizing processes, and decision-making. In franchising, where the success of individual units is intertwined with the larger brand, the role of AI presents both promise and peril. While AI systems can offer valuable insights and automate tasks, they also hold the potential to generate hallucinations—outputs divorced from reality—or propagate bad information. [90] These occurrences can have profound ramifications for franchisors, franchisees, and consumers, necessitating the establishment of robust mechanisms for review and confirmation to navigate the ethical complexities of AI-driven franchising.

(i) Understanding Hallucinations in Artificial Intelligence

Hallucinations in AI arise from a myriad of factors, ranging from biased training data and algorithmic limitations to overfitting and inherent uncertainties in complex systems. In the context of franchising, hallucinations may manifest as skewed market predictions, erroneous financial forecasts, or biased customer profiling. For example, an AI-driven predictive model may erroneously recommend a franchise location based on flawed data, leading to misguided investment decisions and operational inefficiencies.

For example, imagine a fast-food franchising company, "Burger Barn," is looking to expand its presence into a new city. They decide to use an AI-driven predictive model to analyze various factors such as population demographics, income levels, foot traffic, and competition to recommend the most promising location for a new franchise outlet. The AI model, trained on historical data from existing franchise locations, is supposed to provide data-driven insights to optimize the decision-making process. However, due to various factors contributing to hallucinations in AI, the model makes a critical error in its recommendation.

Due to these factors, the AI-driven predictive model erroneously recommends a franchise location in a particular neighborhood based on flawed data and faulty predictions. Despite appearing promising on paper, the recommended location might have insufficient demand, intense competition, or other unforeseen challenges that weren't adequately accounted for by the AI model.

As a result, Burger Bites invests resources into opening a franchise at the recommended location, only to realize later that it is not as profitable as anticipated. This leads to misguided investment decisions, operational inefficiencies, and potentially financial losses for the company. The hallucinations in the AI model have inadvertently misled the franchisor, highlighting the risks associated with relying solely on AI-driven insights without thorough human oversight and validation.

[90] Nick Pope, *5 AI Trends That Will Shape Franchising in 2024*, FRANCHISE WIRE (Jan. 13, 2024), https://www.franchisewire.com/5-ai-trends-that-will-shape-franchising-in-2024/.

(ii) Risks of Bad Information in Franchising

Bad information generated by AI systems poses significant risks to franchising operations and relationships. Misleading recommendations for site selection can result in suboptimal locations with limited market potential, impacting revenue streams and profitability. The World Economic Forum highlights the potential dangers of AI to businesses and society. Chief Risk Officers (CROs) from major corporations and international organizations emphasize that while AI promises significant benefits, it also poses risks. Malicious use of AI is a concern, as generative AI technologies can be abused for spreading misinformation, facilitating cyber-attacks, or accessing sensitive personal data. The "opaque inner workings" of AI content creation contribute to inadvertent sharing of personal data and bias in decision-making based on AI algorithms.[91] Similarly, flawed marketing strategies driven by inaccurate data may fail to resonate with target audiences, undermining brand perception and customer engagement. Moreover, biased performance evaluations based on faulty algorithms can foster dissatisfaction among franchisees and erode trust in the franchisor-franchisee relationship, ultimately jeopardizing the sustainability of the franchise network.

(iii) The Role of Review in Artificial Intelligence-driven Franchising

To mitigate the risks associated with hallucinations and bad information, franchisors must prioritize the implementation of robust review mechanisms. Regular audits, conducted by franchisees or independent assessors, play a pivotal role in validating AI-generated outputs against real-world data and market dynamics. For instance, franchisees can compare algorithmic recommendations with historical sales data and competitor analysis to assess the reliability of AI-driven pricing strategies. Furthermore, human oversight is indispensable in ensuring the integrity and fairness of AI-enabled decision-making processes, particularly in sensitive domains such as recruitment and selection. Franchise employees should review algorithmic decisions and intervene if necessary to mitigate bias and uphold ethical standards.

(iv) Importance of Confirmation in Franchising

Confirmation serves as a crucial safeguard against the propagation of erroneous information in AI-driven franchising. Franchisors must foster a culture of skepticism and critical inquiry among franchisees, encouraging them to independently verify AI-generated insights before making consequential decisions. This may involve consulting domain experts, soliciting feedback from local communities, or cross-referencing AI recommendations with industry benchmarks. By instilling a sense of accountability and diligence, franchisors empower franchisees to challenge assumptions and rectify inaccuracies, thereby fortifying the resilience of the franchise network against the pitfalls of misinformation.

---

[91] Douglas Broom, *AI: These Are the Biggest Risks to Businesses and How to Manage Them*, WORLD ECON. F. (Jul. 27, 2023), https://www.weforum.org/agenda/2023/07/ai-biggest-risks-how-to-manage-them/.

(v) Legal Implications and Compliance

In addition to ethical considerations, the integration of review and confirmation mechanisms in AI-driven franchising carries significant legal implications. Franchisors are bound by regulations governing, among other things, data privacy, consumer protection, and fair competition, requiring them to uphold transparency and accountability in AI deployment. Failure to adhere to legal requirements may expose franchisors to litigation risks and regulatory sanctions, underscoring the importance of robust governance frameworks.[92] By proactively addressing legal concerns and aligning AI practices with regulatory mandates, franchisors can mitigate legal liabilities and safeguard the reputation of the franchise brand.

Effectively navigating hallucinations and bad information in AI-driven franchising demands a comprehensive approach that integrates review and confirmation into the fabric of franchise operations. By leveraging rigorous audit processes, human oversight, and independent verification, franchisors can mitigate the ethical and legal risks associated with AI deployment. Moreover, by fostering a culture of transparency, accountability, and continuous learning, franchisors can take advantage of the potential of AI while safeguarding the integrity and resilience of the franchise model in an increasingly digitized landscape.

In addition to review and confirmation, continuous training and refinement of AI models are imperative to enhance accuracy and mitigate the occurrence of hallucinations. Franchisors should invest in ongoing education and skill development initiatives to equip franchisees with the knowledge and tools necessary to navigate the complexities of AI-driven decision-making. Furthermore, collaboration with industry peers and regulatory bodies can facilitate the exchange of best practices and standards, fostering a collective effort to promote responsible AI adoption in franchising. By embracing a holistic approach that encompasses technological innovation, ethical stewardship, and regulatory compliance, franchisors can position themselves as leaders in the ethical and sustainable deployment of AI in the franchise ecosystem.

Some best practices and standards may include: (a) establishment of industry working groups; (b) development of ethical guidelines; (c) sharing of case studies and use cases; (d) collaborative research initiatives; (e) engagement with regulatory bodies; (f) training and education programs; and (g) regular dialogue and communication channels. By embracing a holistic approach that encompasses technological innovation, ethical stewardship, and regulatory compliance, franchisors can position themselves as leaders in the ethical and sustainable deployment of AI in the franchise ecosystem.

(f) Addressing Potential Socioeconomic Disparities

The integration of AI technologies into various industries, including franchising, has sparked both excitement and apprehension regarding its potential impact on socioeconomic dynamics. While AI promises to revolutionize operational efficiency and

[92] INTERNICOLA LAW FIRM, *supra* note 70.

customer experiences, there are growing concerns about its unintended consequences, particularly its potential to widen existing socioeconomic disparities. The comments and thoughts expressed in this section aim to examine the implications of AI adoption in franchising through a socioeconomic lens, highlighting the challenges it poses and proposing strategies to mitigate its adverse effects. There are no silver bullets offered here. By addressing issues such as job displacement, unequal access to technology, data privacy concerns, the digital divide, and regulatory compliance, franchisors can fully experience the power of AI while promoting inclusivity and shared prosperity.

(i) The Digital Divide and Unequal Access to Technology

The digital divide refers to the gap between individuals who have access to digital technologies and those who do not, which can exacerbate socioeconomic disparities in access to opportunities, resources, and information. In the franchising context, the digital divide can manifest in various ways, including disparities in access to online marketing channels, e-commerce platforms, and digital payment systems. Franchisees from underserved communities or with limited digital literacy may face barriers to participating in the digital economy, such as lack of internet access, digital skills training, or affordable technology infrastructure. By leveling the playing field and ensuring equal access to AI technology across all franchise units, franchisors can empower franchisees to compete more effectively in the marketplace and drive collective growth and prosperity.

To bridge this gap, franchisors can implement initiatives to promote digital inclusion and empower franchisees with the tools and knowledge needed to succeed in a digital-first environment. Being mindful to avoid risks associated with joint employer liability, this may involve offering training programs, workshops, and mentorship opportunities on topics such as digital marketing, social media management, website development, and e-commerce optimization.[93] Franchisors can also leverage AI technologies to develop innovative solutions that cater to the unique needs of diverse populations, such as multilingual chatbots, accessible user interfaces, and personalized customer experiences.

According to an article in MIT Technology Review, disparities in access to AI technology among franchisees can exacerbate existing socioeconomic inequalities within the franchising ecosystem. Larger franchisors with greater financial resources may have the means to invest in sophisticated AI systems, giving them a competitive advantage over smaller franchisees with limited capital. Disparities in access to AI technology can indeed exacerbate existing socioeconomic inequalities within various ecosystems. This investment gives them a competitive advantage over smaller franchisees who may have limited capital.[94] This digital divide can further marginalize franchisees operating in

[93] Claude Dyer & Sebastian Buckup, *Bridging the Digital Divide: These Tech Projects Are Empowering Global Inclusion*, WORLD ECON. F. (Sept. 28, 2023), https://www.weforum.org/agenda/2023/09/bridging-digital-divide-technology-empowering-global-inclusion/.

[94] David Rotman, *How to Solve AI's Inequality Problem*, MIT TECH. REV. (Apr. 19, 2022), https://www.technologyreview.com/2022/04/19/1049378/ai-inequality-problem/.

underserved communities or with constrained budgets, hindering their ability to leverage AI for business growth and innovation.

To address this disparity, franchisors should consider implementing financial assistance programs or subsidies to facilitate AI adoption among smaller franchisees. This could involve providing low-interest loans, grants, or tax incentives to offset the upfront costs associated with acquiring and implementing AI technologies. Additionally, franchisors can collaborate with technology providers to develop scalable and affordable AI solutions tailored to the needs of smaller franchisees. This may involve negotiating bulk discounts, licensing agreements, or shared infrastructure arrangements to make AI technology more accessible and cost-effective for franchisees operating on tighter budgets. By prioritizing digital inclusion and equal access to opportunities, franchisors can empower franchisees from all backgrounds to thrive in the digital economy and contribute to shared prosperity.

(ii) Data and Privacy Bias

The use of AI algorithms in franchising relies heavily on data collection and analysis to optimize decision-making, personalize customer experiences, and improve operational efficiency. However, this reliance on data raises significant concerns about privacy, security, and algorithmic bias.

Franchisors collect vast amounts of sensitive data from customers, franchisees, and employees, including personal information, transaction history, and behavioral patterns. Inadequate data protection measures can compromise individuals' privacy rights and erode trust in the franchising brand. Moreover, AI algorithms are susceptible to biases inherent in the data used to train them, which can lead to discriminatory outcomes in areas such as hiring, marketing, and customer service. Biases may arise from historical patterns of discrimination, unequal representation in training data, or algorithmic design flaws.

To mitigate these risks, franchisors must prioritize data privacy compliance and adopt transparent and accountable AI practices. This includes implementing robust data security protocols, obtaining informed consent for data collection and processing, and providing individuals with control over their personal data. It is very important to maintain trust, protect privacy, and mitigate risks associated with AI integration by ensuring compliance with data governance requirements and regulations.[95] Additionally, franchisors should invest in algorithmic fairness and bias detection tools to identify and address potential biases in AI systems. This may involve conducting regular audits of AI algorithms, monitoring performance metrics for disparate impact, and incorporating diversity and inclusion considerations into algorithm design and evaluation.

[95] Arun Dhanaraj, *Discover How to Navigate Compliance Challenges at the Intersection of Data Governance and AI Integration*, CLOUD SEC. ALL. (Sept. 6, 2023), https://cloudsecurityalliance.org/blog/2023/09/06/discover-how-to-navigate-compliance-challenges-at-the-intersection-of-data-governance-and-ai-integration.

By proactively addressing data privacy concerns and algorithmic biases, franchisors can uphold ethical standards, build trust with stakeholders, and ensure that AI technologies are deployed responsibly and equitably.

(iii) A Regulatory Framework and Ethical Guidelines

Effective regulation and ethical guidelines are essential for ensuring that AI technologies are deployed responsibly and equitably in franchising. Governments and regulatory bodies play a critical role in establishing clear policies and standards to govern the use of AI in franchising, including regulations on data privacy, algorithmic transparency, and anti-discrimination measures. The White House, Congress, and various federal agencies have been actively involved in shaping AI governance policies in the United States. These initiatives aim to address the full spectrum of AI effects, balancing benefits and potential harms. Notable agencies include the Federal Trade Commission, the Consumer Financial Protection Bureau, and the National Institute of Standards and Technology.[96]

Franchisors must comply with relevant laws and regulations, conduct regular audits of AI-driven practices, and prioritize ethical principles such as fairness, accountability, and transparency. This may involve establishing internal governance structures, appointing data protection officers, and conducting impact assessments to evaluate the ethical implications of AI technologies on employees, customers, and society at large. Additionally, franchisors should engage in stakeholder dialogue and collaboration to develop industry-wide best practices and standards for responsible AI deployment. By promoting ethical AI practices and compliance with regulatory standards, franchisors can mitigate the risk of exacerbating socioeconomic disparities and foster a more inclusive and sustainable franchising ecosystem.

While AI presents unprecedented opportunities for innovation and efficiency in franchising, its implications for socioeconomic disparity demand careful consideration and proactive measures. By addressing concerns such as job displacement, unequal access to technology, data privacy, the digital divide, and regulatory compliance, franchisors can mitigate the negative effects of AI and foster a more equitable and inclusive franchising environment. Collaboration between stakeholders is essential to ensure that AI technologies benefit all members of society and contribute to shared prosperity. Through responsible AI deployment and a commitment to inclusivity, franchisors can pave the way for a more equitable future in franchising.

In the franchise context, being mindful of avoiding the risk associated with joint employment, franchisors can implement the following practices to align their options within the parameters of the regulatory landscape:

- *Inclusive Hiring Practices*: Franchisees can implement blind recruitment strategies, prioritize diversity and inclusion, and partner with local organizations to provide job training and entrepreneurship programs in underserved communities.

[96] Müge Fazlioglu, *US Federal AI Governance: Laws, Policies and Strategies*, IAPP (updated Nov. 2023), https://iapp.org/resources/article/us-federal-ai-governance/.

- *Investment in Community Development*: Franchisees can invest in community development initiatives such as education, job training, and mentorship programs to empower individuals from disadvantaged backgrounds.

- *Regulatory Compliance*: Franchisees must comply with labor laws and regulations, conduct regular audits of AI-driven practices, and prioritize ethical AI principles to ensure fair treatment of employees and customers alike.

(g) Navigating the Impact of Artificial Intelligence on Jobs and Workforce Dynamics

The introduction of AI in franchising inevitably changes the job landscape, by automating routine and repetitive tasks, while opening up opportunities for employees to engage in more meaningful and complex work. Franchisors and franchisees must navigate this transition by investing in training and development to help their respective employees transition to these new roles, emphasizing adaptability and continuous learning.

(i) Automation and Job Displacement

Automation has the potential to significantly transform the labor landscape within franchises. McKinsey & Company highlights that automation and AI have the potential to transform businesses and contribute to economic growth. They also address societal challenges and improve productivity. The adoption of AI and automation is expected to lead to higher productivity and GDP growth.[97] AI-driven automation streamlines operations within franchising businesses, leading to increased productivity and cost-effectiveness. Tasks such as order processing, inventory management, and customer service can be automated through AI-driven technologies like chatbots, robotic process automation, and predictive analytics.

While automation can lead to increased operational efficiency and cost savings for franchisors, it also raises concerns about job displacement, particularly for low-skilled workers whose roles are most susceptible to automation. To address this, employers should consider implementing comprehensive workforce development strategies that prioritize reskilling and upskilling programs for employees whose roles are at risk of being automated. These programs should focus on equipping employees with the digital and soft skills necessary to thrive in an AI-driven environment. For example, in a retail franchise, AI-powered inventory management systems can significantly reduce the time and effort required for inventory tracking and stock replenishment. However, this automation may lead to the displacement of employees responsible for manual inventory management tasks. Employers can mitigate this by offering training programs to help these employees transition to roles focused on customer engagement, product knowledge, and personalized services. Employers can also explore alternative

[97] James Manyika & Kevin Sneader, *AI, Automation, and the Future of Work: Ten Things to Solve for*, MCKINSEY & CO. (Jun. 1, 2018), https://www.mckinsey.com/featured-insights/future-of-work/ai-automation-and-the-future-of-work-ten-things-to-solve-for.

employment opportunities within the organization, such as redeploying displaced workers to roles that require human creativity, emotional intelligence, and problem-solving skills.

(ii) Creation of New Job Roles

AI creates opportunities for new roles requiring human expertise and creativity. Franchising businesses can leverage AI technologies to enhance customer experiences, personalize marketing strategies, and optimize supply chain management. Investment in workforce development programs is crucial to equip employees with necessary skills. For example, AI-driven customer relationship management systems can analyze customer data to personalize marketing campaigns and improve customer retention rates. This necessitates the creation of roles such as AI specialists, data analysts, and customer experience managers. Training and development opportunities can be provided to employees to empower them to excel in these new roles, ensuring they possess the technical skills and business acumen required to leverage AI technologies effectively.

(iii) Augmentation of Human Capabilities

AI technologies augment human capabilities rather than replace them entirely. By automating repetitive tasks and providing data-driven insights, AI enables employees to focus on higher-value activities requiring human judgment, creativity, and emotional intelligence.[98] For example, AI-powered chatbots can handle routine customer inquiries and support requests, freeing up employees to focus on more complex and strategic interactions. This allows employees to utilize their interpersonal skills and problem-solving abilities to provide personalized assistance and build stronger relationships with customers.

For example, a fast-food franchise could use an AI-powered chatbot integrated into the franchise's website and mobile app to handle routine customer inquiries and support requests. Customers can interact with the chatbot to inquire about menu items, place orders, check order status, or inquire about store locations and hours. The chatbot utilizes NLP to understand and respond to customer queries effectively. By automating these routine interactions, the chatbot frees up employees to focus on more complex tasks, such as handling custom orders, resolving customer complaints, and providing personalized recommendations to enhance the overall customer experience.

By way of further example, a hotel chain could implement an AI-powered chatbot on its website and social media platforms to assist customers with routine inquiries and support requests related to reservations and bookings. The chatbot can handle tasks such as checking room availability, providing pricing information, processing reservation changes or cancellations, and answering frequently asked questions about amenities and policies. By automating these routine interactions, the chatbot reduces the workload on reservation agents, allowing them to dedicate more time to handling complex customer requests,

[98] David De Cremer & Garry Kasparov, *AI Should Augment Human Intelligence, Not Replace It*, HARV. BUS. REV. (Mar. 18, 2021), https://hbr.org/2021/03/ai-should-augment-human-intelligence-not-replace-it.

upselling additional services, and providing personalized recommendations to enhance guests' stay experiences.

Such uses of AI-powered chatbots allows employees to utilize their interpersonal skills and problem-solving abilities to provide personalized assistance and build stronger relationships with customers.

(iv) Ethical Use of Artificial Intelligence in Performance Management

AI-powered tools for performance management raise ethical concerns regarding employee privacy, autonomy and consent. For example, AI-based performance evaluation systems may track employees' activities and behaviors without their explicit consent, raising concerns about privacy and autonomy. Franchisors can address these concerns by establishing clear policies and procedures for the ethical use of AI in performance management, ensuring that employees are informed about how their data is collected, processed, and used. For a more fulsome discussion regarding AI use policies, see section 7(a) below.

The integration of AI into franchising operations has profound implications for jobs and workforce dynamics. By proactively addressing these issues and embracing ethical principles, franchisors can create a more resilient, adaptive, and inclusive workforce.[99] Prioritizing employee empowerment, fairness, and accountability fosters a harmonious relationship between humans and machines in the franchising industry.

This comprehensive exploration of AI's impact on jobs and workforce dynamics in franchising provides a roadmap for navigating the opportunities and challenges presented by AI integration. Through strategic planning, investment in employee development, and a commitment to ethical principles, franchisors can leverage AI to drive innovation and growth while ensuring the well-being and inclusivity of their workforce.

7. Minimizing Risks Related to Artificial Intelligence Use

While the integration of AI presents unprecedented opportunities for franchisors and franchisees to maximize operational efficiency, it is imperative that franchisors and franchisees are aware of, and mitigate against, inherent risks, such as biases in algorithms and data privacy concerns to ensure responsible and ethical AI deployment. By adopting robust frameworks, recognizing contractual risks when engaging with an AI provider and empowering employees to leverage AI, franchisors and franchisees can minimize the potential risks associated with AI systems to safeguard brand reputation, ensure fair and unbiased practices and foster a culture of trust and transparency.

[99] Pope, *supra* note 90.

(a) Employee and Franchisee Artificial Intelligence Use Policies and Training

When adopting and integrating AI, it is imperative that franchisors take steps to equip their employees and franchisees with the necessary training and policies to enable the franchisees and employees to use AI ethically, legally, transparently and in a manner that minimize legal and business risk for the franchise system. Franchisors need clear guidelines for ethical use, prioritizing employee well-being, transparency and accountability throughout the process. As a best practice, franchisors should ensure that they have implemented robust AI use policies for their employees and franchisees that best meet their operational needs while ensuring ethical, legal and responsible use of AI systems ("AI Use Policy"). By establishing and implementing clear policies, franchisors can foster a culture of trust by mitigating the risks associated with biased decision-making and legal and business risk arising from improper use of AI systems.

While there will be some differing considerations in the employee and franchisee context, generally speaking, the AI Use Policy should delineate the permissible scope of the use of AI applications, data sharing restrictions and compliance requirements, rules related to the disclosure and creation of IP, guidance on using and relying on outputs, inclusion of disclaimers and accountability and compliance with privacy laws. Franchisors should consider providing users with risk-based guidelines that highlight applicable use cases, associated risk level and outline the parameters of permitted usage. By defining the parameters for the use of AI, employees and franchisees gain greater clarity regarding the rights, responsibilities and limitations associated with AI technologies. An AI Use Policy can also strengthen partnerships and collaboration with third-party vendors by setting clear expectations and guidelines around the use of AI.

As further discussed in Section 6(g)(i) above, effective training on the use of AI can equip employees and franchisees with the requisite knowledge, skill and competency to leverage AI effectively and ethically. In addition to implementing an AI Use Policy, franchisors should provide comprehensive training to employees and franchisees to empower them to operate AI systems effectively by maximizing their potential use and mitigating associated risks. Training should cover a variety of topics, such as the fundamentals of AI, data sharing, privacy law compliance, protection of IP and competitively sensitive information, verification of outputs, bias mitigation and ethical considerations.

Furthermore, franchisors can play a proactive role in community development by investing in vocational training programs, apprenticeships, and job placement services in collaboration with local governments, educational institutions, and nonprofit organizations. By empowering individuals with the skills and resources needed to succeed in the digital economy, franchisors can mitigate the negative impact of automation on socioeconomic disparity and promote inclusive growth. As the AI landscape continues to evolve, franchises should foster a culture of continuous learning and adaptation to empower employees and franchisees to embrace the advancement of AI.

(b) Ethical and Responsible Use Guidelines

An essential element that overlays every aspect of the use of AI, in franchising and elsewhere, is ethical and responsible use of this incredible technology. With its nearly limitless potential comes great responsibility to ensure that it is used correctly and in a manner that engenders trust and reliability.

(i) Transparency and Informed Consent

As we have been discussing throughout this paper, the importance of sharing information about AI programs with every person that will be impacted by the use of AI cannot be overstated. AI programs should include responsible disclosure to everyone that will come in contact with the AI technology or be impacted by its application. Such disclosure should clearly explain the particular AI application and the information/data that is gathered or used and obtain the informed consent of all participants.

(ii) Data Privacy and Security

Franchisors should implement robust data protection measures and policies throughout their systems to safeguard any personal or business information collected through AI systems. The more that any given technology relies on data and collects data, the greater the risk that this data can be stolen, compromised, or used in unanticipated ways. It is imperative that franchisors ensure compliance with relevant data protection, privacy, and consumer protection laws and regulations when using AI in franchising.

(iii) Fairness and Non-Discrimination

Franchise systems should also ensure that AI algorithms are developed and used in a fair and non-discriminatory manner, avoiding biases that could disadvantage certain users. As mentioned above, AI programs can perpetuate and greatly amplify existing biases and discriminatory application. Unfortunately, making AI fair is not straightforward, and there are no one-size-fits-all solutions. It requires a process of continuous learning, adaptation and collaboration.[100]

This challenge requires a commitment to thorough research and vetting, thoughtful policies and ethical practice. To make it work, franchise systems will need to ensure that considerations of fairness are woven into all aspects of the AI development and implementation process, from its conception through data collection and algorithm design to deployment and beyond.[101]

(iv) Accuracy and Reliability

It is vital to have a systematic process in place for validating the accuracy and reliability of AI-generated insights and recommendations to ensure that such output is based on

[100] Fernando Fioretto, *Building Fairness in AI is Crucial – and Hard to Get Right*, THE CONVERSATION (Mar. 19, 2024), https://theconversation.com/building-fairness-into-ai-is-crucial-and-hard-to-get-right-220271.

[101] *Id*.

sound data and analysis. This is an on-going and regular process that needs to take place at every stage of AI development and use. Franchise systems that rely heavily on the use of AI would be well-served to create very specific processes for the review and analysis of such data accuracy and reliability.

(v) Human Oversight and Control

As AI technologies continue to advance at the unprecedented pace we have been discussing, the importance of human oversight cannot be overstated. Humans bring ethical decision-making, accountability, adaptability and continuous improvement to the process. By integrating human expertise with AI systems, franchisors will be able to harness the greatest potential of AI that is well-tailored to their systems and franchisees, while also mitigating risks and ensuring a responsible and sustainable application.[102]

By addressing these ethical considerations, franchisors can leverage AI responsibly to enhance franchisee support, improve decision-making, and drive innovation while maintaining trust and fostering a positive franchisee-franchisor relationship and brand integrity and reputation.

(c) Diligence and Contractual Review of Artificial Intelligence Providers

Technology vendor agreements can be very complex given the necessity to consider many factors. The integration of AI presents various contractual considerations for franchises to consider when contracting with an AI provider, including: (a) data security and privacy issues; (b) ownership and use of data generated by the AI; (c) safeguarding confidential information and IP of the parties involved; (d) compliance with applicable laws; (e) bias and ethics; (f) risk allocation; (g) representations and warranties; (h) exclusivity provisions (as applicable); (i) crucial indemnity and insurance issues; and (j) control and disruption.[103]

As discussed, an AI model is trained on vast amounts of data to improve its accuracy and ability to make informed decisions. In the context of franchising, this data may include proprietary information, trade secrets, competitively sensitive information, order history, frequency of visit or geolocation, biometric data as well as personally identifiable information, such as name, address and contact information. Franchisors and franchisees should be aware that AI systems that rely heavily on consumer data can put this data at risk of being stolen, compromised or used in unauthorized ways. To mitigate this risk, franchisors should, at a minimum, consider including express provisions in their agreements with AI providers that deal with data ownership and use restrictions, as well as representations, warranties and indemnities related to how the models were and are trained, including the AI providers compliance with all applicable laws related to privacy

---

[102] Tyler Weitzman, *The Ethics of AI: Balancing Innovation and Responsibility*, FORBES (Dec. 14, 2023), https://www.forbes.com/sites/forbesbusinesscouncil/2023/12/14/the-ethics-of-ai-balancing-innovation-and-responsibility/?sh=191d5c122948.

[103] Gary R. Batenhorst, Lindsey Cooper, & Daniel Graham, *Mobile Apps, Remote Ordering, and Loyalty Programs; Risks and Opportunities*, ABA 42ND ANN. F. ON FRANCHISING , at W-7, 22 - 26 (2019).

and AI. In addition, if the franchisor is using the AI service providers standard terms and conditions, they should pay careful attention to the risk allocation provisions to ensure that the franchisor is not taking on unreasonable risk or unreasonably limiting the provider's risk.

(i) Due Diligence of Artificial Intelligence Providers

Picking the right vendor is a critical decision for any franchise system. While most vendor checklists will include the big picture elements, it is essential to delve deeply into the details to ensure that the potential vendor is the best choice for the specific needs of the franchise. Thoroughly vetting any AI vendor will allow the franchise to ascertain how reliable an AI algorithm is by understanding how the system was trained, the testing protocols used and any known errors. Some essential questions would include the following: (a) information regarding the vendor's cybersecurity policies and procedures, including their practices related to encryption and protection of data; (b) what measures are taken in the development of the applicable technology to ensure compliance with applicable privacy laws (both U.S. and international); (c) the measures that will be included to insure protection of the franchise system's data; (d) information regarding the vendors insurance coverage—especially cyber insurance; (e) what assurances or guarantees is the vendor able to provide in the event of a data breach; and (f) whether they will agree to an indemnification provision.[104]

(ii) Contractual Risks and Considerations

Given the data-driven nature of AI, a franchise should be aware of the downstream risks of integrating AI when contracting with an AI provider and consider the following: (i) requiring express restrictions on the provider's use and disclosure of inputs, including whether inputs can be used to train the model for third-party use; (ii) ensuring that the provider has all required rights and consent to use the inputs that were used to train the model; (iii) implementing internal safeguards to protect confidential, proprietary and competitively sensitive information from being inputted into the AI technology; and (iv) implementing appropriate guardrails around the verification and use of outputs. The standard terms and conditions of AI providers typically contain broad boilerplate disclaimers that the provider makes no representations or warranties regarding sourcing training data, training the model, or the output. The disclaimers typically cover performance, accuracy, infringement, and compliance with law. Therefore, franchisors should review AI provider contracts carefully and strike provisions or add provisions to appropriately allocate risk between the provider and the franchisor.

(A) Use and Ownership of Inputs

When engaging with an AI provider, the franchisor must give careful consideration to the ownership and intended use of the inputs. Franchisors likely want to retain ownership over their inputs, or at the very least make it clear that the AI provider is not obtaining ownership merely by the franchisor putting inputs into the AI system. In considering the

[104] Morrison et al., *supra* note 43, at 37; Sabrina Pagnotta, *How to Create a Vendor Risk Management Checklist*, BITSIGHT (Jun. 20, 2023), https://www.bitsight.com/blog/vendor-risk-management-checklist.

franchisor's intended use of the inputs, the franchisor should consider whether they have the rights and permission to disclose inputs to the AI provider. For example, if consumer information is being used to train the model, has the franchisor obtained the requisite consents from the consumer? Franchisors should also consider whether various laws or third-party contracts expressly prohibit disclosure of the data for the purposes of training AI models or the use of generative AI. Lastly, franchisors should consider whether they want to expressly restrict the provider's use of inputs for any purpose other than to provide the AI system to the franchise, such that these inputs are not disclosed to third parties or used to train the AI model to benefit other customers.

(B) Use and Ownership of Outputs

When engaging with an AI provider, the franchisor must also give careful consideration to the ownership and intended use of the outputs. The manner in which the franchisor intends to utilize the generated outputs will determine the level of control and protection that the franchisor will require when contracting with an AI provider. The franchisor must assess whether ownership of the outputs or a broad and perpetual license for use of the output aligns best with their operational needs. Output that is used for commercial purposes or incorporated into external products, services or marketing carry greater risk than output used for internal use. Franchisors should consider express contractual restrictions that prevent the AI provider, its customers and third parties from utilizing the generated output. By expressly assigning the ownership rights in the output to the franchisor, the franchisor would effectively have the right to control the reproduction, distribution, display and modification of the output.

As the legal and regulatory environment continues to develop, franchisors should be vigilant and aware of the associated legal risks discussed above.

(d) Strategies for Upskilling and Reskilling Employees in the Era of Artificial Intelligence

The integration of AI in franchising heralds unprecedented opportunities alongside challenges. While AI-powered technologies promise operational efficiency and enhanced customer experiences, they also demand a workforce equipped with requisite skills and ethical awareness.[105] The comments and thoughts expressed in this section attempt to provide a holistic approach to address these imperatives, ensuring a sustainable transition to the AI era within franchising.

(i) Identifying Future Skills Requirements

Conducting a comprehensive analysis of current and projected skill gaps is foundational. For instance, within a fast-food franchise, the advent of AI-driven automated ordering systems necessitates proficiency in customer interaction augmented by emotional intelligence. Similarly, a retail franchise transitioning to AI-driven inventory management requires employees skilled in data analysis and logistics optimization. For example, in a fast-food franchise, implementing AI-driven recommendation systems for personalized

[105] Flick, *supra* note 21.

menu suggestions requires employees to understand customer preferences, enhancing upselling opportunities while maintaining a personalized experience.

(ii) Implementing Tailored Training Program

Customized training programs should encompass both technical competencies and soft skills pertinent to AI adoption. By way of example, consider a hospitality franchise introducing AI-driven chatbots for customer service. Training modules should not only cover chatbot management but also emphasize empathy and adaptability to ensure seamless customer interactions. In a hospitality franchise, implementing AI-powered chatbots for handling customer inquiries necessitates training employees to seamlessly integrate human touch with automated responses, ensuring customer satisfaction while leveraging AI efficiency.

(iii) Promoting a Culture of Continuous Learning

Fostering a culture of lifelong learning is pivotal. Incentivizing employees to engage in upskilling initiatives cultivates a dynamic workforce ready to embrace technological advancements. A case in point is a healthcare franchisee encouraging its employee nurses to pursue AI in healthcare courses, empowering them to leverage AI-powered diagnostics for enhanced patient care. For example, in a healthcare franchise, encouraging nurses to enroll in AI in healthcare courses equips them with the knowledge to interpret AI-generated patient data accurately, improving diagnostic accuracy and treatment efficacy.

(iv) Facilitating Knowledge, Sharing, and Collaboration

Cross-functional collaboration catalyzes innovation and knowledge exchange. Within a real estate franchise, collaborative projects integrating AI for property valuation require agents, data analysts, and AI specialists to work synergistically. Emphasizing ethical considerations ensures responsible AI utilization across collaborative endeavors.[106] For example, in a real estate franchise, collaborating on AI-driven property valuation projects requires agents to provide domain expertise, data analysts to interpret market trends, and AI specialists to develop accurate valuation algorithms, ensuring fair and transparent property assessments.

(v) Investing in Career Pathways and Support Systems

Clear career pathways coupled with supportive structures are instrumental in employee development. For instance, a financial services franchise offering career advancement opportunities in AI-driven financial modeling equips employees with growth trajectories aligned with organizational objectives. Financial assistance for AI-related certifications further incentivizes skill acquisition. For example, in a financial services franchise, offering financial analysts with opportunities to specialize in AI-driven financial modeling facilitates

[106] Sarah Laoyan, *Cross-Functional Work: The Secret to a Collaborative Workplace*, ASANA (Jan. 6, 2022), https://asana.com/resources/cross-functional-collaboration-work.

career advancement and skill development, enabling them to leverage AI technologies for more accurate financial predictions and risk assessments.

Franchisors must proactively address the imperatives of upskilling and reskilling their employees and franchisees in the AI era. By deploying tailored training programs, fostering a culture of continuous learning, promoting collaboration, and investing in career pathways, franchisors can navigate ethical minefields associated with AI adoption while empowering their workforce to thrive. Embracing these strategies ensures a resilient franchise ecosystem poised for sustained success amidst AI-driven disruptions.

Other examples of AI use in franchising to support employee development and career advancement include:

- *Healthcare Franchise*: Implementing AI-powered medical imaging systems necessitates training radiology technicians to interpret AI-generated reports alongside traditional scans, ensuring accurate diagnosis and treatment planning.

- *Education Franchise*: Introducing AI-driven adaptive learning platforms requires educators to integrate personalized learning pathways, catering to diverse student needs and maximizing learning outcomes.

- *Logistics Franchise*: Adopting AI-driven route optimization algorithms necessitates training delivery drivers to leverage real-time data for efficient navigation, minimizing fuel consumption and carbon footprint.

8. Conclusion

AI has disrupted the landscape of franchising, offering unprecedented opportunities for innovation, efficiency and customer satisfaction. However, the adoption of AI also entails significant legal, ethical, and operational challenges that franchisors and franchisees must address proactively and responsibly. This paper has explored various aspects of AI use in franchising, highlighting the benefits, risks, and best practices for navigating franchising in the AI era. Ethical deployment of AI requires franchisors and franchisees to prioritize fairness, transparency, and accountability. This includes emphasizing the implementation of robust mechanisms for review, confirmation, and mitigation of AI risks. By embracing a holistic approach that integrates technological innovation, ethical stewardship, and regulatory compliance, franchisors and franchisees can leverage AI to drive growth and maintain a competitive position in the market, while simultaneously ensuring the well-being and inclusivity of their workforce and customers. AI is here to stay, and franchising must adapt and evolve to harness its potential and mitigate its pitfalls.

APPENDIX A

Figure 1. Generated by ChatGPT-4 with input prompt “generate a picture of a typical scientist”