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DRAFTING DISPUTE RESOLUTION CLAUSES FROM A LITIGATOR’S PERSPECTIVE

I. INTRODUCTION

Franchise litigators and transactional lawyers should talk more often. Lawyers who draft franchise agreements can learn a great deal from how the contract provisions they prepare relating to dispute resolution fare in the “real world” of litigation, when an opposing lawyer tries to pick apart and challenge contract language that the drafter believed was so clear. This paper explores common dispute resolution clauses in franchise agreements and discusses how courts have applied those clauses, as well as how those clauses might be attacked. The goal of this paper is to show franchise lawyers how most effectively to craft dispute resolution clauses that are enforceable and are effective to achieve the drafter’s intent.

II. GETTING INTO COURT (OR NOT) – PROVISIONS ADDRESSING HOW THE ACTION WILL PROCEED

One of the most important decisions a franchisor makes in drafting a dispute resolution clause is determining the forum and process for resolution of disputes. These issues are typically set forth by the franchisor in the franchise agreement, and they usually are not subject to significant negotiation by a prospective franchisee. Franchisors typically designate whether disputes are required to be resolved in court (either state or federal) or in arbitration. Some franchisors also require that the franchisee engage in mediation or non-binding negotiation before resorting to a binding dispute resolution process like litigation or arbitration. In recent years, franchisors have attempted to eliminate franchisees’ ability to bring class or collective actions by including waiver language and requiring franchisees to pursue claims exclusively on an individual basis. This section addresses drafting and enforceability considerations regarding these issues.

A. Arbitration clauses

1. Enforceability in General

Franchisors include arbitration clauses in their franchise agreements for many different reasons. Some believe that arbitration is faster and cheaper than traditional court litigation. Others perceive arbitration as mitigating the risk and unpredictability of the jury system. Still others want to take advantage of the great deference courts give to agreements to arbitrate under the Federal Arbitration Act, which increases the opportunities for enforceability of favorable provisions such as forum selection clauses and class or collective action waivers.

In any case, the unmistakable trend in federal courts is to enforce agreements to arbitrate according to their terms. This means the franchisees have a very high burden to avoid an arbitration clause in the franchise agreement. This section will discuss recent case law from the United States Supreme Court enforcing agreements to arbitrate.

Analysis of the enforceability of arbitration agreements starts with the Federal Arbitration Act (“FAA”).1 The FAA embodies a broad public policy favoring arbitration and requiring the

1 9 U.S.C. §1, et seq.
enforcement of arbitration agreements precisely as written. The FAA was enacted in 1925 to reverse the longstanding judicial hostility toward arbitration, and it “sought to ‘overcome the rule of equity, that equity will not specifically enforce any arbitration agreement.’” The FAA is to be given a “broad reach” that is to be “unencumbered by state-law constraints.”

The Supreme Court consistently has required federal courts to apply the FAA to “rigorously enforce agreements to arbitrate.” The FAA ensures “that private arbitration agreements are enforced according to their terms, . . . [and] parties may agree to limit the issues subject to arbitration,” “to arbitrate according to specific rules,” and “to limit with whom a party will arbitrate its disputes.” The FAA’s command to enforce arbitration agreements applies regardless of objections on public policy grounds, or because the cost of proving one’s case in arbitration outweighs the likely recovery.

Despite the unabated federal policy in favor of arbitration, there is a historical pattern of courts interpreting state law in ways that evince hostility to arbitration. Periodically, in response to these anti-arbitration decisions, the Supreme Court strikes down offending rules and reiterates the strong national policy in favor of arbitration. The Concepcion and Italian Colors decisions are the latest, and perhaps most forceful, examples of the Supreme Court’s periodic correction of anti-arbitration sentiment in some courts.

The Supreme Court has explained that in enacting the FAA, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration. The FAA’s “national policy favoring arbitration” thus preempts state law to the extent such law conflicts with the FAA.

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4 Id.


9 Keating, 465 U.S. at 10, 104 S. Ct. at 858 (holding a state-law restriction on arbitration agreements to be preempted pursuant to the FAA).

10 See, e.g., Preston v. Ferrer, 552 U.S. 346, 352, 128 S. Ct. 978 (2008) (like Keating, holding a state-law restriction on arbitration agreements to be preempted pursuant to the FAA); Doctor’s Assocs. v. Casarotto, 517 U.S. 681, 688, 116 S. Ct. 1652, 1656-57 (1996) (“Courts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration provisions.”). The long list of preempted state-law restrictions includes state-law requirements that parties proceed to administrative review of their disputes prior to arbitration (Preston, 552 U.S. at 357, 128 S. Ct. at
The FAA permits a state-law based analysis of the enforceability of an arbitration provision only on the same grounds, and in the same way, that any other contract might be challenged and revoked. While courts may look to state law to determine whether an arbitration agreement is enforceable, as with any contract, they may not impose a higher burden on the enforceability of an arbitration agreement than is imposed on other contracts.

What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal “footing,” directly contrary to the Act’s language and Congress’ intent.

The United States Supreme Court has issued a series of important opinions in the past several years that have reaffirmed – and some would say have even expanded – the FAA’s liberal policy favoring arbitration agreements. In *Stolt-Nielsen v. AnimalFeeds Int'l Corp.*, the Court specifically addressed the issue of whether a party could be compelled to submit to class arbitration where the arbitration agreement did not evidence that the party affirmatively agreed to do so. It explained that the FAA protects, as a matter of federal law, both the right to arbitrate and the terms under which any arbitration is to proceed. The Court held that “a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so.” It reasoned that The FAA prohibits limitations on the rights of contractual parties to decide “with whom they choose to arbitrate their dispute,” even if that choice, like here, is to litigate disputes on an individual -- not class -- basis.

In reaching this conclusion, the Court rejected the argument that any purported “public policy” favoring class actions can alter the parties’ contractual choice to disregard class mechanisms. Because class arbitration involves different characteristics and procedures from tradition bilateral arbitration, the Court held that consent to bilateral arbitration does not mean consent to class arbitration. In the absence of evidence that the parties to the arbitration agreed

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986), attempts to insulate certain claims from arbitration entirely (*Keating*, 465 U.S. at 6, 104 S. Ct. at 856), and even requirements demanding particular formats for arbitration provisions so that they are particularly conspicuous (*Casarotto*, 517 U.S. at 683, 116 S. Ct. at 1654). Pursuant to the FAA, “Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed ‘upon the same footing as other contracts.’” *Casarotto*, 517 U.S. at 687, 116 S. Ct. at 1656 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511, 94 S. Ct. 2449, 2453 (1974)).

11 See 9 U.S.C. § 2; *Casarotto*, 517 U.S. at 687, 116 S. Ct. at 1656 (requiring that courts put arbitration agreements on “equal footing” with other contracts).


14 *Id.* at 130 S. Ct. at 1773-74 (“Whether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must give effect to the contractual rights and expectations of the parties.”) (quotation omitted).

15 *Id.* (emphasis in original).

16 *Id.*

17 *Id.* (noting that the arbitrator’s reliance on this public policy constituted “manifest disregard for the law”).
to engage in class arbitration, imposing class arbitration “is fundamentally at war with the foundational FAA principle that arbitration is a matter of consent.”

Shortly thereafter, in *Rent-A-Center, West, Inc. v. Jackson*, the Supreme Court addressed the question of who should decide challenges to the enforceability of the agreement containing the arbitration provision. The Court held that if the party seeking to defeat arbitration raises grounds that challenge the validity of the underlying agreement as a whole, as opposed to the validity of just the arbitration provision, that validity challenge should be decided by the arbitrator. The Supreme Court reasoned that an agreement to arbitrate disputes regarding arbitrability is itself “an additional, antecedent agreement” to arbitrate. In order to challenge the enforcement of that antecedent agreement, a plaintiff must show that submitting the question of arbitrability to an arbitrator would itself be unconscionable. Instead of addressing this question, the plaintiff in *Rent-A-Center* criticized the arbitration provision as being unfair and one-sided because the arbitration provision’s fee-shifting provision and discovery provisions were inadequate. The Supreme Court explained that those arguments went to the merits being submitted to the arbitrator, but did not relate to the unconscionability of submitting the question of arbitrability itself to the arbitrator.

The Supreme Court’s love affair with arbitration and its exultation of the FAA reached its zenith in *AT&T Mobility LLC v. Concepcion*, decided in 2011. The Supreme Court held that the FAA pre-empted a California state decisional law rule, known as the “Discover Bank Rule,” holding that a class action waiver in a consumer contract of adhesion is unconscionable in actions to recover small amounts of money. The Concepcions sued AT&T for fraud after being charged approximately $30 in sales tax for cell phones that AT&T advertised as “free.” The district court and the Ninth Circuit denied AT&T’s motion to compel arbitration, citing the Discover Bank Rule. The Supreme Court reversed, however, holding that the FAA pre-empted the California rule.

In sweeping language, the Supreme Court explained that “requiring the availability of class-wide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.” Although noting that the “savings clause” of Section 2 of the FAA preserves generally applicable state law defenses to contracts, the Court held that the savings clause did not apply to state law rules such as this one “that stand as an obstacle to the accomplishment of the FAA’s objectives.” The Court reiterated that the principal purpose of

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18 Id.


20 Id. at 70.

21 Id. at 72.

22 Id. at 73.

23 Id. at 71–72.


25 131 S. Ct. at 1748.

26 Id. at 1743.
the FAA is to ensure that private arbitration agreements are enforced according to their terms, and that parties may limit the issues or other parties with whom they will arbitrate. Finally, the Court rejected the California rule’s allowance that a party to a consumer contract may demand class arbitration, holding that non-consensual class arbitration is inconsistent with the FAA.27

Most recently, the Supreme Court put what many consider as the final nail in the coffin of non-consensual class arbitration in its 2013 decision in *American Express Co. v. Italian Colors Restaurant.*28 American Express merchant agreements required arbitration of all disputes with “no right or authority for any Claims to be arbitrated on a class action basis.” A group of merchants filed an antitrust class action against American Express, which moved to compel individual arbitration of the merchants’ claims. The merchants opposed the motion based primarily on their argument, supported by expert witness testimony, that the high cost of individually establishing each merchant’s antitrust claim greatly exceeded the potential recovery, thus effectively preventing the merchants from being able to vindicate their rights under the arbitration provision. The Second Circuit agreed with the merchants and invalidated the arbitration provision, but the Supreme Court reversed.

Although language in earlier Supreme Court decisions indicated that preventing “effective vindication” a federal statutory right might be a basis to defeat arbitration, the Court rejected that argument in this context. The Court noted that neither the federal antitrust statues nor Federal Rule of Civil Procedure 23 created an entitlement to class proceedings, which the Court noted are the exception and not the rule. The Court rejected the argument that waiver of class proceedings barred the merchants from effectively vindicating their rights because they had no economic incentive to pursue their antitrust claims individually through arbitration.

The effect of these recent Supreme Court decisions cannot be overstated. Although unconscionability remains – at least in theory – a ground to avoid an arbitration clause, procedural limitations in the arbitration clause itself likely will not support such a finding. Prohibitions against class and multi-party arbitration almost certainly will be enforced, even where individual arbitration would be inconvenient or disproportionately expensive given the value of the claim.

2. **Drafting the arbitration provision for specific issues**

a. **Defining the scope of covered disputes**

The first order of business in drafting an arbitration clause is to define the types of disputes that will be submitted to arbitration. This is a crucially important issue because arbitration is a creature of contract, and a party may only compel arbitration of those claims covered by the agreement to arbitrate. The key is to express the parties’ intent as clearly as possible to minimize the opportunity for disagreements in interpretation after a dispute arises.

Parties to a contract for the provision of specific goods and services often will want to restrict arbitration to issues relating to performance or breach of that contract. In that situation, a provision for arbitration of “all disputes relating to the performance, breach, or other rights

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27 *Id.* at 1750.

“under this contract” might be appropriate. But such a limited clause might not cover non-contract claims such as common-law tort or statutory claims. Thus, the parties would not receive the full benefits or protections of an arbitration provision with this language.

The American Arbitration Association, in its publication “Drafting Dispute Resolution Clauses, a Practical Guide,” suggests the following language regarding the scope of arbitrable claims: “Any controversy or claim arising out of or relating to this contract, or any breach thereof, shall be settled by arbitration. . . .”29 While broader than the language discussed above, the AAA’s proposed language still is arguably limited to claims relating to the contract and might not cover other claims arising from the dealings with the parties.

In a franchise relationship, claims can arise from many sources of duty or obligation other than the contract. Thus, a franchisor that wants to obtain the greatest benefit or protection from arbitration should draft the arbitration clause to cover any and all claims between the parties, subject to any specific carve outs discussed below. Appropriate language for a broadly applicable arbitration agreement might be:

- Any and all disputes, controversies, or claims between Franchisor and Franchisee arising from, related to, or involving the parties franchise relationship shall be resolved by arbitration . . ; or
- Any and all disputes, controversies, or claims of whatsoever kind or nature between the parties shall be resolved by arbitration. . .

Although courts generally provide generous constructions of the scope of arbitration provisions and resolve all doubts in favor of arbitrability, the much better practice is to draft clearly to express the parties’ intent. If the parties desire to arbitrate all claims that might arise, the language of the arbitration provision should expressly say that.

b. Carve-Outs for Certain Claims or for Interim Injunctive Relief

Franchisors that have a preference for arbitration in general still might desire to preserve their right to seek relief in court on certain claims, or to preserve their right generally to seek interim injunctive relief if necessary pending a final decision in the arbitration. Because arbitration is a matter of contract, courts generally allow parties to exclude particular claims or types of disputes from arbitration. In the franchise context, exceptions to mandatory arbitration can include claims for:

- infringement of intellectual property rights or breach of confidentiality requirements;
- impairment of the good will or reputation of a franchisor’s marks or system;
- breach of post-termination de-identification obligations;
- breaches of contract or other violations concerning public health or safety,
misleading customers;

- breach of a covenant not to compete or other restrictive covenants;
- specific performance of franchise agreement provisions;
- failure to pay fees or recovery of money owed to the franchisor;
- obtaining possession of real estate owned by the franchisor.

The most common rationale for excluding claims relating to intellectual property rights, confidentiality obligations, or impairment of good will is that those kinds of claims require immediate action, which is not always available in an arbitration forum. Moreover, franchisors are understandably hesitant to trade a judicial forum for the uncertainty of arbitration when it comes to disputes that can have a significant impact on the brand or the system as a whole. Courts are more experienced in evaluating intellectual property claims and in applying legal standards regarding injunctive relief. And if the franchisor believes that a court has reached a wrong result, it has the right to appeal an adverse preliminary or permanent injunction whereas it would have limited or no appeal rights from an adverse arbitration decision.

Franchisors include other kinds of carve-outs in order to allow them to proceed quickly or to take advantage of summary procedures, such as the right to dispossess a tenant who fails to pay rent. Preserving a judicial remedy for fees owed allows a franchisor to bring a straightforward money claim which, at least theoretically, will not be complicated by unrelated counterclaims which the franchisee would have to bring in arbitration.

A significant question for franchisors is whether to make these carve-out claims available exclusively for the franchisor or instead to make them mutual. There is little downside to making certain claims mutual, such as infringement of intellectual property rights, failure to pay fees or obtaining possession of real estate, because franchisees would rarely be in a position to have any such claims. A more general carve-out for interim injunctive relief, however, could be used by a franchisee, for example, to try to enjoin a termination. It is tempting as to those situations for a franchisor to make the carve-out unilateral and require the franchisee to go through the usually more difficult procedure of seeking injunctive relief in arbitration.

There are good reasons, however, why a franchisor should consider making mutual even the more general carve-out for interim injunctive relief. First and foremost, making the exceptions to arbitration mutual creates less of a chance that a court will later invalidate the arbitration provision as unconscionable. Although strict mutuality generally is not required, the more one-sided the provision is in favor of the franchisor the greater the chance that a court will determine it to be substantively unconscionable. In addition, courts generally require a party seeking injunctive relief to meet a reasonably high threshold for likelihood of success on the merits and proof of irreparable harm in the absence of injunctive relief. This is particularly so in

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30 Compare *Ticknor v. Choice Hotels Int'l Inc.*, 265 F.3d 931, 940 (9th Cir. 2001) (finding arbitration clause unenforceable under Montana law because it “allowed [the franchisor] to bring its claims against [the franchisee] into state or federal court, yet forced [the franchisee] to submit all claims to binding arbitration at [the franchisor’s] headquarters in Maryland”) with *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 180 (3d Cir. 1999) (“[T]he mere fact that Green Tree retains the option to litigate some issues in court, while Harris must arbitrate all claims does not make the arbitration agreement unenforceable.”).
federal courts after the United States Supreme Court decisions in *eBay, Inc. v. MercExchange, LLC* 31 and *Winter v. Natural Resources Defense Council, Inc.* 32 Finally, a franchisor has the right to appeal preliminary injunction entered by a court but most likely would not have the right to appeal interim injunctive relief entered by an arbitrator.

Franchise agreements containing arbitration clauses typically carve out the right to obtain emergency or interim injunctive relief to preserve the status quo pending arbitration. Where that carve out is expressly stated in the arbitration agreement, courts will enforce the parties intent as stated. A particularly clear provision to this effect, which the court held “leaves no room for ambiguity,” stated: “[n]otwithstanding the foregoing, this provision shall not be construed to limit a party’s right to seek preliminary or permanent injunctive relief in any court of competent jurisdiction.” 33

Even where the agreement does not expressly state that the parties may seek interim injunctive relief in court, most courts will consider an application for interim injunctive relief where such relief is necessary to preserve the situation between the parties to allow arbitration to provide an effective remedy. 34 Nonetheless, it is better practice to specifically provide for this right rather than have to rely on a court’s inherent authority to issue an injunction to preserve the status quo pending an arbitration.

c. **Class and Collective Action Waiver**

Recent United States Supreme Court decisions have made clear that class action waivers in arbitration agreements generally are enforceable under the Federal Arbitration Act. The analysis of class waivers in arbitration agreements is discussed in detail in section II.C., below. Based on this precedent, the way for a franchisor to have the greatest likelihood to avoid class or multi-party claims is to provide for arbitration on an individual basis and include an express waiver of the right to bring or participate in a class or collective action. An unconscionability challenge is not likely to prevail, although a challenger still may have a contract construction argument, depending on the language of the clause, that some form of multi-party action is appropriate.

In any event, the best practice is to draft language that clearly sets forth the parties’ intent on the issue of class and multi-party proceeding. If the franchisor wants to exclude the franchisee from bringing a class claim, it should explicitly say so. But a prohibition against bringing class claims might not be enough. Does a prohibition against bringing a class or collective action prohibit that franchisee from participating in a class or collective action brought by another party? This can be a real issue in systems that have different versions of franchise

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agreements, some of which might not include class waiver language. Thus, to cover all the bases, the franchise agreement should state in substance the following:

- All claims, disputes, or controversies shall be arbitrated on an individual basis between franchisor and franchisee;
- Neither party shall bring any class, collective, or multi-party claims against the other; and
- Neither party shall be a claimant or otherwise participate as a party in any class, collective, or multi-party claims or proceedings brought by any other person or entity.

d. Discovery and Arbitration Procedure

One of the primary features that can make arbitration faster and cheaper than court litigation is the lack of formal discovery procedures. Some parties, however, become frustrated with the arbitration process because they are not allowed to take sufficient discovery to prove their claims or develop their defenses. The basic AAA commercial arbitration clause does not address discovery, and the only mandatory “discovery” required by the AAA Commercial Arbitration Rules is an exchange of exhibits prior to the hearing. The AAA Rules give the arbitrator discretion to “manage any necessary exchange of information among the parties,” which could include ordering certain depositions or other discovery, but there are no meaningful guidelines for when or to what extent to allow such discovery.\(^{35}\) The AAA rules also allow an arbitrator to require the parties to respond to requests to produce documents reasonably believed “to be relevant and material to the outcome of disputed issues,” but again there are no more specific guidelines for exercising that discretion.\(^{36}\) Thus, a party relying merely on general rules of a tribunal like the AAA might find itself in a multimillion dollar dispute yet have no ability to take depositions of the opposing party, its key witnesses or its experts. Conversely, a party might find itself in a relatively small-dollar dispute yet have an arbitrator allow the other party to take multiple depositions and create significant discovery expense.

To avoid such uncertainty, a franchisor might include parameters for discovery in the arbitration agreement. One idea is to establish alternative frameworks depending on the dollar value of the particular dispute. For example, for disputes below a certain dollar threshold, no discovery would be allowed and the parties would only exchange exhibits prior to the hearing. For disputes within a higher dollar range, the parties would be allowed to take single representative deposition of the other side and serve a certain number of document requests. For disputes involving a significantly high dollar amount, the agreement might provide that the parties can take up to a certain number of depositions (say, five) and require production of all documents relevant to the issues.

The parties are also free to incorporate other sets of rules as their specified discovery procedures. Some arbitration agreements expressly incorporate all discovery mechanisms authorized under the Federal Rules of Civil Procedure. Allowing such expansive discovery,

\(^{35}\) AAA Rule 2(a).
\(^{36}\) AAA Rule 22(b).
however, almost certainly means that arbitration will be no less expensive or time consuming than litigation under the same rules.

Most arbitration agreements do not go into great detail on the procedures for conducting the arbitration hearing. Provider organizations typically do a good job providing guidance for arbitrators, both at the preliminary conference stage to identify issues and at the hearing stage for conducting a fair presentation of evidence. Some agreements provide that the final hearing must be held within a certain number of days of filing. While it is understandable that a party might want to ensure a prompt resolution, such mandatory deadlines might cause more trouble than they are worth. Specifying the desired rules of the provider organization is generally sufficient to cover procedure for the arbitration hearing.

Parties to an arbitration also may specify the form of the award to be issued by the arbitrator(s). An arbitrator or panel generally need not explain its decision, and where no specific form of award is requested, the panel may simply announce a result similar to the form of a jury verdict. The parties, however, can choose to require the arbitrator to issue an award that explains their decision. Such a “reasoned award” can be anywhere along a spectrum from a limited statement of the outcome based on credibility determinations to detailed findings of fact and conclusions of law similar to those issued in a bench trial under Federal Rule of Civil Procedure 52. An arbitrator’s failure to provide an award in the form required in the arbitration agreement can be a basis to vacate the award on the ground that the arbitrator exceeded her powers under Section 10(d)(4) of the FAA.

Of course, requiring a reasoned award likely will increase the cost of an arbitration. Courts also tend to construe liberally what constitutes a reasoned award, unless the parties are very specific in their agreement about the form of the award. Again, the party drafting an arbitration agreement should think about what form of award it wants and describe that desire precisely in the agreement.

e. Claims Against Affiliates and Related Individuals

Arbitration is a creature of contract, and the consent of all parties is required to participate in and be bound by an arbitration proceeding. Thus, a party normally cannot be compelled to arbitrate unless it is a party to the agreement containing an arbitration clause. Courts, however, have recognized several exceptions to this rule. The primary doctrines through which a non-signatory can be bound by arbitration agreements entered into by others are: (1) assumption; (2) agency; (3) estoppel; (4) veil piercing; and (5) incorporation by reference.

Equitable estoppel is perhaps the most frequently invoked theory to bind a non-party. Courts have held that equitable estoppel is proper in two contexts: (1) when the signatory relies


38 See, e.g., Cat Charter, LLC v. Schurtenberger, 646 F.3d 836 (11th Cir. 2011) (reversing district court order vacating arbitration award and holding that arbitration panel sufficiently explained basis for decision to constitute “reasoned award”).

on the terms of the written agreement in asserting its claims against the nonsignatory and (2) when the signatory raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract.\textsuperscript{40}

Several courts have applied the equitable estoppel doctrine to permit nonsignatories to compel arbitration in franchise disputes. For example, in \textit{CD Partners, LLC v. Grizzle},\textsuperscript{41} a franchisee sued its franchisor, who successfully moved to compel arbitration based on an arbitration clause in the franchise agreement. While the arbitration was pending, the franchisee sued the CEO, CFO, and COO of the franchisor alleging negligence, negligent misrepresentation, and fraudulent misrepresentation all related to the operations of the franchisee. Among other things, the franchisee alleged that the individual defendants “provided [the franchisee] with false information to influence the franchise transactions between the parties,” failed to protect the exclusive territories under the franchise agreements, failed to make improvements to the point-of-sale software, and failed to provide promised financing for capital improvements to the stores.\textsuperscript{42} The individual defendants moved to compel arbitration pursuant to the arbitration clause in the franchise agreement, but the franchisee argued that the individuals, as nonsignatories, could not invoke the arbitration agreement. The Eighth Circuit disagreed, reasoning:

A nonsignatory can enforce an arbitration clause against a signatory to the agreement in several circumstances. One is when the relationship between the signatory and nonsignatory defendants is sufficiently close that only by permitting the nonsignatory to invoke arbitration may evisceration of the underlying arbitration agreement between the signatories be avoided. Another is when the signatory to a written agreement containing an arbitration clause must rely on the terms of the written agreement in asserting [its] claims against the nonsignatory.

We believe both circumstances are present here. The relationship between signatory [franchisor] and the nonsignatory appellants is a close one. The tort allegations against the three appellants all arise out of their conduct while acting as officers of [franchisor]. Evisceration of the underlying arbitration agreement will be avoided only by allowing the three principals to invoke arbitration. Similarly, [franchisee’s] claims against the three appellants rely upon, refer to, and presume the existence of the written agreement between the two corporations. Thus, arbitration is appropriate.\textsuperscript{43}

On the other hand, some courts have declined to allow nonsignatories to compel arbitration even where the parties appear to be acting in concert, noting that the equitable


\textsuperscript{41} 424 F.3d 795 (8th Cir. 2005).

\textsuperscript{42} \textit{Id}. at 798.

\textsuperscript{43} \textit{Id}. at 798-99 (internal citations and quotations omitted); see also \textit{Cahill v. Alternative Wines, Inc.}, No. 12-cv-110, 2013 WL 427396 (N.D. Iowa Feb. 4, 2013); \textit{Alltel Commc'ns, LLC v. Oglala Sioux Tribe}, No. CIV-10-5011, 2010 WL 1999315 (D.S.D. May 18, 2010).
estoppel test is a fact-specific inquiry that is not necessarily met simply because a plaintiff alleges concerted action by the defendants. In *In re Humana Inc. Managed Care Litig.*, for example, nonsignatory defendants sought to invoke an arbitration clause adopted by a signatory defendant based on the fact that the plaintiffs alleged a RICO conspiracy. The Eleventh Circuit rejected this argument, explaining that “the lynchpin for equitable estoppel is equity, and the point of applying it to compel arbitration is to prevent a situation that would fly in the face of fairness.”

Parties can avoid this uncertainty, however, by proper drafting. To require the franchisee to arbitrate claims not just against the franchisor but against related parties, the arbitration agreement can specify that it covers all claims against the franchisor’s officers, directors, employees, or affiliated companies. To cover related parties associated with the franchisee, the agreement can state that the agreement to arbitrate extends the principals or owners of the franchisee as well as any entities in which those individuals have a controlling interest. To cast the net as broadly as possible, a franchisor could state:

This agreement to arbitrate applies to Franchisee as well as to (i) all guarantors of Franchisee’s obligations under this Agreement, (ii) all owners, officers or principals of Franchisee, and (iii) all others who claim any rights or benefits based upon or relating to the franchise relationship or who make any claim or defense based upon or relating to this Agreement.

Where the franchisor wants to bind individuals associated with the franchisee entity, the best practice is to require those individuals to execute in their individual capacities the franchise agreement or other document containing the agreement to arbitrate so there is no question that those individuals are subject to the arbitration agreement.

f. Confirmation or Challenge to an Arbitration Award

Because arbitration is a private adjudication process, an award entered by an arbitrator is not self-executing. Instead, the prevailing party must confirm the award before a court of competent jurisdiction as provided in Section 9 of the FAA. That statute provides that at any time within one year after the award is made, any party to the arbitration may apply to the court specified in the agreement for an order confirming the award, and that court “must grant such an order unless the award is vacated, modified, or corrected as prescribed in Sections 10 and 11 of the [FAA].” If no court is specified for confirmation in the arbitration agreement, then application may be made to the federal court for the district in which the award was made. The FAA further provides for special service of process procedures upon the adverse party in a confirmation proceeding. Section 13 of the FAA provides what a party must file when moving for confirmation of an award, which includes the arbitration agreement and the award itself.

Most arbitration agreements do not go into great detail in describing the procedures for confirmation. The AAA’s standard commercial arbitration clause states that “judgment on the award rendered by the arbitrator’s may be entered in any court having jurisdiction thereof.” Most franchise agreements containing arbitration clauses also will contain a forum selection

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clause, usually designating the franchisor’s home, city or state, as well as a consent to jurisdiction provision whereby the franchisee consents to personal jurisdiction in the franchisor’s selected forum. Thus, if the arbitration occurs in the franchisor’s selected forum, the general language for confirmation from the AAA clause should allow for confirmation by the federal court in the same forum.

Arbitration agreements typically do not address challenges to an award. Grounds for vacating an arbitration award are very limited. Section 10 of the FAA provides that a court may vacate an arbitration award only:

1. where the award was procured by corruption, fraud, or undue means;

2. where there was evident partiality or corruption in the arbitrators, or either of them;

3. where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

4. where the arbitrators exceeded their powers, or so imperfectly executed them that a final, mutual, and definite award upon the subject matter submitted was not made.46

Under limited circumstances a court may remand a case to the arbitrator for clarification of the award.47

Although not enumerated in the statute, some courts continue to employ a judicially created basis to overturn an award where the challenger can show that the arbitrator “manifestly disregarded” applicable law.48 The Supreme Court has not made an explicit holding on this issue, but its recent holdings have expressed substantial doubt as to whether this “manifest disregard” standard is appropriate under the FAA as an independent ground for review.49

**g. Appeal Options**

Unlike a decision of a trial court, there is no mechanism for judicial appeal of a binding arbitration award. The only judicial mechanism for review is a petition to vacate or modify the award under sections 10 and 11 of the FAA, but as discussed above that is very much an uphill battle. The Supreme Court has made clear that sections 10 and 11 of the FAA provide the exclusive grounds for vacating (section 10) or modifying (section 11) an arbitration award issued

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48 See, e.g., Comedy Club, Inc. v. Improv West Assocs., 553 F.3d 1277 (9th Cir. 2009) (treating “manifest disregard” as shorthand for the arbitrators exceeding their powers, per section 10(a)(4) of the FAA).

49 See Stolt-Nielsen, 559 U.S. at 672, 130 S.Ct. at 1768 n. 3.
under the Act. In *Hall Street*, the Court rejected the parties’ attempt to fashion in their arbitration agreement an expanded scope of judicial review beyond the limited grounds specified in the FAA. A losing party thus will be stuck with a bad arbitration decision unless that party can establish one of the very limited grounds for review under the FAA or common law for vacating the award.

To combat the feeling among many practitioners that the lack of an effective appeal option is a significant disincentive to arbitrate, the AAA adopted new Optional Appellate Arbitration Rules effective November 1, 2013. These Rules provide for an appeal of an arbitration award to an appellate arbitration panel that would apply a standard of review more liberal than that allowed by the FAA and state statutes. As with other aspects of arbitration the parties must consent to utilize these Appellate Rules in their arbitration agreement, and a party may not unilaterally appeal an award under these Rules absent agreement between the parties. The AAA Rules provide sample language for an arbitration clause to incorporate these appellate procedures:

Notwithstanding any language to the contrary in the contract documents, the parties hereby agree: that the Underlying Award may be appealed pursuant to the AAA’s Optional Appellate Arbitration Rules (“Appellate Rules”); that the Underlying Award rendered by the arbitrator(s) shall, at a minimum, be a reasoned award; and that the Underlying Award shall not be considered final until after the time for filing the notice of appeal pursuant to the Appellate Rules has expired. Appeals must be initiated within thirty (30) days of receipt of an Underlying Award, as defined by Rule A-3 of the Appellate Rules, by filing a Notice of Appeal with any AAA office. Following the appeal process the decision rendered by the appeal tribunal may be entered in any court having jurisdiction thereof.

The Appellate Rules provide that a party to an arbitration award may initiate an appeal within 30 days from the date of the award by filing a notice of appeal, and the opposing party or parties may cross-appeal within seven days after the notice. The Rules provide for a panel of three appellate arbitrators unless the parties agree to use a single arbitrator. A party may appeal on the grounds that the underlying award is based upon either (1) an error of law that is material and prejudicial, or (2) determinations of fact that are clearly erroneous. Appeals will be determined based on the written submissions of the parties, unless a party makes a timely request for oral argument and the appeal panel agrees to hear it. The appeal tribunal must either render a decision or request additional information within 30 days of service of the last brief, and the appeal tribunal may not order a new arbitration hearing or send the case back to the original arbitrator(s) for further review. Finally, the appeal tribunal’s decision shall be in

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52 Rule A-3(a)(i) & (c).
53 Rule A-10.
54 Rule A-15.
55 Rule A-18(a).
writing and include a concise summary explaining the decision unless the parties agree otherwise.\footnote{Rule A-19(c).}

If the parties incorporate the Appellate Rules, it is crucial that they also specify that the arbitrator in the underlying proceeding must issue a reasoned award explaining the bases for the decision. Also, it is essential in virtually all cases to have a record of the arbitration proceeding, otherwise the appeal tribunal will have no basis on which to evaluate whether any fact determinations were clearly erroneous.

A final observation on these new Appellate Rules: this procedure will be costly to the parties. An appealing party or cross-appealing party must pay a non-refundable $6,000 administrative fee to the AAA. In addition, the parties will have to pay for the fees of three arbitrators, which could easily run into the tens of thousands of dollars. These Rules also allow the appeal tribunal to reallocate a party’s share of the fees and administrative costs of the appeal to an unsuccessful party, as well as attorney’s fees to the prevailing party if a statute or the parties’ contract provides for such an award.\footnote{Rule A-11, A-12.} These direct expenses, combined with the costs of a hearing transcript from the underlying arbitration proceeding, should cause parties to think long and hard about whether utilizing these Appellate Arbitration Rules is worth the additional costs.

3. **Unconscionability as a Defense to Enforcement of an Arbitration Clause**

Section 2 of the FAA states that written agreements to arbitrate are valid and enforceable, “save upon such grounds as exist at law or in equity for the revocation of any contract” – for instance, fraud, duress, or unconscionability. Perhaps the most commonly used of these defenses is unconscionability. Although courts often consider the concept of unconscionability, the term itself is not clearly defined, and what definitions do exist vary from state to state. For instance, some states still apply a very old definition of an unconscionable contract: one that “no man in his senses and not under delusion would make on the one hand, and . . . no honest and fair man would accept on the other.”\footnote{See, e.g., Hume v. United States, 132 U.S. 406, 406 (1889) (defining unconscionable contract as “a contract which no man in his senses, not under delusion, would make, on the one hand, and which no fair and honest man would accept on the other”); LegalZoom.com, Inc. v. McIlwain, 249 S.W.3d 261 (Ark. 2013) (“While ‘unconscionability’ is not precisely defined in the law, one of the earliest applications of the doctrine described an unconscionable contract as one that ‘no man in his senses and not under delusion would make on the one hand, and . . . no honest and fair man would accept on the other.’”); Reserves Mgmt., LLC v. Am. Acquisition Prop. I, LLC, 86 A.3d 1119 (Del. 2014) (“Traditionally, a contract will be found unconscionable where ‘no man in his senses and not under delusion would make on the one hand, and . . . no honest or fair man would accept, on the other.’”); TEM Capital, LLC v. Leonard, A13-0158, 2013 WL 6152186 (Minn. Ct. App. Nov. 25, 2013) (“A contract is unconscionable if it is “such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept on the other.””); Leeman v. Cook’s Pest Control, Inc., 902 So. 2d 641, 645 (Ala. 2004) (“This Court has stated that ‘[a]n unconscionable ... contractual provision is defined as a ... provision such as no man in his sense and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.’”); Hill v. Wackenhut Servs. Intl’, 865 F. Supp. 2d 84, 95 (D.D.C. 2012) (“A substantively unconscionable contract is one that ‘no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.’”); Bose Corp. v. Ejaz, civ.-A. 11-10629-DJC, 2012 WL 4052861 (D. Mass. Sept. 13, 2012) aff’d, 732 F.3d 17 (1st Cir. 2013) (“Under Massachusetts law, an unconscionable contract is one ‘such as no man in his
definition of the term: "an absence of meaningful choice of one of the parties together with contract terms which are unreasonably favorable to the other party." But however defined, it is clear that "[t]he principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power."

Although definitions vary, most states divide unconscionability into two subcategories, procedural and substantive, and require evidence of both elements to invalidate a given clause or contract. Although distinct considerations, the concepts of substantive and procedural unconscionability are often considered on a sliding scale: the more procedurally unconscionable a contract is, the less substantively unconscionable it need be to be invalidated, and vice versa. Whether a contract or contractual provision is substantively and procedurally

senses and not under delusion would make on the one hand, and no honest and fair man would accept on the other."); Woebse v. Health Care & Ret. Corp. of Am., 977 So. 2d 630, 632 (Fla. Dist. Ct. App. 2008) ("A substantively unconscionable contract is one that "no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.").

59 See, e.g., Graham v. Bank of Am., N.A., No. 226 Cal. App. 4th 594, 616 (2014) ("Generally, unconscionability is recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."); Caplin Enterprises, Inc. v. Arrington, 2011-CT-01332-SCT, 2014 WL 1875364 (Miss. May 8, 2014) ("A contract is substantively unconscionable if there is an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."); Stark v. Gift Groupe, Inc., 13 CIV. 5497 LLS, 2014 WL 1652225 (S.D.N.Y. Apr. 24, 2014) ("Under New York law, [a] determination of unconscionability generally requires a showing ... of an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."); Glover ex rel. Glover v. Darway Elder Care Rehab. Ctr., 4:13-CV-1874, 2014 WL 931459 (M.D. Pa. Feb. 4, 2014) report and recommendation adopted, 2014 WL 931470 (M.D. Pa. Mar. 10, 2014) ("A court may find that a contract is unconscionable, and, therefore, unenforceable, when one party to the agreement shows 'an absence of meaningful choice together with contract terms which are unreasonably favorable to the other party.'"); Glover ex rel. Glover v. Darway Elder Care Rehab. Ctr., 4:13-CV-1874, 2014 WL 931459 (M.D. Pa. Feb. 4, 2014) report and recommendation adopted, 2014 WL 931470 (M.D. Pa. Mar. 10, 2014) ("A court may find that a contract is unconscionable, and, therefore, unenforceable, when one party to the agreement shows 'an absence of meaningful choice together with contract terms which are unreasonably favorable to the other party.'"); Green v. Full Serv. Prop. Prop. Inspections, L.L.C., 2013-Ohio-4266 (Ohio Ct. App. 2013) ("Unconscionability includes both an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.").

8 Williston on Contracts § 18:8 (4th ed.).

60 See, e.g., Armendariz v. Found. Health Psychcare Servs., Inc., 114, 6 P.3d 669, 690 (Cal. 2000) ("The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability."); Jerry D. Goldstein, LLC v. Megapath Corp., CIV. 13-5294 FSH, 2014 WL 2094100 (D.N.J. May 20, 2014) ("Unconscionability requires a showing of both procedural unconscionability and substantive unconscionability."); Cohn v. Ritz Transp., Inc., 2:11-CV-1832 JCM NJK, 2014 WL 1577295 (D. Nev. Apr. 17, 2014) ([B]oth procedural and substantive unconscionability must be present for a court to decline to enforce a contractual clause.").

62 See Armendariz, 114, 6 P.3d 669 ("Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves."); Jerry D. Goldstein, LLC, 2014 WL 2094100 ("Both components must be present, but not in the same degree; by the use of a sliding scale, a greater showing of procedural or substantive unconscionability will require less of a showing of the other to invalidate the claim."); Branch Banking & Trust Co., 2014 WL 1870606 ("[Procedural and substantive unconscionability] need not be present
unconscionable is determined based on the facts at the time of the contract was made, not at the time of performance or some other later point, and is typically a question of law for the court, rather than a factual question. 63 The following sections discuss procedural and substantive unconscionability and identify factors that may be indicative of each in the context of arbitration provisions in franchise agreements.

a. Procedural Unconscionability

Procedural unconscionability, as the term suggests, relates to procedural deficiencies in the contract formation process itself. For example: “Did one party adequately explain the content of the agreement to the other? Was the explanation in a language readily understood by the other party? Were there sharp practices or overreaching? Did one party take advantage of the other’s lack of experience or naiveté?” 64 In the franchise context, an allegation of procedural unconscionability is often accompanied by two primary complaints: first, that the franchise agreement is a contract of adhesion, offered on a take-it-or-leave-it basis, and second, that the franchisor has considerably greater bargaining power than the franchisee.

Franchisees have historically asserted such allegations with varying success. For instance, the Ninth Circuit, quoting the California Court of Appeals, 65 has noted that franchise agreements may inherently create a risk of procedural unconscionability:

Although franchise agreements are commercial contracts they exhibit many of the attributes of consumer contracts. The relationship between franchisor and franchisee is characterized by a prevailing, although not universal, inequality of economic resources between the contracting parties. Franchisees typically, but not always, are small businessmen or businesswomen or people like the [franchisees] seeking to make the transition from being wage earners and for whom the franchise is their very first business. Franchisors typically, but not always, are large corporations. The agreements themselves tend to reflect this gross bargaining disparity. Usually they are form contracts the franchisor prepared and offered to franchisees on a take-[it-]or leave-it basis.

Franchising involves the unequal bargaining power of franchisors and franchisees and therefore carries within itself the seeds of abuse. Before the relationship is established, abuse is threatened by the franchisor’s use of contracts of adhesion presented on a take-it-or-leave-it basis. 66

63 8 Williston on Contracts § 18:12 (4th ed.).

64 Howard O. Hunter, § 19:41.


66 Nagrampa v. MailCoup’s, Inc., 469 F.3d 1257, 1282 (9th Cir. 2006) (noting that evidence that defendant had “overwhelming bargaining power, drafted the contract, and presented it to [plaintiff] on a take-it-or-leave-it basis”
Other courts, however, have expressly rejected the comparison between consumer contracts and franchise agreements, noting that franchisees are typically business people entering into commercial contracts and should be treated as such. As stated by the Seventh Circuit in a frequently cited passage from a franchise case:

[The franchisees] are not vulnerable consumers or helpless workers. They are business people who bought a franchise (actually two, though the other isn't in issue in this case) in another state as an investment to be managed by local managers. They were not forced to swallow unpalatable terms.67

In addition to the sophistication of the franchisee, courts declining to find procedural unconscionability have also relied on the fact that franchisees typically receive specific disclosures before signing a franchise agreement. For instance, in Kairy v. Supershuttle Int'l, Inc., a franchisee argued that an arbitration provision in his franchise agreement was procedurally unconscionable because the franchisor had substantially greater bargaining power and that the franchise agreement was a non-negotiable, take-it-or-leave-it agreement. The United States District Court for the Northern District of California disagreed, noting that franchisors are required to make detailed disclosures to prospective franchisees, and that the arbitration clauses were not hidden, but rather clearly labeled in the table of contents.69

The extent to which these procedural unconscionability arguments remain persuasive is somewhat diminished following the Supreme Court's 2011 decision in AT&T Mobility LLC v. Concepcion,70 in which Justice Scalia, writing for the majority, noted that "the times in which consumer contacts were anything other than adhesive are long past."71 Since Concepcion, several courts have interpreted the decision to affect the procedural unconscionability analysis amounted to at least minimal procedural unconscionability); see also Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., 622 F.3d 996, 1004 (9th Cir. 2010) (finding that arbitration provision in franchise agreement was procedurally unconscionable because the franchisor had considerably greater bargaining power).

67 Original Great Am. Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd., 970 F.2d 273, 281 (7th Cir. 1992); see also Doctor's Associates, Inc. v. Jabush, 89 F.3d 109, 113 (2d Cir. 1996) ("As purchasers of a Subway sandwich franchise, the [franchisees] 'were' not vulnerable consumers or helpless workers. They [were] business people who bought a franchise.") (quoting Original Great Am. Chocolate Chip Cookie Co., 970 F.2d at 281); We Care Hair Dev., Inc. v. Engen, 180 F.3d 838, 843 (7th Cir. 1999) (finding arbitration clause was not unconscionable because each franchisee was a business person who was provided a copy of the uniform offering circular which clearly disclosed challenged terms).


69 Id.; see also Siemer v. Quizno's Franchise Co. LLC, 07 C 2170, 2008 WL 904874 (N.D. Ill. Mar. 31, 2008) (finding no procedural unconscionability because franchisors were sophisticated business people and because the franchise agreement specifically advised: "Before signing this agreement, franchisee should read it carefully with the assistance of legal counsel . . .").

70 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011). Because Concepcion was recently decided, it is still unclear how broadly lower courts will apply it. What's more, following Rent-A-Ctr., W., Inc. v. Jackson, 561 U.S. 63, 130 S. Ct. 2772, 177 L. Ed. 2d 403 (2010), it is likely that many unconscionability decisions may be delegated to an arbitrator rather than decided by courts, leading to fewer published opinions regarding unconscionability of arbitration agreements.

71 Id. at 1750.
as well as the substantive one. For example, in *Bernal v. Burnett*, the United States District Court for the District of Colorado declined to find that an adhesion contract was procedurally unconscionable, reasoning that “[t]he fact that the contract at issue in *Concepcion* was an adhesion contract did not affect the Supreme Court’s analysis and, indeed, the majority in *Concepcion* appeared to be little troubled by that fact.” Likewise, in *Ipcon Collections LLC v. Costco Wholesale Corp.*, the United States District Court for the Southern District of New York granted a motion to compel arbitration over the plaintiff’s claim of procedural unconscionability, noting that the parties’ respective sizes or economic power, “are irrelevant in determining whether an arbitration provision should be enforced” after *Concepcion*.

b. **Substantive Unconscionability**

In contrast to procedural unconscionability, the concept of substantive unconscionability relates to the contract terms themselves and whether those terms are overly harsh, one-sided, or unreasonably favorable to one party over another. Because the Supreme Court has frequently emphasized the liberal federal policy favoring arbitration, franchisees have had limited success establishing that an agreement to arbitrate is substantively unconscionable.

Typically, successful challenges have fallen into one of three categories. Even in those categories, however, the likelihood of success is limited following *Concepcion*. First, some franchisees have successfully challenged arbitration agreements that do not contain mutual obligations to arbitrate. For instance, in *Ticknor v. Choice Hotels Int’l, Inc.*, the Ninth Circuit, applying Montana law, found that an arbitration provision contained in a franchise agreement was substantively unconscionable because it allowed the franchisor to bring its claims in state or federal court, yet forced the franchisee to submit all claims to binding arbitration near the franchisor’s headquarters in Maryland. Likewise, in *Nagrampa v. MailCoups, Inc.*, the Ninth Circuit, applying California law, found that a franchise agreement’s arbitration clause was unconscionable because, among other things, it gave the franchisor access to a judicial forum for certain claims, but restricted the franchisee to arbitral forum. Non-mutual obligations,

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73 Id. at 1287.


75 See id. at *4 n. 5; see also *Day v. Persels & Assoc., LLC*, No. 8:10-CV-2463-T-33TGW, 2011 WL 1770300 (M.D. Fla. May 9, 2011) (noting that, following *Concepcion*, “the plaintiff’s claim of procedural unconscionability is not meaningfully enhanced by characterizing the Client Agreement as an adhesion contract”).

76 See, e.g., *Am. Exp. Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2306, 186 L. Ed. 2d 417 (2013) (“Courts must ‘rigorously enforce’ arbitration agreements according to their terms . . . .”); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745, 179 L. Ed. 2d 742 (2011) (“We have described § 2 of the FAA as reflecting both a ‘liberal federal policy favoring arbitration,’ and the ‘fundamental principle that arbitration is a matter of contract.’”); *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 667, 181 L. Ed. 2d 586 (2012) (“Section 2 of the FAA establishes ‘a liberal federal policy favoring arbitration.’”); *Moses H. Cone Mem’l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24, 103 S. Ct. 927, 941 (“Section 2 of the FAA is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.”).

77 265 F.3d 931, 940 (9th Cir. 2001).

78 469 F.3d 1257, 1281 (9th Cir. 2006).
however, do not necessarily mandate a finding of substantive unconscionability. For instance, in *Barker v. Golf U.S.A., Inc.*,\(^79\) the Eighth Circuit, applying Oklahoma law, upheld an arbitration agreement permitting the franchisor to bring certain claims in a judicial forum, noting that “mutuality of obligation is not required for arbitration clauses so long as the contract as a whole is supported by consideration.”\(^80\)

Second, some franchisees have successfully challenged arbitration provisions in franchise agreements based on oppressive and unreasonable forum-selection clauses. For example, in *Nagrampa*, the Ninth Circuit found that the arbitration agreement was substantively unconscionable because, in addition to imposing non-mutual obligations to arbitrate, it contained a forum-selection clause requiring that any arbitration be held in Boston, Massachusetts, a location considerably more convenient to the franchisor.\(^81\) Again, however, an unconscionability determination is fact-specific, and the presence of an inconvenient forum selection clause does not necessarily establish substantive unconscionability. In *Doctor's Associates, Inc. v. Stuart*,\(^82\) for example, the Second Circuit rejected a franchisee’s contention that an arbitration provision in a franchise agreement was unconscionable because it required that the arbitration be held in Connecticut, causing the franchisee to incur substantial travel expenses to litigate her claim. In reaching its conclusion, the court cited Supreme Court precedent emphasizing the liberal federal policy in favor of arbitration.\(^83\)

Finally, some franchisees have successfully challenged arbitration provisions that limit the remedies available in arbitration. For instance, in *Htay Htay Chin v. Advanced Fresh Concepts Franchise Corp.*,\(^84\) the California Court of Appeals found an arbitration provision in a franchise agreement to be unconscionable based on two requirements: first, a provision stating that “[a]ny award shall be based on established law and shall not be made on broad principles of justice and equity,” and second, a provision limiting damages to compensatory damages and

\(^{79}\) 154 F.3d 788, 792 (8th Cir. 1998).

\(^{80}\) Id.

\(^{81}\) 469 F.3d at 1285; *see also Chavez v. Bank of Am.*, C 10-653 JCS, 2011 WL 4712204 (N.D. Cal. Oct. 7, 2011) (finding forum selection clause requiring plaintiff to travel thousands of miles to arbitrate claim invalid, severing that provision, and enforcing the remainder of the arbitration clause).

\(^{82}\) 85 F.3d 975, 980 (2d Cir. 1996).

\(^{83}\) Some states have enacted franchise legislation containing prohibitions on forum selection clauses in franchise agreements. Following Supreme Court precedent regarding FAA preemption, however, most courts to consider the issue have held that provisions barring forum selection clauses in arbitration agreements as a matter of law are preempted by the FAA. For instance, in 2001, the California Franchise Relations Act provided that “[a] provision in a franchise agreement restricting venue to a forum outside [California] is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state.” In *Bradley v. Harris Research, Inc.*, 275 F.3d 884 (9th Cir. 2001), the Ninth Circuit held that FAA preempted this statutory provision because the provision “apply[ed] only to forum selection clauses and only to franchise agreements; it therefore did not apply to ‘any contract.’” Id. at 890; *see also Flint Warm Air Supply Co., Inc. v. York International Corp.*, 115 F. Supp. 2d 820, 827 (D. Mich. 2000) (holding that prohibition on forum selection clauses in Michigan Franchise Investment law was preempted by the FAA); *KKW Enterprises, Inc. v. Gloria Jean’s Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 51 (1st Cir. 1999) (holding that prohibition on forum selection clauses in Rhode Island Franchise Investment Act was preempted by FAA).

\(^{84}\) 194 Cal. App. 4th 704, 711-12, 123 Cal. Rptr. 3d 547, 554-55 (2011).
barring any non-economic or punitive damages.\textsuperscript{85} In \textit{Torres v. Simpatico, Inc.},\textsuperscript{86} on the other hand, the United States District Court for the Eastern District of Missouri held that a limitation of remedies provision contained in the arbitration agreement did not render the arbitration agreement unconscionable, holding that the validity of that provision should be determined by the arbitrator and not by the district court.

As with procedural unconscionability, the Supreme Court’s holding in \textit{Concepcion} has dramatically changed the landscape of the substantive unconscionability analysis. Before \textit{Concepcion}, litigants often sought to invoke state unconscionability law to invalidate arbitration agreements containing prohibitions on class actions under the Federal Arbitration Act’s so-called “savings clause.”\textsuperscript{87} \textit{Concepcion}, however, expressly foreclosed a party’s right to such challenges, holding that the Federal Arbitration Act preempts the application of state unconscionability law invalidating class action waivers.\textsuperscript{88} In reaching its decision, the Supreme Court reasoned that any application of state unconscionability law that “stands as an obstacle to the accomplishment and execution of the full purposes and objective of Congress” is “preempted by the FAA.”\textsuperscript{89} In other words, \textit{Concepcion} appears to apply not only to state unconscionability rules that invalidate class action waivers, but also to any “procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons.”\textsuperscript{90} Indeed, the Court opined that, for instance, hypothetical state laws finding unconscionable arbitration agreements that fail to provide for judicially monitored discovery, that fail to follow the Federal Rules of Evidence, or that fail to mandate an ultimate decision by a “panel of twelve lay arbitrators,” could be inconsistent with the FAA and thus would be preempted.\textsuperscript{91} Thus, in addition to invalidating prohibitions on class action waivers in arbitration agreements, \textit{Concepcion} is likely to make all substantive unconscionability arguments more difficult to make in light of its sweeping language in support of arbitration.

In sum, absent particularly oppressive terms or unfair surprise, a franchisee is unlikely to succeed in avoiding arbitration where the franchise agreement contains an otherwise valid arbitration provision. To further ensure the availability of arbitration, however, a franchisor should avoid using potentially one-sided or oppressive terms in the arbitration clause itself, and consider the following:

- Including a delegation clause: In \textit{Rent-A-Center, West., Inc. v. Jackson},\textsuperscript{92} the Supreme Court instructed that when an arbitration provision clearly and unmistakable delegates gateway issues concerning the validity of the arbitration

\textsuperscript{85} \textit{Id.}


\textsuperscript{87} 9 U.S.C. § 2.

\textsuperscript{88} 563 U.S. 321, 131 S. Ct. 1740 (2011).

\textsuperscript{89} \textit{Id.} at 1753.

\textsuperscript{90} \textit{Id.}

\textsuperscript{91} \textit{Id.} at 1747.

\textsuperscript{92} 561 U.S. 63, 130 S. Ct. 2772 (2010).
provision to an arbitrator, a plaintiff seeking to avoid arbitration on grounds of unconscionability must show that submission of the question of arbitrability to an arbitrator would itself be unconscionable.\textsuperscript{93} Given the difficulty of showing a delegation clause itself is unconscionable, a franchisor is more likely to succeed on an initial motion to compel arbitration if the agreement contains a clear delegation clause.

- Including a severability provision: A franchisor may wish to include a clause stating that if any provision of the arbitration agreement is held unconscionable or otherwise invalid, then the remaining portions of the arbitration provision shall be enforced without regard to the invalid clause, provided that the franchisor wishes to proceed in arbitration absent the certain clauses. By doing so, a franchisor is more likely to successfully compel arbitration, even in the face of a challenge to a portion of the arbitration agreement by a franchisee.\textsuperscript{94}

- Placing terms that may be challenged outside the arbitration provision: A limitation or remedies provision or a potentially oppressive forum selection clause may be better situated outside the arbitration provision itself. By placing such clauses in separate provisions that apply to both arbitration and litigation, it is unlikely that a court would look to those provisions in determining the conscionability of the arbitration provision itself.\textsuperscript{95}

\begin{center}
\textbf{c. Beyond Arbitration – Unconscionability in Other Franchise Contexts}
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Unconscionability challenges in the franchise context are most commonly aimed at arbitration clauses. Still, some franchisees have challenged provisions in franchise agreements that fall outside the arbitration agreement itself. In a 2006 article presented at the ABA Annual Forum on Franchising,\textsuperscript{96} the authors identified several categories of challenges by franchisees that typically fail, including challenges based on the lack of a requirement that the franchisor repurchase inventory after termination,\textsuperscript{97} damages limitations provisions;\textsuperscript{98} forum selection

\textsuperscript{93} Id. at 410-11.


\textsuperscript{95} See IJL Dominicana S.A. v. It’s Just Lunch Int’l, LLC, CV08-5417-VAP, 2009 WL 305187 (C.D. Cal. Feb. 6, 2009) (declining to consider on defendant’s motion to compel arbitration whether provision contractually limiting statute of limitations for various claims to one year was unconscionable, explaining that the provision was “not before the [c]ourt because it appears outside the arbitration provision”).

\textsuperscript{96} Bethany Appleby, C. Griffith Towle, and Carmen D. Caruso, Unconscionability and Franchise Litigation, American Bar Association 29\textsuperscript{th} Annual Forum on Franchising, October 11-13, 2006.

\textsuperscript{97} See id. at 14 (citing W.L. May Co. v. Philco-Ford Corp., 543 P.2d 283 (Or. 1975)).

\textsuperscript{98} Id. at 14–15 (citing Bondy’s Ford, Inc. v. Sterling Truck Corp., 147 F. Supp. 2d 1283 (M.D. Ala. 2001) (punitive
clauses, releases of liability; choice of law clauses; jury waivers; provisions allowing termination without cause or termination at will; hour-of-operation requirements; cancellation clauses; covenants not to compete; and transfer approval requirements, among others. On the other hand, at least some franchisees have successfully challenged certain provision as unconscionable, including provisions requiring the payment of unreasonable liquidated damages on termination; provisions holding the franchisor harmless for its negligence; provisions permitting termination without sufficient notice or an opportunity to


101 Id. at 14 (citing Ticknor v. Choice Hotels Int’l, Inc., 265 F.3d 931 (9th Cir. 2001); Barker v. Golf U.S.A., Inc., 154 F.3d 788, 791 (8th Cir. 1998)).


104 Id. at 15 (citing Doebereiner v. Sohio Oil Co., 683 F. Supp. 791 (S.D. Fla. 1988), aff’d, 880 F.2d 329 (11th Cir. 1989), amended by 893 F.2d 1275 (11th Cir. 1990)).

105 Id. at 15 (citing Seagram Distillers Co. v. Alcoholic Beverages Control Comm’n, 519 N.E.2d 276 (Mass. 1988)).


107 Id. at 15 (citing James v. Whirlpool Corp., 806 F. Supp. 835 (E.D. Mo. 1992)).

108 Id. at 15 (citing Honey Dew Assocs., Inc. v. M & K Food Corp., 81 F. Supp. 2d 352 (D.R.I. 2000)).

109 Id. at 16 (citing Weaver v. Am. Oil Co., 276 N.E.2d 144 (Ind. 1971)).
cure;\textsuperscript{110} certain damages limitations and fee-shifting provisions;\textsuperscript{111} and other provisions that were unreasonably one-sided or unfair.\textsuperscript{112} In short, although not impossible, a franchise agreement provision must be manifestly unfair (or applied in an unreasonably oppressive manner) in order to support the defense of unconscionability.

B. Mandatory Mediation and Negotiation Clauses

1. Pros and Cons of Such Clauses

Mediation has been embraced by commercial parties as a valuable alternative dispute resolution process in virtually all types of disputes. Most parties to a business lawsuit will end up engaging in a mediation at some point during the case, either on the parties’ own initiative or based on an order of the court. Few lawyers or decision-makers for parties in litigation would seriously dispute the value of mediation as a settlement tool.

Recognizing the value of mediation, many franchise agreements now include a provision requiring mandatory mediation or at least direct party negotiation \textit{before} any party may bring a lawsuit. Examples of such agreement provisions that courts have enforced include:

- “Any issue, claim or dispute that may arise out of or in connection with this contract or the franchise relationship, and which [the parties] are not able to resolve themselves by negotiation, shall be submitted to mediation in a manner agreed to by [the parties]. [The parties] agree to use mediation to attempt to resolve such issue, claim or dispute prior to filing any lawsuits, complaints, charges or claims.”\textsuperscript{113}

- “We each agree to enter into mediation of all disputes involving this Agreement or any other aspect of this relationship, for a minimum of four (4) hours, prior to initiating any legal action or arbitration against the other.”\textsuperscript{114}

- “In the event of any dispute arising from this Agreement, the parties agree to submit the dispute to mediation in Virginia Beach, Virginia, prior to filing any action to enforce this Agreement.”\textsuperscript{115}

\textsuperscript{110} \textit{Id.} at 16 (citing Payless Car Rental Sys., Inc., v. Draayer, 716 P.2d 929 (Wash. Ct. App. 1986)).

\textsuperscript{111} \textit{Id.} at 16 (citing Ltd. v. Intl Mktg. Strategies, 403 F.3d 701 (6th Cir. 2005); Bob Schultz Motors, Inc. v. Kawasaki Motors Corp., 334 F.3d 721 (8th Cir. 2003)).


• “Except to the extent that the Company believes it is necessary to seek equitable relief as permitted in Section 20.1, or to recover royalties or other amounts owed to it by the Franchisee, the Company and the Franchisee each agree to enter into mediation of all disputes involving this Agreement or any other aspect of the relationship, for a minimum or four (4) hours, prior to initiating any legal action against the other.”116

• “In order to minimize the expense and difficulty of resolution of disputes related to this Agreement, the parties agree to use every reasonable effort to settle any dispute between them, relative to this Agreement, in the foregoing manner. Should any dispute concerning any aspect of this contract arise between the parties such disputes shall be settled first by conducting mediation. Either party shall give written notice to the other of the existence and subject of a dispute and its desire to commence dispute resolution proceedings. Mediation will be conducted by a mediator in Georgia to be mutually selected. The parties will share the costs of the mediator equally.”117

But while most all agree that mediation can be valuable, it is fair to ask the question when is it most effective to mediate. Mediation usually involves significant expense, including several thousand dollars for the mediator’s time, attorneys’ fees for counsel to prepare mediation statements and attend the mediation, as well as time and distraction for the parties’ decision-makers. Franchisors should think about the pros and cons of mandatory mediation rather than reflexively including such a requirement in their agreements.

The primary benefit of mandatory mediation is that it provides an opportunity to resolve a dispute at an early stage. Doing so saves significant money in attorneys’ fees and litigation expenses, which often run into the tens-of-thousands and can be in the hundreds-of-thousands of dollars. Resolving a dispute at the pre-litigation stage also avoids significant “soft” costs such as the time required for the parties’ witnesses to spend assisting counsel, giving depositions, participating in court proceedings, etc.

Another significant benefit to mandatory mediation is that it provides a mechanism for a franchisor to receive notice of a claim or situation creating significant dissatisfaction for a franchisee before that dispute blossoms into a lawsuit. With early notice, a franchisor can try to correct problem, explain why it has taken the challenged action, or otherwise try to address and defuse potentially explosive situation. Resolving a dispute prior to litigation also has the benefit of not requiring the franchisor to disclose a lawsuit in its Franchise Disclosure Document (“FDD”). Even if a lawsuit is settled shortly after filing, that lawsuit will live on in the FDD potentially provoking inquiries from prospective franchisees.

Finally, a mandatory mediation or negotiation clause can provide “cover” for the parties to negotiate early in a dispute without either side worrying about showing weakness. Some lawyers and parties feel that even suggesting mediation is a sign of weakness or less than full commitment to their position in a dispute. Having a contractual requirement to mediation or

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engage in direct negotiations before filing a lawsuit eliminates that perception, which can be conducive to real and effective negotiations.

There are some potential downsides, however, to requiring mediation before a lawsuit. First, at this stage the parties often have incomplete or imperfect knowledge of all the facts surrounding the dispute and the full basis for the other side’s position. This lack of knowledge can hinder the proper and effective evaluation of one’s own position or the position of the other side. Mediation is often more effective after the parties have engaged in some amount of discovery, including obtaining documents supporting claims and defenses and hearing the testimony of key witnesses. It is often hard to either credit an adversary’s position or modify one’s own position without having meaningful information to justify doing so. For all of the faults of the litigation process, it does a good job of giving the parties sufficient information to realistically evaluate their claims or defenses.

Another potential downside of early mediation is that an unsuccessful pre-lawsuit mediation can have the negative effect of hardening one or both parties’ positions, making it more difficult for the parties to seriously consider settlement for some period of time thereafter. From the franchisee’s perspective, the failure of the franchisor to recognize the legitimacy of the franchisee’s position and forcing the franchisee to incur the expense of litigation could be perceived as more of an affront than if the franchisor merely defended itself in litigation. From the franchisor’s perspective, a perceived unreasonable demand or irrational position taken by the franchisee in an early mediation might cause the franchisor’s decision-makers to take a hard line and try to “teach the franchisee a lesson” through hard-fought litigation.

Finally, sometimes decision-makers on each side simply are not ready to make the required mutual concessions to reach a settlement until they have been through some amount of battle. Maybe the franchisor thinks it will achieve a quick victory on a motion to dismiss, but later finds itself bogged down in expensive discovery. Maybe the franchisee has a sincere motivation to proceed to litigation, but later finds that it is too much of a financial drain. Either way, the reality of “litigation fatigue” can make the parties more amenable to settlement later in the process than they might be at the initial notice stage.

2. **Enforceability of Mandatory Mediation Provisions**

Enforcement of mandatory mediation or negotiations provision is purely a matter of contract law, as there is no special statute like the FAA applicable to mediation. If a party to a contract with a mandatory mediation provision files suit without first attempting to mediate, the opposing party may move to dismiss the lawsuit under several potential theories. The defendant could argue that filing a lawsuit without complying with the mandatory mediation provision is a breach of the contract. Also, to the extent the plaintiff alleges a breach of contract or a claim otherwise based on any contractual right, the defendant can argue that there has been a failure of a condition precedent which should preclude the plaintiffs from attempting to enforce the contract.\(^{118}\) In addition, at least one court has dismissed a lawsuit filed in violation of a pre-litigation mediation requirement for lack of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1).\(^{119}\)

\(^{118}\) See, e.g., Brosman v. Dry Cleaning Station, Inc., 2008 U.S. Dist. LEXIS 4467 (E.D. Cal. 2008).

\(^{119}\) See, Tattooart, Inc. v. TAT Int’l, LLC, 711 F.2d 645 (E.D. Va. 2010).
Other courts, however, have refused to enforce mandatory mediation clauses for various reasons. If the dispute resolution clause is ambiguous in any way, courts may seize on that ambiguity to refuse to enforce a procedure that a court believes is likely to be futile in any event. Further, courts have refused to enforce these provisions where the defendant likewise failed to comply with the pre-dispute mediation requirement, or waived such requirement by engaging in the litigation process itself. The decisions refusing to enforce mandatory mediation provisions seem to apply a practical notion that mediation is not likely to be successful or a valuable use of the parties’ time and expense when one party does not want to participate.

C. Class or Collective Action Waiver Clauses

One of the most hotly litigated issues in recent years has been the enforceability of class and collective action waivers contained in arbitration clauses in commercial and consumer contracts. Little is certain in the law, but recent United States Supreme Court decisions have made clear that class action waivers in arbitration agreements generally are enforceable under the FAA and will not render an arbitration clause unenforceable for unconscionability or other reasons. Indeed, Justice Scalia in *Concepcion* explained that “non-consensual class arbitration is antithetical to the fundamental attributes of arbitration under the FAA. Class arbitration sacrifices the principle advantage of arbitration – its informality – it makes the process slower, more costly, and more likely to generate procedure morass than final judgment.” Class arbitration also injects procedural formality absent from most bilateral arbitrations. More important, in the Court’s view, class arbitration greatly increases risks to defendants and is poorly suited to resolve the higher stakes of class litigation, particularly with no basis for effective review or appeal.

The Supreme Court has clearly held that there must be evidence that the parties consented to class or multi-party arbitration, and even silence on this issue may be deemed as a lack of consent. In *Stolt-Nielsen*, the Court considered whether an agreement to arbitrate all disputes that did not expressly waive class action procedures authorized class arbitration. In that case, the parties stipulated that they had not reached any agreement regarding class arbitration. Reasoning that the defendant could not be compelled to submit to class arbitration without some evidence that it agreed to do so, the Court held that the arbitrator had exceeded his authority by compelling class arbitration. It explained:

We think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties’ mere silence on the issue of class-action arbitration constitutes consent to

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121 See, e.g., *DVDPlay, Inc. v. DVD 123 LLC*, 930 So. 2d 816, 820 n. 2 (Fla. Dist. Ct. App. 2006) (finding that franchisee waived mediation clause because, although it originally requested that franchisor mediate the claims, it “never sought to judicially compel mediation, and instead it filed a lawsuit against [franchisor]”).

122 See discussion of *Stolt-Nielsen* and *American Express* cases in section II.A.1., above.

123 563 U.S. at __, 131 S. Ct. at 1743.

124 *Id.* at 1752.
resolve their disputes in class proceedings.125

Although the Stolt-Nielsen holding appears straightforward, the Court left room for the possibility that the parties’ agreement to arbitrate on a class wide basis could be implicit, rather than express. However, because the parties in Stolt-Nielsen stipulated that there was “no agreement” regarding class arbitration, the Court did not address when it might be appropriate to infer an implicit agreement to arbitrate claims on a class wide basis.

Based on this language, some lower courts have rejected the principle that an agreement to arbitrate on a class-wide basis must be explicitly set out in the arbitration agreement. Instead courts may apply standard rules of contract construction to determine whether the parties implicitly agreed to class arbitration. For example, in Fantastic Sams Franchise Corp. v. FSRO Association Ltd., the First Circuit explained:

The [Stolt-Nielsen] Court acknowledged that “[i]n certain contexts, it is appropriate to presume” that the parties “implicitly authorize[d]” class arbitration. . . . We thus reject the very different precept . . . that there must be express contractual language evincing the parties’ intent to permit class or collective arbitration.126

The Fantastic Sams court declined to compel individual arbitration and instead delegated the question of class arbitration to the arbitrator. Likewise, in Jock v. Sterling Jewelers, Inc. the Second Circuit held that “Stolt-Nielsen does not foreclose the possibility that parties may reach an implicit – rather than express – agreement to authorize class-action arbitration.”127 Several district courts have followed suit.128

It is unclear precisely what type of evidence may support a conclusion that the parties reached an implicit agreement to authorize class arbitration. In Fantastic Sams, however, the Court provided the following examples in dicta:

For example, additional evidence could reveal that the later change in language [which added a class waiver] reflects a conscious choice by the parties to exclude some forms of arbitration, available prior to 1988, after that date. . . . In addition, there may be other evidence of intent presented to arbitrators, such as industry practice.129

125 Stolt Nielson, 559 U.S. at 687.
126 Fantastic Sams Franchise Corp. v. FSRO Ass’n Ltd., 683 F.3d 18 (1st Cir. 2012).
128 See, e.g., Smith v. Cheesecake Factory Restaurants, Inc., 3:06-CV-00829, 2013 WL 494090 (M.D. Tenn. Feb. 8, 2013) (“Thus, Stolt–Nielsen does not require express contractual language authorizing collective arbitration. Courts have held to that effect.”); Rame, LLC v. Popovich, 878 F. Supp. 2d 439, 449 (S.D.N.Y. 2012) (“Without such an agreement as to the parties’ intent, and ‘where that agreement contains what is argued to be an implicit agreement to submit to class arbitration,’ the Arbitrator was free to ‘look to state law principles of contract interpretation in order to divine whether such intent exists.’”); S. Commc’ns Servs., Inc. v. Thomas, 829 F. Supp. 2d 1324, 1339 (N.D. Ga. 2011) aff’d, 720 F.3d 1352 (11th Cir. 2013) (“Therefore, the arbitrator clearly had the power to determine whether the parties implicitly authorized class arbitration under applicable contract law principles.”).
129 Fantastic Sams, 683 F.3d at 23.
Circuit court cases reviewing arbitrator decisions also provide guidance on what evidence an arbitrator might look to in determining whether the parties implicating agreed to arbitrate on a class-wide basis exists. For example, in *Sutter v. Oxford Health Plans, LLC*, the Third Circuit summarized the arbitrator’s reasons for deciding that the arbitration agreement permitted class arbitration as follows:

Framing the question as one of contract construction, the arbitrator turned first to the text of the arbitration clause . . . [and] determined that the clause's first phrase, “No civil action concerning any dispute arising under this Agreement shall be instituted before any court,” embraces all conceivable court actions, including class actions. Because the clause's second phrase sends “all such disputes” to arbitration, he reasoned that class disputes must also be arbitrated. Thus, the arbitrator concluded that the clause expressed the parties' intent to authorize class arbitration “on its face.”

Likewise, in *Jock v. Sterling Jewelers*, the Second Circuit offered the following analysis of the arbitrator’s decision to permit class arbitration:

Based on the language of the agreement, to deny the plaintiffs the right to seek class wide relief would deny them access to at least one type of legal or equitable relief available to them in court—namely, certification to pursue class wide relief. That result would be contrary to the promise of the [arbitration agreement], which states that by signing the agreement the employee is waiving any right to seek relief through any government agency or court, but that she “may, however, seek and be awarded equal remedy through the [arbitration] program” and that the arbitrator has the “power to award any types of legal or equitable relief that would be available in a court of competent jurisdiction.”

A more open question is whether class or collective action waiver clauses are enforceable in litigation versus arbitration. There is relatively little case law on this issue outside the arbitration context, but two of the leading cases are franchise actions involving the Quizno’s system. In *Bonanno v. Quizno’s Franchise Co.*, a group of Quizno’s franchisees sought class action treatment for their claims that the franchisor and related parties misled franchisees with promises of exclusive market areas and expert real estate location assistance for their restaurants. Quizno’s opposed class certification based, in part, on the following franchise agreement language:

The parties agree that any proceeding will be conducted on an individual, not a class-wide basis, and that any proceeding between Franchisor and Franchisee or the Bound Parties may not be consolidated with another proceeding between franchisor or any other entity or person.

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132 *Id.* at 126 (internal citations omitted).

133 2009 WL 1068744 (D. Colo. Apr. 20, 2009). (Justin M. Klein, Esq. and Marks & Klein, LLP, co-author of this article, represented the plaintiff franchisees in this matter.)
In a 53-page decision, the federal court for the District of Colorado enforced the class action waiver provision and denied class certification. The court began with the discussion of the history of Federal Rule of Civil Procedure 23, and concluded that the rule was a procedural tool rather than a substantive right. The court held that a lesser level of scrutiny applied to an agreement to waive a procedural option, as compared to the higher scrutiny that would apply to an agreement to waive a substantive right such as the right to a jury trial. The court rejected the franchisee plaintiffs’ argument that the class action bar was unenforceable on an unconscionability theory, applying a multi-factor test under Colorado state law. Most important, according to the court, was its determination that the class action bar was not substantively unfair because the plaintiffs failed to show that the cost of proceeding with individual lawsuits was prohibitively expensive. The Colorado district court also rejected the plaintiffs’ argument that Quizno’s greater bargaining power should render the class action bar unconscionable. Finally, the court raised “its own concern with the bar, namely whether such a clause improperly intrudes upon the Court’s ability to manage its cases pursuant to the Federal Rules of Civil Procedure.” Noting that a court cannot invoke the Rule 23 procedure on its own initiative without a request from one of the parties, the Bonanno court concluded that there is nothing compulsory or jurisdictional about the class action rule that should prevent the court from applying an otherwise enforceable provision of the parties’ agreement.

Less than two months later, however, a Pennsylvania federal court reached the opposite conclusion on the enforceability of the same franchise agreement language in Martrano v. Quizno’s Franchise Co. The Martrano court framed the question as whether giving effect to the class action waiver would comport with the language and purpose of the Federal Rules of Civil Procedure. It answered that question in the negative, holding that “under Rule 23 and 42, the ultimate governing standard is efficient judicial administration, which leaves no room for enforceability of private agreements among litigants to forego the efficiencies potentially afforded by consolidated or class adjudications.” The court explained that enforcing the agreement would potentially force courts to hold separate trials of dozens, hundreds or even thousands of cases involving extensively overlapping issues, a result that would be “flatly inconsistent with the Federal Rules which should be construed to “secure just, speedy and inexpensive determination of every action.”

One might question whether the Martrano court’s analysis is undercut by the Supreme Court’s recent Atlantic Marine decision, where the Court gave great weight to the parties’ freedom to contract in enforcing a forum selection clause. While that analysis might provide additional fodder for a franchisor’s argument to enforce a class action waiver in federal court litigation, enforceability in litigation remains a far more risky bet than enforcement of a class

134 The court distinguished prior antitrust cases cited by the plaintiffs because litigation in those cases would have been highly complex and much more expensive relative to the small amounts in controversy in those cases. Such an argument is further undermined by the Supreme Court’s recent decision in American Express Co. v. Italian Colors Restaurant, 570 U.S. __, 133 S. Ct. 2504 (2013), which specifically rejected this “cost of vindicating rights” argument has a basis not to apply a class action waiver provision.

135 2009 WL 1068744 at *23.


137 Id. at *21.

138 See discussion in section III.B.2., below.
III. WHICH COURT AND WHICH LAW—JURISDICTION, VENUE AND CHOICE OF LAW

It is common, if not standard, for franchise agreements to contain forum selection clauses that require disputes to be resolved in the state or federal district in which the franchisor is headquartered or has its principal place of business. The reasoning behind the drafting and inclusion of such clauses is obvious—they provide a franchisor with the convenience and potential advantage of litigating in its own chosen forum, where the franchisor is generally most familiar with that jurisdiction’s franchise-specific laws as well as the general disposition of the chosen courts.

A franchisor’s interest in such “home field advantage” is obvious in light of the potential expense of travelling or the risk of litigating in a franchisee’s home state. Given the importance to any party of litigating in a familiar and friendly forum, the careful drafting of these clauses—as either a consent to jurisdiction provision, or mandatory or permissive forum selection clause—is critical to the enforceability of the provision, especially in the context of franchise litigation, as a particular venue or jurisdiction may substantially impact or even determine the outcome of the lawsuit.

A. Consent to Jurisdiction Clauses

Certain contractual provisions are construed by courts as consents to exclusive jurisdiction rather than as forum selection clauses. Such conferrals of exclusive jurisdiction have been specifically recognized as including consents to personal jurisdiction.

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139 The Supreme Court’s oft-cited decision in Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985), serves as a benchmark decision endorsing a franchisor’s ability to bring suit against an out-of-state franchisee in the franchisor’s home state. The Supreme Court in Rudzewicz upheld the franchisee’s obligation to litigate in the franchisor’s home state of Florida based upon the “minimum contacts” the franchisee established with the chosen forum by and through the parties’ long-term franchise relationship. In that instance, such “home field advantage” rendered the Michigan franchisee’s protections against termination under the Michigan Franchise Investment Law inapplicable, as the parties had also agreed that Florida law would govern any dispute.

140 Luca v. Edelstein, 802 F.2d 49, 57 & n.4 (2d Cir. 1986) (parties consented to jurisdiction of Supreme Court of New York, New York County, where clause in contract signed by the parties provided, in pertinent part, “[t]he parties hereby confer exclusive jurisdiction in any . . . action or proceeding [brought by a party hereto against any other party and arising out of this Agreement or any breach thereof] upon the Supreme Court of the State of New York, County of New York”).

141 See, e.g., Orix Fin. Servs., Inc. v. Barnes, 05-CV-9665, 2007 WL 2825881, at *3 (S.D.N.Y. Sept. 28, 2007) (language in contract granting “exclusive jurisdiction and venue of courts located in the State and County of New York” conferred upon the Court personal jurisdiction over defendants); Atlantic Mut. Ins. Co. v. M/V HUMACAO, 169 F. Supp. 2d 211, 214-15 (S.D.N.Y. 2001) (language in contract agreeing to “the exclusive jurisdiction of the U.S. District Court, Southern District of New York, over all legal actions and disputes involving the terms and conditions of this Agreement” constituted consent to personal jurisdiction of that court, which was enforceable “without the need to engage in traditional personal jurisdiction analysis”); cf. Int’l Private Satellite Partners, L.P. v. Lucky Cat Ltd., 975 F. Supp. 483, 485-86 (W.D.N.Y. 1997) (defendant consented to personal jurisdiction of New York where each of four contracts at issue provided, inter alia, that “the parties hereby irrevocably submit to the jurisdiction and venue in the State of New York in connection with any action to enforce or interpret this Agreement”).
In *Pritchett v. Gold’s Gym*, the United States Court of Appeals for the Fifth Circuit strictly construed a contractual provision in the Gold’s Gym franchise agreement as consent to jurisdiction, and determined that the provision and associated consent extended not only to the franchisee, but also to its owners/guarantors. The subject provision in *Pritchett* was entitled, “Consent to Jurisdiction” and stated, in pertinent part:

8. Consent to Jurisdiction. Subject to our and your arbitration obligations in Subsection O.6, you and your Owners agree that all judicial actions brought by us against you or your owners must be brought exclusively in the state courts in Dallas County, Texas or the United States District Court for the Northern District of Texas, Dallas Division. The courts specified in the Subsection O.8 shall have exclusive jurisdiction over all disputes and venue shall lie in Dallas County/Dallas Division, and shall be determined according to Texas law, without regard to the jurisdictional, venue or choice of law provisions of any state or territory other than Texas. You (and each Owner) irrevocably submit to the jurisdiction of such courts and waive any objection you, he or she may have to either jurisdiction or venue.

The court in *Pritchett* enforced the provision and required the franchisee, and its owner/guarantors, to litigate in state or federal court in Texas.

Also illustrative of the manner in which federal courts interpret and enforce “consent to jurisdiction” clauses was the court’s decision in *Rescuecom Corp. v. Chumley*, the court determined that the following provision conferred exclusive jurisdiction on the state or federal courts of New York:

Franchisee acknowledges that this Agreement is entered into in Onondaga County, New York, and that the exclusive jurisdiction . . . for any action sought to be brought by either party, except those claims required to be submitted to arbitration, . . . [is] the appropriate state or federal court sitting in Onondaga County, New York.[143]

Even where a court would not have jurisdiction over a party based on a minimum contacts analysis, it would have personal jurisdiction over the defendants pursuant to the express terms of the franchise agreement signed by the parties. In the analysis and interpretation of a prior version of the plaintiff’s forum selection clause, the Northern District of New York determined a “consent to jurisdiction” existed even though the clause did not explicitly confer exclusive jurisdiction on the New York courts. Conferrals of exclusive jurisdiction, as seen in *Chumley*, have been specifically recognized as including consents to personal jurisdiction.[146]

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144 *Id.* at 442-443.

145 *See Rescuecom Corp. v. Hyams*, 477 F. Supp. 2d 522, 532-33 (N.D.N.Y. 2006) (interpreting prior version of clause, which read, “Franchisee acknowledges that this Agreement is entered into in Onondaga County, New York, and that the venue for any action sought to be brought be either party . . . shall be . . . the appropriate state or federal court sitting in Onondaga County, New York, with jurisdiction over the matter”).

Courts have also determined that obligations pursuant to consent to jurisdiction provisions are transferrable. For instance, in *H-D Michigan, LLC v. Hellenic Duty Free Shops S.A.*, the United States Court of Appeals for the Seventh Circuit held that such provisions are transferred with the explicit or implicit assumption of a contract, particularly as part of a merger.\(^{147}\) However, if a merger does not include the assumption of the contract and its provisions, the clause is not necessarily binding.\(^{148}\)

### B. Venue and Forum Selection Clauses

As set forth by the United States Supreme Court in the leading case of *M/S Bremen v. Zapata Off Shore Co.*, forum-selection clauses “are *prima facie* valid and should be enforced unless enforcement is shown by the resisting party to be ‘unreasonable’ under the circumstances.”\(^{149}\) As such, the party opposing enforcement of a forum-selection clause carries a “heavy burden” of showing the clause should not be enforced.\(^{150}\)

The enforceability of a venue or forum selection clause is based upon a four-part test: The first inquiry is whether the clause was reasonably communicated to the party resisting enforcement. The second step requires the court to classify the clause as either mandatory or permissive, (i.e., to decide whether the parties are required to bring any dispute to the designated forum or simply permitted to do so.) The third part of the test requires the court to determine whether the claims and parties involved in the suit are subject to the forum selection clause.\(^{151}\) If the forum selection clause was (1) communicated to the resisting party, (2) has mandatory force and (3) covers the claims and parties involved in the dispute, it is presumptively enforceable. The fourth, and final, step is to ascertain whether the resisting party has rebutted the presumption of enforceability by making a sufficiently strong showing that “enforcement would be unreasonable or unjust, or that the clause was invalid for such reasons as fraud or overreaching.”\(^{152}\)

#### 1. Mandatory v. Permissive Venue Clauses

Venue and forum selection clauses may be drafted as permissive or mandatory. Where

\(^{147}\) *H-D Michigan, LLC v. Hellenic Duty Free Shops S.A.*, 694 F.3d 827, 830 (7th Cir. 2012).

\(^{148}\) *Id.* (The plaintiff entered into an international licensing agreement with Elmec Sport, S.A., a subsidiary of the defendant. Elmec then merged with the defendant and assumed all contracts. There was a clause as part of the agreement that gave exclusive jurisdiction over all disputes arising from or relating to the agreement to state and federal courts in Wisconsin, and consented to personal jurisdiction in the state with respect to disputes between the parties of the agreement.)

\(^{149}\) *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10 (1972) (noting however that a contractual forum selection clause is “unenforceable if enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or judicial decision”).

\(^{150}\) *Id.* at 17, 19.

\(^{151}\) *Id.* at 15.

\(^{152}\) *Phillips v. Audio Active Ltd.*, 494 F.3d 378, 383-84 (2d Cir. 2007) (quoting *Bremen*, 407 U.S. at 15).
a provision is deemed mandatory, the same is also deemed to constitute a waiver of any challenge to the jurisdiction of the selected forum. Such a waiver is generally expressly stated in the language of the provision.153

In *Global Seafood Inc. v. Bantry Bay Mussels Ltd.*, the Second Circuit provided a succinct explanation of the distinction between a mandatory and permissive venue clause. It held that the forum-selection clause at issue was permissive because it contained no specific language of exclusion evidencing intent by the parties to an exclusive jurisdiction or identifying an obligatory venue for the parties’ disputes.154 The court held that a permissive forum-selection clause allows for litigation in more than one forum, whereas a mandatory forum-selection clause requires a specific forum.

When drafting a forum selection clause, word choice and the particular language used is critical, and the language should make clear that the provision is either permissive or mandatory. For a forum selection clause to be exclusive, “it must go beyond establishing that a particular forum will have jurisdiction and must clearly demonstrate the parties’ intent to make that jurisdiction exclusive.”155

Certain courts have held that when analyzing a transfer under 28 U.S.C. §1404, a permissive clause is entitled to less weight than a mandatory forum selection clause. Other courts have held that the permissive nature of the clause does not affect its weight.156

Given the obvious advantages that forum selection clauses may confer on a franchisor, franchisees often have an incentive to litigate aggressively to avoid the perceived strictures of such clauses. The Ninth Circuit’s decision in *Jones v. GNC Franchising, Inc.* 211 F.3d. 495 (9th Cir. 2000), is a landmark decision in this regard. In *Jones*, the parties had entered into two franchise agreements, each of which contained a choice of law provision requiring that any dispute be “interpreted and construed under the laws of the Commonwealth of Pennsylvania” and also contained a forum selection clause providing that any action must be instituted in state or federal court in Pennsylvania.

The Ninth Circuit, applying California law, refused to enforce the forum selection clause based upon the anti-waiver provisions contained in the California Business and Professional Code voiding any such provision.157 Conversely, in *S.K.I. Beer Corp. v. Baltika Brewery*,158 the

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154 659 F.3d 221, 222 (2d Cir. 2011).


157 Section 20040.5 provides that “[a] provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state.”

158 612 F.3d 705 (2d Cir. 2010) (upholding district court dismissal of plaintiff beer wholesale/exclusive brand agent’s
Second Circuit refused to set aside a mandatory forum selection clause requiring that any action against a beer wholesaler be brought only in the State of New York. The court specifically noted that, unlike the California statute in *Jones*, the statute at issue in that case did not contain any “anti-waiver” language rendering a venue provision requiring litigation in another forum void.\(^{159}\)

Drafters of forum selection clauses should be mindful of the distinction between a mandatory and permissive clause, if the intent is to designate an exclusive forum. For example, the provision should state that the forum is the “exclusive” forum and should avoid using passive words like “may” as opposed to “shall.” Additionally, all parties should acknowledge that they will not contest the exclusive jurisdiction. For drafting purposes, a mandatory forum selection clause may include the following:

- The parties hereby expressly agree that the United States District Court for District of New Jersey, or if such court lacks subject matter jurisdiction, the State Superior Court in Middlesex County, New Jersey, shall be the exclusive venue and exclusive proper forum in which to adjudicate any case or controversy arising out of or related to, either directly or indirectly, this Agreement, ancillary agreements, or the business relationship between the parties;

- The parties further agree that, in the event of such litigation, they will not contest or challenge the jurisdiction or venue of these courts.

2. *Atlantic Marine’s Impact on Traditional 1404(a) Transfer Analysis*

Pursuant to 28 U.S.C. § 1404(a), a federal district court may transfer a case to another district. When considering a motion to transfer venue, a court is statutorily required to balance three factors: (1) convenience of parties, (2) convenience of witnesses, and (3) the interests of justice.\(^{160}\) In keeping with the “flexible and multifaceted analysis that Congress intended to govern motions to transfer within the federal system,”\(^{161}\) evaluation of a transfer motion is not limited to just these three factors, rather “such determinations require a case-by-case evaluation of the particular circumstances at hand and a consideration of all relevant factors.”\(^{162}\)

The United States Supreme Court in *Atlantic Marine Const. Co. v. U.S. Dist. Court for W. Dist. Of Texas* changed the analysis for a transfer of venue motion based on the existence of a contractual forum selection clause.\(^{163}\) Specifically, the Court held that “when the parties have agreed to a valid forum selection clause, a district court should ordinarily transfer the case to the

\(^{159}\) While N.Y. Alco. Bev. Cont. Law 55-c indicates that it is a requirement that a beer wholesaler has a non-waiveable option to maintain a civil action within the state of New York; it does not preclude an action from being brought outside the jurisdiction.


\(^{162}\) *Terra Int’l, Inc. v. Mississippi Chemical Corp.*, 119 F.3d 688, 691 (8th Cir. 1997).

forum specified in that clause rather than “evaluate the convenience of the parties and various public interest considerations” as would be done in a “typical case not involving a forum-selection clause.” Readers are encouraged to review the materials for workshop W-4 of this year’s Forum dealing with the Supreme Court’s ruling in Atlantic Marine for more detailed information regarding this decision.

Despite the perceived wide-ranging impact of the Atlantic Marine decision, in Frango Grille USA v. Pepe’s Franchising Ltd., a federal court in California eschewed the Atlantic Marine analysis in favor of the classic M/S Bremen analysis and found that the extra-jurisdictional forum selection clause contained in the parties’ franchise agreement was invalid and unenforceable. Notwithstanding the Supreme Court’s holding in Atlantic Marine that any “valid forum selection” clause should be enforced, the court in Frango nevertheless invoked the California Franchise Relations Act to rule that the franchisor’s contractual venue provision was invalid and unenforceable on its face because it violated California’s strong public policy against extra-jurisdictional forum selection clauses. As a result, the franchisee was permitted to litigate against Pepe’s in the Central District of California rather than London, England, the contractually required venue. The court in Frango cited to -- and mirrored -- the reasoning in two other recent post-Atlantic Marine California federal court decisions. Notably, the recent trend in California federal courts seems to be at odds with courts in other jurisdictions that have fully embraced and applied the United States Supreme Court’s ruling in Atlantic Marine when analyzing challenges to the validity of forum selection clauses.

3. Impact of First-to-File Rule and Other Bases for Challenge

The first-to-file rule is “[a] generally recognized doctrine of federal comity which permits a district court to decline jurisdiction over an action when a complaint involving the same parties and issues has already been filed in another district.” Under the rule, when cases involving the same parties and issues have been filed in two different districts, the second district court may (but is not required to) transfer, stay, or dismiss the second case if it would further the interests of judicial economy and avoid duplicative litigation.

164 Id. at 581.


170 Id. at 1097; see also Saes Getters S.P.A. v. Aeronex, Inc., 219 F. Supp. 2d 1081, 1089 (S.D. Cal. 2002) (“Where
Courts generally consider three factors when determining whether to apply the first-to-file rule: (1) chronology of the two actions, (2) similarity of the parties, and (3) similarity of the issues.171 Notably, the first-to-file analysis differs among the circuits. For instance, the Second Circuit applies a different and comparatively more relaxed test than the Ninth Circuit test for determining whether to transfer or stay a second-filed action.172 The rule is not rigidly applied in every circumstance, and judges are vested with discretion to dispense with the rule for reasons of equity.173

Several cases in recent years have applied the first-to-file rule in the franchise context, particularly involving the enforcement of a forum selection clause. For instance, in Pressdough v. Bismarck, LLC v. A&W Restaurants, Inc., a federal court in North Dakota dismissed a second-filed action against a franchisor because there was already pending litigation between the same parties in Kentucky.174 The parties' contracts designated North Dakota as an appropriate venue, but those provisions were not mandatory. Conversely, other contracts between the parties did contain mandatory provisions requiring that the parties litigate in Kentucky. The court applied the “first-to-file” rule and required that the parties litigate the entire dispute in Kentucky.175

More recently, in Basalite Concrete Products, LLC v. Keystone Retaining Wall Systems, Inc., a federal court in California transferred a second-filed action to the District of Minnesota based upon: (1) the existence of a forum selection clause in the parties' agreement designating Minnesota as the appropriate mandatory forum, (2) a related action between substantially similar parties had been filed in Minnesota 19 days before the California action, and (3) the issues being litigated in both matters were substantially similar.176 Notably, the court rejected the plaintiff's argument that California's public policy requires litigation involving California franchises to occur in California in all circumstances, and it held that any such public policy

171 See Alltrade, Inc. v. Uniweld Products, Inc., 946 F.2d 622, 625 (9th Cir. 1991).

172 See Ontel Prods., Inc. v. Project Strategies Corp., 899 F. Supp. 1144, 1153-55 (S.D.N.Y. 1995) (holding that the chronology of filing is not a dispositive factor and instead adopting the same analysis as a motion to transfer pursuant to 28 U.S.C. § 1404(a)); Factors Etc., Inc. v. Pro Arts, Inc., 579 F.2d 215, 219 (2d Cir. 1978) (“The rule in this circuit is that the first suit should have priority, ‘absent the showing of balance of convenience in favor of the second action . . . or unless there are special circumstances which justify giving priority to the second.’”) (citations omitted).

173 Alltrade, 946 F.2d at 628; see also Pacesetter Systems, Inc., 678 F.2d at 95. (“[The] ‘first-to-file’ rule is not a rigid or inflexible rule to be mechanically applied, but rather is to be applied with a view to the dictates of sound judicial administration.”); Kerotest Mfg. Co. v. C-O-Two Fire Equipment Co., 342 U.S. 180, 183-84 (1952) (“Wise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation, does not counsel rigid mechanical solution of such problems.”). The circumstances warranting an exception to the rule based upon equitable considerations include bad faith, anticipatory suit, and forum shopping. Alltrade, 946 F.2d at 627-28.


175 Id.

considerations do not require a California court to ignore the “first-to-file” rule.177

Notwithstanding these decisions, as evidenced by the converse decision in Megadance USA Corp. v. Knipp, federal courts are not universally willing to ignore contractual choice of law provisions on the basis of the first to file rule and where a franchisee engages in a race to the courthouse in order to avoid a franchisor’s anticipated filing in the chosen forum.178


Despite the holding in M/S Bremen that forum selection clauses are presumptively enforceable, the analysis becomes more complex in the franchise context when such provisions contravene anti-waiver language contained in an applicable state franchise statute. Approximately twenty states, including California, Connecticut, Florida, Idaho, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, New Jersey and New York, North Carolina, North Dakota, Rhode Island, South Dakota, Texas, Washington and Wisconsin, have franchise statutes containing anti-waiver provisions which, in certain instances, court relied on to void otherwise enforceable forum selection clauses.

New Jersey courts, like several other states, have held that franchise agreement provisions providing for out-of-state arbitrations are enforceable.179 In a leading case, the New Jersey Supreme Court in Kubis & Perszyk Assocs. v. Sun Microsystems, held that a forum selection clause in franchise agreements is presumptively invalid and should not be enforced.180

In accord with Kubis, state and federal courts in other jurisdictions have also determined that state-specific franchise statutes void a contractual forum selection clause requiring litigation in another jurisdiction. For instance, in Phoenix Surgicalcs, LLC v. Blackstone Med., Inc., the court relied on the public policy of the state of Connecticut as expressed by the anti-waiver provision of the Connecticut Franchise Act (“CFA”)181 in refusing to enforce an out-of-state forum-selection clause in a franchise agreement.182

More recently, the Northern District of Illinois in Sojka v. DirectBuy, Inc., determined that Illinois and California law invalidated the franchise agreements’ forum selection clauses.183

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177 Id. at *13 (“Even if California’s public policy extends to application of the first-to-file rule, California’s public policy is only one consideration of many in applying that rule.”).


179 However, New Jersey courts (as in other states) have distinguished arbitration provisions from other forum selection clauses under the rationale that the Federal Arbitration Act preempts state franchise laws. This legislation would effectively negate the rationale applied by the Allen court, as well as other courts throughout the country. See, e.g., Allen v. World Inspection Network, Int’l, Inc., 911 A.2d 484 (N.J. Super. Ct. App. Div. 2006).


181 CONN. GEN. STAT. ANN. § 42-133e(b) (West 2000).


However, despite the existence of such anti-waiver provisions in various states, the same are not uniformly applied to void the forum selection clause contained in franchise agreements.\textsuperscript{184} For instance, in \textit{Luv2bit, Inc. v. Curves Int'l, Inc.},\textsuperscript{185} a federal court in New York held, after careful consideration of the parties' arguments and a review of the NYFSA itself that the anti-waiver provision of the NYFSA does not override its policy of enforcing forum selection clauses.

When crafting forum selection clauses, practitioners should also note that, as seen in the recent \textit{Basalite} decision, statutory anti-waiver provisions and related state public policy considerations may not always defeat a forum selection clause contained in the franchise agreement. Moreover, a recent decision from the United States District Court for the Central District of California suggests that the anti-waiver provision of California Franchise Relations Act (CFRA) will not apply to all agreements between a franchisor and franchisee. In \textit{Musavi v. Burger King Corp.}, plaintiffs were the owners of four Burger King franchises in California.\textsuperscript{186} In January 2013, Burger King terminated the franchises for a variety of alleged defaults and breaches. The parties then entered into Limited License Agreement (LLA) which provided a right to operate through May 2013 so that they could either shut down or attempt to sell their franchises. The plaintiffs were unable to sell or refused to shut down; instead they brought suit against Burger King in California. Burger King countersued in Florida and moved to transfer the California lawsuit to Florida.

The California court considered and rejected the former franchisees' argument that the anti-waiver provision in the CRFA voided the out-of-state forum selection clause in the LLA. The court acknowledged the existing precedent under the CFRA as applied to franchise agreements, but nonetheless chose to transfer the matter on the basis that the LLA was not a franchise agreement as defined in the CFRA. Practitioners should note the recent decision in \textit{Musavi} as it highlights a court's distinction, in those unique factual circumstances, between a franchise agreement and another agreement between franchisor and franchisee that is not technically a franchise agreement in connection with the enforcement of a forum selection clause and the interaction of such clauses with an anti-waiver provision in a state franchise statute.

C. Choice of Law Clauses


The enforceability of choice of law provisions in franchise and dealer agreements is frequently litigated. As a general proposition, courts follow the framework established in the Restatement (Second) Conflicts of Laws under which choice of law provisions are presumptively

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\textsuperscript{185} 06-CV-15415, 2008 WL 4443961 (S.D.N.Y. Sept. 29, 2008).

\textsuperscript{186} \textit{Musavi v. Burger King Corp.}, 2013 U.S. Dist. LEXIS 154467 (C.D. Cal. October 25, 2013).
Choice of law provisions are generally upheld if reasonably related to the transaction, and the chosen law is not contrary to the fundamental policy of the forum. While choice of law provisions have the incidental effect of preventing one party from gaining access to the laws of excluded jurisdictions, courts have held that contractually selecting a forum for future litigation “is not an impermissible waiver of rights and does not violate public policy.”

In the absence of a choice of law provision in a contract, the law of the state with “the most significant relationship to the transaction and the parties” controls. In determining which state has the most significant relationship the following factors should be considered:

a) the place of contracting,
b) the place of negotiation of the contract,
c) the place of performance,
d) the location of the subject matter of the contract, and
e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

Many states, including California, Ohio, Pennsylvania, Washington and Texas, follow the rules set out in section 187 of the Restatement and will enforce the parties’ choice-of-law clause, unless either:

1. the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice; or
2. application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state.

Other states, like New York, follow the more limited “substantial relationship” approach, or variations thereof, which essentially omit the Restatement’s language “no other reasonable

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187 Allen v. Lloyd’s of London, 94 F.3d 923, 928 (4th Cir. 1996) (citing M/S Bremen, supra, and holding that the United States Supreme Court has consistently accorded choice of forum and choice of law provisions presumptive validity).


190 Restatement (Second) of Conflict of Laws § 188(1).

191 Restatement (Second) of Conflict of Laws § 188(2).

basis for the parties’ choice” from the first prong of section 187. This approach allows a court to
disregard the parties’ choice, even if they had a reasonable basis for it, if the “most significant
contacts” are with another state.193

Under the more expansive approach adopting the entirety of section 187, many courts
have recognized that multi-state franchising itself satisfies the reasonable basis element of the
test’s first prong, since it is objectively reasonable for franchisors to pick one state’s law to apply
to all of their agreements.194

When drafting a choice of law provision, the drafter should be mindful of the elements
courts will look to in determining the enforceability of such provisions. If accurate, the drafter
should consider including specific acknowledgments as to the facts surrounding the execution
and performance of the agreement, such as:

- The Parties acknowledge that the Agreement was negotiated and entered into in
  the State of New York;
- The Parties agree that the performance of the obligations of this Agreement shall
take place substantially in the State of New York.

2. Impact of State Franchise Laws

When choice-of-law provisions conflict with state-specific franchise laws, the analysis
generally involves the second prong of the Restatement’s test for enforceability, that is, whether
applying the chosen law would offend a state’s fundamental public policy. This analysis is
important in the franchise context because many state franchise statutes include anti-waiver
provisions.195 For example, in the matter 1-800-Got Junk? LLC v. Superior Court, the California
Appellate Court confronted this issue but declined to interpret section 20010 of the CFRA to
invalidate a choice of law provision. Here, rather than undermining the franchisee’s protections
under the statute, the Washington choice of law provision actually enhanced the franchisees
protections and was therefore deemed enforceable.

With respect to the interplay between the Restatement Section 187 analysis and the
competing policies of potentially applicable state laws pertaining to franchisees, it is notable that
the United States District Court for the Southern District of Ohio, has three times voided an Ohio
choice of law provision contained in a franchise or license agreement. In these cases, courts
have held that where the choice of law clause conflicts with a fundamental public policy of the

193 Walter E. Heller & Co. v. Video Innovations, Inc., 730 F.2d 50, 52 (2d Cir. 1984); see also Manion v. Roadway
will be given effect, subject to two limitations: 1) there must be a sufficient relationship between the chosen forum, the
parties, or the transaction; and 2) it must not offend Illinois public policy”).

194 See 1-800-Got Junk? LLC v. Superior Court, 189 Cal. App. 4th 500, 514 (2010) (“[c]ase law has recognized it is
reasonable for a franchisor to designate a single state’s law to apply to all of its franchise agreements”); see also
1983).

195 See e.g., Cal. Bus. & Prof. Code § 20010; Cal. Corp. Code § 31512; Mich. Comp. Laws § 445.1527(b); Iowa Code
state in which the franchisee or licensee was operating, which in each instance had a fundamentally greater interest in the subject dispute and in protecting the interests of the franchisee/licensee, the choice of law provision applying a different state’s law should not be enforced.196

Most recently, in *Lifestyle Improvement Ctrs., LLC v. East Bay Health, et al.*, the Southern District of Ohio followed its prior decisions in the franchise context in *Clark* and *Ball*, and again determined that despite the inclusion of an Ohio choice of law provision in the parties’ franchise agreement, California law should apply to determine the validity of a non-competition provision also contained in the parties’ franchise agreement. The court determined that California had a materially greater interest in the dispute and that its policy precluding enforcement of non-competition agreements (except in the narrowest circumstances) would be subverted by enforcing the Ohio choice of law provision.197 Conversely, a federal court in Texas applied a similar choice of law analysis but reached a different result in determining that a contractual provision applying California law to the parties’ franchise dispute did not violate Texas’ public policy merely because it deprived the plaintiff franchisees of their right to bring claims under Texas consumer protection law.198

**D. Waiver of Jury Trial**

Franchisors often include a contract provision waiving the parties’ right to a jury trial if they choose litigation over arbitration. A jury waiver has particular value to a franchisor in situations where the facts and circumstances surrounding the parties’ dispute might inflame the sympathies or passions of a jury of a franchisee’s peers, such as where a franchisee has lost his life’s savings, the franchised business is franchisee’s sole livelihood, or the franchisee’s default was caused by unfortunate change in circumstances. Where courts deem that parties have assented to such provisions knowingly and voluntarily and that the entry into the provisions was not the product of duress or coercion, federal courts throughout the United States have readily enforced such provisions in the franchise context.199

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196 See Power Marketing Direct, Inc. v. Clark, 2006 U.S. Dist. LEXIS 63582 (S.D. Ohio Sept. 6, 2006) (Southern District applied § 187 of the Restatement and found that the State of Texas had materially greater interest in parties’ dispute over license agreement); Power Marketing Direct, Inc. v. Bryce Ball, 2004 U.S. Dist. LEXIS 30016 (S.D. Ohio June 28, 2004)(Southern District interpreting same license agreement as to a California licensee and concluding that California had materially greater interest in agreement). Thus, California law should apply to determine whether the subject restrictive covenants are indeed enforceable.

197 *Lifestyle Improvement Ctrs., LLC v. East Bay Health, et al.*, 2013 U.S. Dist. LEXIS 144685 (S.D. Ohio Oct. 7, 2013) (Justin M. Klein, Esq. and Marks & Klein, LLP, co-author of this article, represented the defendant franchisee in this matter.)


199 See, e.g., Bakrac, Inc. v. Villager Franchise Sys., Inc., 164 F. App’x 820 (11th Cir. 2006) (holding that waiver of right to jury trial provision in hotel franchise agreement was enforceable since contract was negotiable, the waiver was conspicuously set forth in large type and plain language, franchisee was college educated, he was experienced in the hotel business, and was not under duress); PostNet Int’l Franchise Corp. v. Americas Int’l, Inc., No. CIVA06CV00125 PSFBNB, 2006 WL 1775599 (D. Colo. June 26, 2006) (it must be shown that the waiver was assented to knowingly, voluntarily, and intelligently); Bonfield v. AAMCO Transmissions, Inc., 717 F. Supp. 589 (N.D. Ill. 1989) (When the franchisee knowingly and intelligently waived right to jury in action arising out of franchise agreement; agreement contained caption in boldface type “Jury Trial Waived,” waiver was expressly discussed with franchisee and franchisee was experienced businessman, such a clause is valid); Dunkin’ Donuts Franchised Restaurants LLC v. Manassas Donut Inc., 1:07CV446 (JCC), 2008 WL 110474 (E.D. Va. Jan. 8, 2008) (“Courts
However, a few jurisdictions refuse to enforce jury waivers in state court actions. The
diligent franchisor should be aware of the law in its chosen jurisdiction before committing to it
through a choice-of-law provision.200

IV. AVAILABLE RELIEF—PROVISIONS ADDRESSING DAMAGES AND
CONTRACTUAL LIMITATIONS PERIODS

Like many kinds of commercial litigation, franchise disputes can involve claims for large
damages. Thus, it is common to include provisions in the franchise agreement providing caps
on damages or identifying a shorter limitations period to bring any claims. As a general rule,
contract provisions limiting damages and truncating statutes of limitations are typically
enforceable.

A. Damage Limitations

An oft-cited franchise treatise declares that a “franchise agreement may limit, condition
or shape the damages recoverable by either party in the event of litigation between them.”201 In
an attempt to prevent potentially crippling damages awards, franchisors often try to limit their
potential liability to franchisees for consequential, punitive or exemplary damages arising from a
breach or other violation that may arise under the franchise agreement. Despite best efforts
from diligent franchisees or their counsel, provisions limiting damages are rarely negotiated out
of a franchise agreement.

1. No punitive or exemplary damages

In certain circumstances, punitive damages may be awarded in addition to actual
damages. Punitive damages are considered “punishment” and are awarded when the
defendant’s behavior is found to be intentional or especially harmful. Punitive damages
normally are not awarded for breach of contract.202 However, punitive damages have been
awarded on some contract claims in franchise cases.

Courts may award punitive damages not only where the defendant intentionally pursued
a course of conduct for the purpose of causing injury, but also where the defendant knew or
should have known that, in light of the surrounding circumstances, its conduct would naturally
and probably result in injury.203 In Holiday Inn Franchising, Inc. v. Hotel Associates, Inc., the

consider various factors in determining the validity of a jury trial waiver. These factors include: (1) the parties’
negotiations concerning the waiver provision; (2) the conspicuousness of the provision in the contract; (3) the relative
bargaining power of the parties; and (4) whether the waiving party’s counsel had an opportunity to review the
that a contractual waiver of a jury trial as part of a franchise agreement is regularly enforceable).

200 See, e.g., Grafton Partners L.P. v. Superior Court, 116 P.3d 479 (Cal. 2005) (stating that a contractual waiver of
jury trial violates state constitutional right to jury trial in civil cases); Bank S., N.A. v. Howard, 444 S.E.2d 799 (Ga.
1994) (stating that pre-litigation contractual waivers of right to trial by jury are not enforceable in cases tried in the
Georgia state courts).


Court of Appeals of Arkansas, in addition to a $10 million compensatory damages judgment, upheld a $12 million punitive-damages award against Holiday Inn Franchising, Inc. based on claims for breach of contract, promissory estoppel, and fraud. The court reasoned that while Holiday Inn had no intent to harm the plaintiff, the actions taken by Holiday Inn and its employees justified the jury’s $12 million punitive-damages award.

To avoid such liability, franchisors can include a provision waiving any claim for punitive damages. Generally, waivers and limitations of liability in contracts are enforceable. The burden to overcome such a waiver lies on the party attempting to prove that a contract term is invalid, and not on the party seeking to enforce the waiver.

Courts have upheld waivers of claims for punitive damages where they are expressly stated in the franchise agreement. For example, in Dunkin’ Donuts Franchising LLC v. SAI Food and Hospitality, LLC, the United District Court for the Eastern District of Missouri granted Dunkin’s motion to strike the franchisee’s request for punitive damages. The court supported its decision by explaining that the franchise agreement’s waiver clause was listed in (i) a conspicuous manner, (ii) in two places, (iii) both times, in capital letters, and (iv) once in bold font — all of which weighed in favor of a finding that Defendants knowingly and voluntarily waived any claims for punitive damages.

2. No Consequential or “Non-Direct” Damages

Consequential damages, also referred to as “non-direct” damages, generally refer to losses or injuries that “do not flow directly and immediately from the act of the party, but only from some of the consequences or result of such act.” To recover consequential damages

Bank of Comm., 745 S.W.2d 120, 125 (Ark. 1988)); see also Cox v. Doctor Assocs., 613 N.E.2d 1306, 1326-27 (Ill. App. Ct. 1993) (Ill. Law) (franchisor was found to have misrepresented willfully and wantonly material facts to a franchisee, punitive damages were properly awarded.)


205 Id.


207 Silver, 2005 WL 1668060, at *2; (holding that plaintiffs made no showing that the waiver of punitive damages clause was “ambiguous, unconscionable, or otherwise unenforceable”); see also Pampillonia v. RJR Nabisco, Inc., 138 F.3d 459, 463 (2d Cir. 1998).


210 Id. (stating that franchise agreement provisions waiving punitive damages and lost future profits “are not fundamental rights”).

from the breaching party, the damages must have been reasonably foreseeable and within the contemplation of the parties at the time they made the contract.\textsuperscript{212} It is common for franchise agreements to include a provision limiting these types of damages as well.

In \textit{Ingraham v. Planet Beach Franchising Corp.},\textsuperscript{213} the court enforced the franchise agreement’s damage limitation clause. The court held that the provision was enforceable because: (i) contract language, although confusing, was not ambiguous; (ii) the franchisee’s signature was at the bottom of the page, (iii) the waiver language was highlighted as a separate provision, and (iv) the franchisee was a “sophisticated businesswoman.”\textsuperscript{214}

3. \textbf{Grounds for Challenging Enforceability}

In practice, enforcing a damage limitation clause may not be as simple as drafting one into a franchise agreement. Many legislatures and courts have shown concern for the bargaining power of franchisees by enacting protective statutes. Courts may refuse to enforce a damages limitation clause as unconscionable if it contravenes public policy by limiting remedies available in an applicable protective statute, or if it is one sided.\textsuperscript{215}

In \textit{Saleemi v. Doctor's Associates, Inc.},\textsuperscript{216} the defendant tried to enforce a damage limitation provision in the parties' franchise agreement. The franchisee argued, however, that the damage limitation provision conflicted with Washington's Franchise Investment Protection Act and Consumer Protection Act. Under Washington's Franchise Investment Protection Act,\textsuperscript{217} commission of any unfair or deceptive acts or practices or unfair methods of competition prohibited under FIPA constitutes an unfair or deceptive act or practice under Washington’s Consumer Protection Act.\textsuperscript{218} Washington’s Consumer Protection Act provides that a plaintiff may recover actual and punitive damages. Therefore, the damage limitation clause directly contravened the policy of the Washington law. Accordingly, the court held that the provision was unenforceable and permitted the plaintiff to seek punitive damages.\textsuperscript{219}

Similarly, in \textit{Graham Oil v. Arco Products Co.}, the Ninth Circuit refused to enforce an arbitration clause between the petroleum franchisor and its franchisee that prohibited punitive

\textsuperscript{212} \textit{Taylor v. Kaufhold}, 84 A.2d 347, 351 (Pa. 1951).

\textsuperscript{213} 2009 U.S. Dist. LEXIS 38164 (E.D. La. Apr. 17, 2009).

\textsuperscript{214} \textit{Id.} at *5


\textsuperscript{216} \textit{Saleemi v. Doctor’s Assocs.}, 292 P.3d 108 (Wash. 2013) (plaintiff operated three Subway franchises in Washington State, and each agreement limited compensatory damages in the form of $1000 or franchise and royalty fees paid during the previous three years, whichever was greater).

\textsuperscript{217} See Wash. Rev. Code. § 19.100.190(1).

\textsuperscript{218} See Wash Rev. Code. § 19.86.010 et. seq.

\textsuperscript{219} \textit{Id.} (citing \textit{McKee v. AT&T Corp.}, 191 P.3d 845 (Wash. 2008); \textit{Dix v. ICT Group, Inc.}, 161 P.3d 1016 (Wash. 2007); \textit{Scott v. Cingular Wireless}, 161 P.3d 1000 (Wash. 2007)).
damages because that limitation was in direct conflict with the Petroleum Marketing Practices Act ("PMPA"). The arbitration provision in Graham purported to forfeit the statutorily-mandated protections afforded to franchisees under the PMPA, specifically the right to recover exemplary damages from ARCO. The court held that the rights forfeited under the terms of the arbitration clause expressly hindered the effectuation of the PMPA’s policies.

B. Attorneys’ fees and other expenses of litigation

The general rule in commercial litigation is that each party pays its own fees and other expenses barring a contractual agreement that shifts fees to one party. As part of such a fee-shifting clause in a franchise agreement, the “prevailing party” may have their expenses paid for by the other side. The phrase “prevailing party,” however, can often give rise to confusion when the result of litigation is not clear-cut. Therefore, when drafting a franchise agreement, it is advisable to define the phrase “prevailing party,” or provide the court with guidance on how to interpret the phrase.

For example, if both the plaintiff and defendant are awarded relief, there is no bright line way to determine the “prevailing party.” In Wheeler v. T.L. Roofing, Inc., the plaintiff recovered $400 and the defendant $2,401.76. As both parties received damages, both parties technically prevailed in some sense. In that case, the Colorado Court of Appeals awarded the defendant “prevailing party” status, because it won more money than the plaintiff in that matter.

Even if a party obtains a technical victory with nominal damages awarded and thus arguably is the “prevailing party,” it is not necessarily entitled to recover its attorneys’ fees. In Farrar v. Hobby, the Supreme Court found that while nominal damages made the plaintiff the prevailing party, such a technical victory does not necessarily rise to the level that may require the award of fees.

The Ninth Circuit recently held in a franchise case that it is possible for litigation to result in no “prevailing party,” even if the parties’ agreement authorizes the award of fees. The court held that the award of fees is a discretionary matter left to the trial court. Similarly, the Supreme Court has recently noted that the phrase “prevailing party” is a “term of art,” because it involves the weighing of the individual facts of the case and cannot be reduced to a bright line rule.

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220 Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244 (9th Cir. 1994).

221 Id. at 1247 (15 U.S.C. § 2805(d)(1)(B) states, in relevant part, “[i]f the franchisee prevails in any action..., such franchisee shall be entitled...to exemplary damages where appropriate.”).

222 Id.


226 Transport. Truck & Trailer, Inc. v. Freightliner, LLC, 368 F. App’x 786, 789 (9th Cir. 2010).

In *Choice Hotels International v. SM Property Management, LLC*, the Fourth Circuit made clear that fees and costs may not be awarded until the judgment is final.\textsuperscript{228} Until that point, a motion for fees and costs is premature and, thus, not ripe. Similarly, in *Yousuf v. Motiva Enterprises, LLC*, a service station franchisee filed suit against the franchisor to contest the termination of their franchise agreement.\textsuperscript{229} The franchisee received a preliminary injunction and eventually sought dismissal with attorneys’ fees and costs. The Fifth Circuit held that a preliminary injunction merely preserves the status quo and, despite being “won” by a party, does not confer “prevailing party” status. However, if either the franchisor or franchisee can point to resolution of the dispute that changes legal relationship between them, that party can become the prevailing party and recover its fees and reasonable costs.\textsuperscript{230}

Barring a contractual definition of “prevailing party” in a franchise agreement, other courts have looked to a generalized “winner” in the litigation as was done in *Wheeler*, discussed above. In *Kissinger, Inc. v. Singh*, the Western District of Michigan held that in the absence of a contractual definition of “prevailing party,” that party is generally the one “in whose favor judgment was entered, even if that judgment does not fully vindicate the litigant’s position in the case.”\textsuperscript{231} Under this analysis, the party that is awarded more damages than the opposing side likely would be considered the prevailing party.

Additionally, some courts have identified multi-factor tests for prevailing party status when the franchise agreement doesn’t explicitly list a method of determination.\textsuperscript{232} One such test from the District of Minnesota in a dispute over a franchise agreement, which test is representative of that used by other jurisdictions, requires consideration of “(1) the result obtained in relation to the relief sought; (2) whether there were multiple claims or issues; and (3) the extent to which either party prevailed on each claim or issue.”\textsuperscript{233}

The Tenth Circuit has noted that deciding which party is the “prevailing party” is results-oriented, and that courts should look to see which party has had affirmative judgment rendered in its favor.\textsuperscript{234} In *Pruitt v. New England Petroleum Ltd. Partnership*, a district court in Connecticut held that regardless of the franchisee’s manner of operating their franchise, their intent in bringing a lawsuit, and if they voluntarily surrendered their franchise, they may be awarded fees as long as they succeed in their claim.\textsuperscript{235} Thus, the only factor that matters is the result. While

\textsuperscript{228} *Choice Hotels Int'l, Inc. v. SM Prop. Mgmt., LLC*, 519 F.3d 200, 211 (4th Cir. 2008).

\textsuperscript{229} *Yousuf v. Motiva Enter. LLC*, 246 F. App’x 891, 894 (5th Cir. 2007).

\textsuperscript{230} *Jones v. Crew Distrib. Co.*, 984 F.2d 405 (11th Cir. 1993).


\textsuperscript{232} *Dearmore v. City of Garland*, 519 F.3d 517, 524 (5th Cir. 2008) (listing a three-prong test for §1988(b) civil rights violations in a franchise case).


the result is the single most important factor, the different analyses in these cases shows that determining the “prevailing party” is a fluid concept with no fixed result, barring a more specific contractual definition in the franchise agreement.

Once the court has identified the prevailing party, the amount to be awarded is a clearer issue. The general rule is that for costs to be awarded due to a fee-shifting provision, the costs must be explicitly listed in the franchise agreement. For example, the Northern District of Illinois refused to award expert witness fees to a prevailing party, holding: “Unless the [franchise] statute expressly authorizes the shifting of expert-witness fees, the parties must bear their own.”236 In another case, the franchise agreement stated that the prevailing party may recover “reasonable attorneys’ fees, experts’ fees, court costs and all other expenses of litigation.”237 The Southern District of New York found the language clear and enforceable, so awarded experts’ fees in addition to the attorneys’ fees.

The lack of a bright line rule creates challenges when drafting a fee-shifting provision in a franchise agreement. It is not sufficient simply to say that the “prevailing party” shall be awarded fees. Rather, to avoid the unpredictability and vagueness inherent in deciding the “prevailing party,” the better practice is to include a definition or method of determining the prevailing party and to specifically identify the kinds of expenses (such as expert witness fees) that are recoverable. Examples for defining “prevailing party” include:

- The “prevailing party” means the party in whose favor a judgment, decree, or final order is rendered;
- The term “prevailing party” means the party obtaining substantially the relief sought, whether by compromise, settlement or judgment.

C. Contractual Limitations Periods

Many franchisors include a provision in their franchise agreement that require the franchisee to assert its claims or file suit within a specified period, which may be significantly shorter than what would otherwise be permissible under the applicable statute of limitations. The failure of a party to bring the action within the appropriate time period can be devastating to the party seeking relief. A contractual limitations period thus can be a great tool for reducing legal risk.238

1. Enforceability in General

Generally, courts enforce contractual limitations of action provisions that shorten the


238 See Sandy T. Tucker, Contractual Limitations of Actions Periods in Franchise Agreements, 24 Franchise L.J. 18 (Summer 2014); see also Keating v. Baskin-Robbins USA Co., No. 5:99-CV-148, 2001 WL 407017, at *4 (E.D.N.C. 2001) (holding, as parties to an agreement, plaintiffs and defendants are free to contractually limit the period within which claims could be asserted to one year).
time that would otherwise apply to a state or federal claim, provided such provisions are reasonable.239 In evaluating reasonableness, courts will consider whether the agreed period is “sufficient to allow the plaintiff to investigate and file his case within the limitations period” and is not “so short as to amount to a practical abrogation of the right of action or which would require plaintiff to bring his action before his loss or damage can be ascertained….” 240

In United Commercial Travelers of Am. v. Wolfe, the Supreme Court recognized contracting parties’ rights to reduce the period within which they may bring an action to enforce the contract to a shorter period than that set forth in a state’s general statute of limitations, provided there is no controlling statute to the contrary and the shorter period is reasonable.241 However, while the Court definitively upheld the concept of contractual limitations clauses, it left substantial ambiguity as to what constituted a “reasonable” period.

In the franchise context, in Protter v. Nathan’s Famous Systems, Inc., the New York Supreme Court found that the one-year period of time set forth in the parties’ franchise agreement was unreasonably short, and would allow for a claim to accrue and expire at such time as all of the facts establishing the cause of action were known.242 On appeal, however, the Appellate Division disagreed with the lower court expressing the general rule that courts recognize and enforce contractual limitation provisions “absent proof that the contract is one of adhesion, or is the product of overreaching, or that the altered period is unreasonably short.” 243


240 Glenn, A.L.R. 3d. 1197, at § 2.


242 See Protter et al. v. Nathan’s Famous Systems, Inc., 246 A.D. 2d 585 (N.Y. App. Div. 1998) (arose out of the sale of three Nathan’s famous restaurants franchises in the New York Metropolitan area. Under the sale agreements, the individual plaintiff, Erwin Protter, purchased three Nathan’s Famous restaurant franchises from the defendant, Nathan’s Famous Systems, Inc. The restaurants subsequently proved to be unprofitable and Protter filed this lawsuit seeking $13,088,359 in damages, claiming that he was induced to purchase the franchises as a result of a series of fraudulent misrepresentations made by defendants.).

243 Id.
Thus, the court held that the one-year limitations period was reasonable and applicable to franchise agreements.\textsuperscript{244}

In \textit{Creative Playthings Franchising Corp. v. Reiser}, the franchisor terminated its franchise agreement and filed suit against Reiser alleging, among other things, breach of contract and trademark infringement.\textsuperscript{245} Reiser counterclaimed, alleging, among other things, breach of the implied covenant of good faith and fair dealing and fraudulent inducement. Creative Playthings moved for summary judgment as to Reiser's counterclaims, on the basis that those claims were time-bared by the limitations clause in the franchise agreement.\textsuperscript{246} The court, recognizing that Massachusetts had yet to decide the enforceability of such provisions, certified the question to the Massachusetts Supreme Judicial Court.\textsuperscript{247}

Although the governing law set forth a six-year limitations period, the Massachusetts Supreme Judicial Court held that contractual limitations provisions in franchise agreements are enforceable so long as they are reasonable in the particular circumstances, and not contrary to public policy.\textsuperscript{248} The court further stated what constitutes a reasonable period of time in which to require the commencement of legal action will vary according to the type of contract and the circumstances in which a given agreement is reached.\textsuperscript{249}

Similarly, California permits contracting parties to agree upon shorter limitations period for bringing an action than that is prescribed by statute.\textsuperscript{250} The Ninth Circuit, in \textit{Han v. Mobil Oil Corp.}, held that California permits contracting parties to agree upon shorter limitations periods for bringing an action. The limitations provision in \textit{Han} stated:

\begin{quote}
Any other claim by Dealer [Han] of any kind, based on or arising out of this Agreement or otherwise, shall be waived and barred unless Mobil is given written notice within ninety (90) days after the event, action, or inaction to which such claims relates. Notwithstanding notice by Dealer to Mobil, any claim by Dealer shall be waived and barred unless asserted by the commencement of a lawsuit in a court of competent jurisdiction within 12 months after the event, action or inaction to which such claim
\end{quote}

\begin{flushright}
\textsuperscript{244} Id. (citing \textit{H.P.S. Capitol v. Mobil Oil Corp.}, 186 A.D.2d. 98 (N.Y. App. Div. 1992)).
\textsuperscript{245} \textit{Creative Playthings Franchising Corp. v. Reiser}, 978 N.E.2d 765 (Mass. 2012).
\textsuperscript{246} Id.
\textsuperscript{247} Id.
\textsuperscript{248} Id.
\textsuperscript{249} Id.
\end{flushright}
relates.

The court gave deference to the franchise agreement’s contractual limitation provision and held that requiring a plaintiff to commence an action within twelve (12) months following the event giving rise to a claim was a reasonable limitation.251

Courts have upheld provisions as short as 60 days for some claims. For example, in Island Cash Registers, Inc. v. Data Terminal Sys., Inc., the franchise agreement required the parties to submit a demand for arbitration within 60 days after receiving notice of termination.252 The court upheld the limitation on the premise that a contract is presumed to be valid and enforceable, and the franchisee failed to show that the contractual limitation period was unenforceable.253

In drafting a contractual limitation provision, court precedent has proven to be less than helpful since courts have not been uniform in determining what constitutes a “reasonable limitation”. Thus, it might be wise for a franchisor to err on the side of granting a slightly longer period rather than to risking having a court refuse to enforce its provision.

2. Grounds for Challenging Enforceability

Generally, contractual limitations clauses are enforceable unless those provisions contravene public policy. Thus, not all states will allow parties to circumvent legislated limitations periods. If a state views its statutory limitations period as representing a fundamental public policy, a contract provision defining a shorter limitations period might be void as against public policy.

For example, Florida law provides that “[a]ny provision in a contract fixing the period of time within which an action arising out of the contract may be begun at a time less than that provided by the applicable statute of limitations is void.”254 In Randall v. Lady of America Franchise Corp.,255 the franchisor, with the help of the Florida Franchise Misrepresentation Act, argued that the claims brought by the plaintiff were barred by the two-year limitations provision found within the agreement. The franchisee countered that the limitations provision was void under Florida law. The court determined that “[b]ecause recovery under the Florida Franchise [Misrepresentation] Act presupposes that the parties have entered into a franchise relationship, actions under the Act necessarily ‘arise out of the contracts’ governing relationship.”256 As a result, the court held that the franchisor’s attempt to shorten the limitations period was void

251 Han, 73 F. 3d at 877 (citing Fageol Truck & Coach Co. v. Pacific Indem. Co., 117 P.2d 669, 672 (Cal. 1941); Lawrence v. Western Mut. Ins. Co., 204 Cal. App. 3d 565 (Cal. 1988)).


253 Id.

254 Fla. Stat. § 95.03.


256 Id. at 1093.
under the Florida Statute § 95.03.\textsuperscript{257}

Another example, although not in the franchise context, is found in \textit{Oregon Mutual Insurance Co. v. Brady},\textsuperscript{258} where an Idaho federal district court voided a contractual limitations provision as a matter of law. In \textit{Brady}, the insured argued that a two-year limitations provision in an insurance policy was void because it conflicted with Idaho’s five-year statutory limitations period for contract claims. The court noted that if the Idaho Legislature intended to allow for a shorter statute of limitations, it would have provided for such by prescribing a different limitations period for insurance policies; however, the Legislature had not done so. As a result, the court found that the two-year contractual limitations provision was void as against public policy.\textsuperscript{259}

In other cases, courts have refused to enforce a contractual limitations clause on the grounds that it prevents a party from taking advantage of its statutory rights.\textsuperscript{260} As the Supreme Court stated in \textit{Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.}, if certain terms in an arbitration agreement serve to act “as a prospective waiver of a party’s rights to pursue statutory remedies..., we would have little hesitation in condemning the agreement as against public policy.”\textsuperscript{261}

Courts have also voided contractual limitations provision based on the lack of economic bargaining power on the side of the franchisee. For example, again, in \textit{Graham}, supra, the United States Court of Appeals for the Ninth Circuit noted that “[i]f franchisees could be compelled to surrender their statutory-mandated protections as a condition of obtaining franchise agreements, then franchisors could use their superior bargaining power to deprive franchisees of the PMPA’s protections.” The court held that an arbitration clause that shortens the statute of limitations for filing claims under the PMPA violates the statute, and therefore, is unenforceable.\textsuperscript{262}

\textbf{V. CONCLUSION}

No one wants to go into a franchise relationship thinking about disputes, but the fact is that disputes often arise. And when they do, dispute resolution provisions in the franchise agreement can determine – both procedurally and substantively – how and on what terms those disputes are resolved. Franchisors can protect themselves procedurally by including choice of law and forum selection clauses in their franchise agreements. Franchisors can protect themselves substantively by including an agreement to arbitrate, as well as provisions limiting recoverable damages and shortening the time in which a franchisee can bring any claims. In all

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{257} \textit{Id.}
\item \textsuperscript{259} \textit{Id.} at *12.
\item \textsuperscript{261} \textit{Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.}, 473 U.S. 614, 637 n.19 (1985); \textit{see also Ragone v. Atlantic Video}, 595 F.3d 115, 125 (2d Cir. 2010).
\item \textsuperscript{262} \textit{Graham}, 43 F.3d at 1247.
\end{enumerate}
\end{footnotesize}
events, clear drafting is the key to maximizing the chance that the parties’ agreement will be enforced according to their expectations and intent.
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